



FAX COVER SHEET

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Message

FYI

Zurich Financial Services, Inc.
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INTELLECTUAL AMMUNITION

Enron, Krugman, and the Public Intellectuals

Monday, January 28, 2002

Donald Luskin

The failure of Enron has had important impacts for its shareholders, creditors and business counterparties. There will be some important second-order impacts, too.

Enron has already become an excuse for politicians and special interest groups to seek useless and costly new regulations to "prevent another Enron in our lifetime." For example, I've already written about the abusive attempts to employ the problems in Enron's 401(k) plan to scuttle the individual investor empowerment revolution, and set back the cause of privatizing Social Security (see "What Enron's Collapse Doesn't Mean" December 4, 2001).

And Enron has surely triggered a new skepticism about the integrity of the disclosure process for public companies – in an era of when widespread use of "pro forma" earnings have further elevated what is an already historically high plateau in equity valuations. If the underpinnings of valuation begin to be questioned deeply enough, those valuations could be threatened (see "Biotech Comes Down With Enronitis" January 24, 2002).

But there is one respect in which Enron *doesn't* matter, at least not very much – and that is last week's embarrassment of the punditariat *en masse*, as one after another of them was "outed" for being on Enron's payroll in one way or another. It has been revealed now that such headline members of the nattering class as **William Kristol**, **Paul Krugman**, **Lawrence Kudlow**, **Peggy Noonan**, and **Irwin Stelzer** have all been paid by Enron for various services over the last several years -- making them the very "crony capitalists" that they themselves are railing against.

I've taken great satisfaction in these revelations, coming as they do just as these commentators have elbowed their way to the head of the Enron lynch-mob to try to give the impression that they are leading it. A particular pleasure has been watching Paul Krugman squirm like a butterfly on a pin, waiting for the gas to be administered, brought down by the same kind of attacks on his personal integrity that he himself deals out to others so irresponsibly from the high mountaintop of his *New York Times* column. But I have no particular sympathy for the others in this matter, either.

What we see at work here is a perfect laboratory example of the principles described in *Public Intellectuals: A Study of Decline*, the extraordinary new book by **Richard Posner**, Judge of the US Court of Appeals for the Seventh Circuit. Some of the people who got ensnared in Enron's web wouldn't even qualify for Posner's high-brow definition of a "public intellectual" – after Krugman and Kristol, Posner would probably regard most of them as little more than teevee talking heads. But the conclusion he reaches in this far-reaching and scholarly study applies to *all* of them, however elegantly credentialed they may be: their output is demonstrably of consistently low quality.

For example, Posner cites this howler showing of the low quality of Krugman's output as a public intellectual:

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"He was not hired by the *Times* for his record as a prophet. In a book published in 1990 [*The Age of Diminished Expectations*] he had offered as 'the most likely forecast for the U.S. domestic economy in the 1990s.... fairly slow growth, modestly rising incomes for most Americans, generally good employment performance, [and] a gradual accumulation of inflation' to 7 percent. He predicted that by 2000 the United States would 'have sunk to the number three economic power in the world,' after Europe and Japan, and that the world economy would be less unified than it had been in the 1980s. He published a 'revised and updated' edition four years later, but retained these predictions."

Posner's economic analysis of the market for public intellectual product concludes that its consumers don't have any illusions about its quality.

"Public intellectual work... is a classic 'credence' good, a good the consumer must take largely on faith because he cannot inspect it to determine its quality... Absent... from this market are the conditions (such as an informed consuming public or expert consumer intermediaries, legally enforceable warranties of product quality, and high costs of exit for sellers detected selling products of poor quality) that discipline other markets in credence goods. The public protects itself against the high variance and low average quality of public-intellectual work mostly by not taking it very seriously.

"...There is even a vicious cycle at work. The less accurate that public intellectuals are in their assessments or predictions, the less seriously they are taken, which reduces the demand for accuracy..."

Posner argues that public intellectuals primarily entertain the general media audience, and provide moral support for that fraction of the audience whose special interests they represent. So it really doesn't matter whether or not what they say has any objective value. This would be especially true in cases such as Krugman's, in which the output is of such a nakedly political character.

"Most public intellectuals are identified with one or another ideological school, such as welfare liberalism, multiculturalism, social conservatism, or libertarianism. Most of their readers are members of the same school and are seeking to shore up their own preconceptions rather than see them challenged. When a public intellectual's predictions go awry, normally as a result of his having extrapolated some current trend that his ideological confreres consider dire, they are reluctant to drop him. To do so would discredit their side of the ideological divide. Instead they close ranks around one who fought the good fight, albeit unsuccessfully."

But under Posner's analysis of public intellectual product as a "credence good," reputation damage of the type suffered by Krugman and the others for their association with Enron may be the one and only way that a public intellectual can lose value in the market.

"Aristotle's theory of rhetoric emphasizes the 'ethical appeal,' which means trying to persuade your audience that, quite apart from the intrinsic merit of your argument, you are the type of person who is worthy of belief. ...The ethical appeal is an appeal to the authority of the speaker or writer. Credentials, style, appearance, character -- and audience's belief in the quality of these inputs into the speaker's output can increase the credibility of the output with that audience."

No wonder Krugman has gone through humiliating and transparent contortions to transform his past references to his association with Enron into "disclosure." And no wonder that he is eager

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NEWS



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DAILY NEWS SUMMARY

SUPPLEMENT

TUESDAY JANUARY 22, 2002

6:30 A.M.

HOT TOPIC

ENRON

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The New York Times

January 19, 2002

Auditing Firms Gaining Muscle in Washington

By STEPHEN LABATON

WASHINGTON, Jan. 18 — When Arthur Levitt Jr., then chairman of the Securities and Exchange Commission, tried to impose tough conflict-of-interest rules on the accounting industry two years ago, he was hit by a barrage of high-powered lobbying, including calls from 10 or 11 senators. The senators, whom he did not identify, warned that if he did not relent on the new regulations, the agency's appropriations could be cut, he said.

Executives from the auditing firms said the proposals were unduly burdensome and unnecessary. But speaking of the episode this week, Mr. Levitt said the calls reflected the political influence of the industry, which ultimately succeeded in weakening his proposals to reduce the potential conflicts of interests at accounting firms.

"I have never been subjected to a more intensive and venal lobbying campaign," said Mr. Levitt, who led the S.E.C. for almost eight years, the longest-serving chairman in the commission's 67-year history. "I spent nearly all of my time during those months responding to senatorial and congressional queries and visits. It was totally time consuming."

Now, with revelations of document destruction at Arthur Andersen, the auditors for the Enron Corporation (news/quote), and the losses of more than \$60 billion by Enron shareholders, accounting firms are preparing for a new fight against regulation. The battle waged against Mr. Levitt shows how difficult it may be for more stringent proposals to be adopted.

The accounting firms, including Andersen, are hiring teams of lobbyists — former senior aides to lawmakers and presidents, both Republican and Democrat — as well as using their own formidable staffs. While there is talk in Washington of significant oversight and toughened enforcement, Congressional aides and some experts say it will not happen, at least not without changes in campaign finance rules, because of the industry's political muscle.

"It's just whimsical," said James D. Cox, a law professor at Duke University who has written a textbook on accounting and legal issues. "There will be a lot of posturing about how bad Enron and Andersen are. But at the end of the day, if we can't get campaign finance reform, it's hard to believe we get tighter standards. These are two very related issues."

The profession's growing influence is perhaps most apparent at the S.E.C. Last month, President Bush said he would nominate partners from two of the Big Five accounting firms, PricewaterhouseCoopers and Ernst & Young, to two vacancies on the five-member commission.

Joel Seligman, who wrote a history of the S.E.C., said he could not recall a partner at a leading accounting firm ever being a commissioner. Moreover, the commission's current chairman, Harvey L. Pitt, a securities lawyer, once represented all five major accounting firms as well as

the American Institute of Certified Public Accountants before he took over at the S.E.C. last summer.

On Thursday, Mr. Pitt announced plans to create a group dominated by experts from outside the accounting industry to discipline unethical accountants. That role is now filled by an industry group. Unlike Mr. Levitt, Mr. Pitt said that it was unnecessary to adopt any rules that would restrict accounting firms from performing multiple services for clients.

At the height of the fight between the industry and Mr. Levitt in the second half of 2000, all the Big Five accounting firms sharply increased their political donations and spending on lobbying. Andersen doubled its lobbying budget, to \$1.6 million.

The investment paid off.

Among other proposals, Mr. Levitt sought to prohibit an accounting firm from performing both accounting functions and consulting services for the same company. That proposal threatened billions of dollars in revenues at the Big Five firms, and their defeat of the proposals in 2000 illustrated the industry's growing influence in Washington. Had the Levitt proposals been in place, it would not have been possible for Andersen to bill Enron \$27 million for consulting services last year while also billing \$25 million for audits.

The profession has succeeded in fighting off tougher regulation over the decades, but it reached its apex in political power only in the last few years, a reflection of the industry's mushrooming campaign contributions and increased lobbying.

As the firms have grown and become more profitable by expanding into new lines of business, including lobbying and political consulting, they have also spent considerably more money in Washington, broadening their influence.

The industry has contributed more than \$53 million since 1990 to congressional and presidential candidates. More than \$14 million of those contributions came in 2000, putting accountants in the same category of more established big donors like telephone companies, higher education and the building trade unions.

For all the talk about Enron's influence, by some measures the accounting industry has even stronger ties to government. Of the 20 largest contributors to President Bush's 2000 campaign, three accounting firms — including Andersen — gave more money than Enron. All Big Five accounting firms were among the campaign's top 20 contributors.

Moreover, 94 current senators and more than half the current members of the House have received some campaign donations from Andersen since 1989, according to a study for the Center for Responsive Politics, a nonpartisan group that studies the influence of money in politics.

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In recent years, the accounting firms have set up Washington operations to represent their interests and those of their clients. They have retained batteries of former government and Congressional aides. And they have been among the largest political fund-raisers and donors.

During the last presidential election, Andersen was the fifth-largest contributor to Mr. Bush's campaign, giving more than \$145,000 through its employees and political action committee, according to the Center for Responsive Politics. The fourth-largest was Ernst & Young, which gave more than \$179,000; PricewaterhouseCoopers was eighth, contributing more than \$127,000.

Enron, by contrast, gave about \$113,800. Andersen also organized a big Bush campaign fundraiser.

The largest Congressional recipient of Andersen donations has been Representative Billy Tauzin, the Louisiana Republican who heads the House Energy and Commerce Committee, one of the 10 Congressional committees examining Enron's collapse. He has received \$57,000 from Andersen in the last decade.

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The New York Times

January 19, 2002

Despite Warning, Enron Chief Urged Buying of Shares

By RICHARD A. OPPEL Jr.

WASHINGTON, Jan. 18 — More than a month after an Enron (news/quote) vice president warned that the company might be an "elaborate accounting hoax," Kenneth L. Lay, the chairman, used an online chat to urge employees to buy Enron shares, a transcript of the session shows.

Mr. Lay, who apparently disposed of some Enron stock himself within days of receiving the warning, assured employees in the chat session that the company's leaders "were convinced both by all of our internal officers as well as our external auditor and counsel" that its finances were legal and appropriate.

In his comments to workers on Sept. 26, Mr. Lay made no reference to the issues raised in a letter he received in mid-August from Sherron S. Watkins, the vice president, warning him of serious accounting problems at Enron. Nor did Mr. Lay mention that he had asked Enron's outside law firm, Vinson & Elkins, to review the letter's claims.

Ultimately, Enron restated nearly \$600 million in profits over four years, largely because of the issues that Ms. Watkins had brought to Mr. Lay's attention. The earnings restatement in November, and other negative financial disclosures, put the company on the path to filing for bankruptcy protection on Dec. 2.

In Washington, the White House confirmed today that Vice President Dick Cheney met with a top Indian politician in June "about the status" of an Indian power plant project owned primarily by Enron, whose executives have been major campaign contributors to President Bush. The meeting was part of a broader administration effort to aid the troubled project by putting pressure on the Indian government.

Mr. Cheney discussed the Dabhol power plant with Sonia Gandhi, president of the opposition Congress Party in India. The plant has been an albatross for Enron as the company has fought a long-running battle with Indian politicians over the fate of the project. The discussions were first reported Friday by The Daily News in New York.

Last year, the Maharashtra state utility in India, which had agreed to buy all of the plant's output, objected that the price was too high and stopped paying its power bills. The plant was partly financed with more than \$600 million in loans and risk insurance obtained from the federal Overseas Private Investment Corporation and the United States Export-Import Bank.

Today, Ari Fleischer, the White House spokesman, said Mr. Cheney intervened because the administration was "looking out to protect America's jobs and taxpayers' money." He noted that Clinton administration officials had also been advocates on behalf of Enron in India.

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Mr. Lay met with the vice president during the preparation of the administration's energy policy blueprint last year. The energy report reflected some, but not all, of the policy prescriptions favored by Enron.

Mr. Fleischer said that administration officials considered having Mr. Bush raise the issue during a meeting Nov. 9 with the Indian prime minister, Atal Behari Vajpayee, but that they opted not to do so because the subject "did not rise to the president's level" and because Mr. Cheney had already intervened. The timing of that meeting would also have made it awkward for Mr. Bush to mention Enron, as it came one day after the company's huge profit restatement.

Enron and its executives have been Mr. Bush's largest campaign contributors since his first run for Texas governor in 1994, donating more than \$600,000. But today, in a briefing with reporters, Mr. Fleischer brushed aside the notion that Mr. Bush decided against bringing up Dabhol because of "the appearance of impropriety."

He did, though, acknowledge that White House lawyers told Lawrence B. Lindsey, the president's chief economic adviser, that Mr. Lindsey should have "no direct involvement in the Dabhol plant" because of his prior work for Enron. Mr. Lindsey, who heads the National Economic Council, was paid \$50,000 in 2000 for work on an Enron advisory board.

Earlier this week, the White House said that Mr. Lindsey directed a review of the effect Enron's collapse could have on the nation's economy, concluding that it would be minimal. Mr. Fleischer said there was no reason for Mr. Lindsey to recuse himself from that study.

"It's apples and oranges," he said. "One was a more direct involvement. The other was reviewing broader implications having nothing to do with the specifics of Enron's financing."

Later in the news briefing, Mr. Fleischer added that President Bush was "very concerned" that "the leaders of Enron took advantage of the people of Enron."

Thousands of Enron employees lost a large part of their life savings as Enron shares plunged last year. Lawyers suing the company have calculated that senior Enron executives and directors sold more than \$1 billion in company stock in the last three years.

Today, investigators from the House Energy and Commerce Committee interviewed Enron officials in Houston, including Richard A. Causey, the chief accounting officer. Investigators in New York interviewed Michael C. Odom, one of several executives of the Arthur Andersen accounting firm in Houston who were relieved of management duties this week. The firm said that widespread destruction of Enron-related documents took place in October, after auditors learned that the Securities and Exchange Commission was investigating Enron.

In the transcript of Mr. Lay's online chat, which was released today by a lawyer for Enron workers suing the company, Mr. Lay was explicit about the endorsements he said the company had received from Arthur Andersen for its complex financial transactions.

"In many cases, not only has the local Arthur Andersen office approved these vehicles, but they have also been approved at Arthur Andersen's headquarters office from some of the world's leading experts on these types of financing," Mr. Lay said.

An Andersen spokesman said tonight that on the most significant of the deals at issue, Enron failed to provide the accountants with critical information.

Documents released this week by the House committee laid out a timeline that indicates that within days of receiving Ms. Watkins's warning about Enron's finances, Mr. Lay was disposing of some Enron shares.

But in the chat session, Mr. Lay argued that the stock was a good buy, and he suggested that employees "talk up the stock and talk positively about Enron to your family and friends."

He also told employees that the third-quarter financial results were "looking great." Three weeks later, Enron disclosed that it lost \$618 million in the quarter and that it was writing down \$1.2 billion of its net worth partly to reflect the reversing of some of its complex deals.

Eli Gottesdiener, the lawyer who released the transcript today, criticized Mr. Lay's comments as misleading and damaging to employees at Enron who still trusted Mr. Lay.

"This is more than a full month after Watkins is basically blowing the whistle," Mr. Gottesdiener said. "Despite all that he knows, he is not only telling people to stay put, but he has the nerve to tell people this is a buying opportunity."

This evening, Mark Palmer, an Enron spokesman, referred questions about Mr. Lay's chat session to Earl J. Silbert, Mr. Lay's Washington lawyer. Mr. Silbert did not return a phone call.

One portion of Enron took a step toward getting a fresh start tonight when a bankruptcy court in New York approved the sale of the company's flagship energy trading business to UBS Warburg.

Under the deal, Enron will get one-third of the profits from the trading operations that UBS Warburg is taking over through a licensing agreement. UBS Warburg will pay nothing upfront for the acquisition of the trading business, which was once responsible for about 90 percent of Enron's revenue.

In Texas, meanwhile, a former Enron executive, Max Yzaguirre, resigned as chairman of the state's public utility commission, a casualty of Enron's collapse. For weeks, Texas Democrats have blasted Gov. Rick Perry, a Republican, who accepted a \$25,000 campaign contribution from Mr. Lay one day after he appointed Mr. Yzaguirre in June. As chairman of the utility commission, Mr. Yzaguirre had considerable influence over policies involving electricity deregulation.

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The New York Times

January 19, 2002

As Andersen's Troubles Grow, Clients Are Taking Note

By JONATHAN D. GLATER

NewsAnalysis Arthur Andersen L.L.P., the proud accounting firm nearly a century old, finds itself surrounded by angry and desperate victims of the collapse of the Enron Corporation (news/quote), whose deeply flawed books it audited.

Longtime corporate clients are nervously following each new report about Andersen's role in Enron's fall and the repercussions. Connecticut's attorney general has suggested that the state suspend Andersen's permit to practice there, a step that New York may follow; some Enron creditors have already filed lawsuits against the firm, and several other suits brought by Enron shareholders against Andersen look far stronger now than they did a week ago, before the firm admitted destroying documents and fired one of its auditors.

The bad news comes just as corporate boards are considering whether to retain their current auditors for the coming year, and some of Andersen's biggest clients say they are closely monitoring its condition. If too many clients decide that the firm's future is uncertain and switch, Andersen's business could erode in a crisis of confidence.

"I don't think any firm has faced this kind of challenge," said Jon C. Madonna, former chairman of KPMG International and now president of DigitalThink Inc. (news/quote)

Andersen, with revenue of more than \$9 billion last year, has deep financial pockets to combat lawsuits, and some of its clients say they intend to stand by their auditor. The firm, which does not disclose its insurance coverage, probably has hundreds of millions of dollars in insurance. Even that, though, falls shy of the amounts that creditors and shareholders say they lost.

"It's got to be in the tens of billions," said Dan L. Goldwasser, a lawyer at Vedder, Price, Kaufman & Kammholz in New York. "The potential amounts of the lawsuits are going to be staggering."

Potentially at risk are thousands of jobs. Since its founding by a Chicago university professor in 1913, the firm has grown to more than 85,000 people in 84 countries. After the consolidation of the accounting industry from the Big Eight in 1989 to the current Big Five, regulators may be concerned that a "Final Four" would be too few.

"The last thing they'd want is for Andersen to just totally fail," Arthur W. Bowman, editor of Bowman's Accounting Report, said of regulators' views. They would be inclined to allow another Big Five firm to buy Andersen, despite antitrust concerns, he said.

"The worst thing to have happen would be, no one makes a deal for Andersen, and they're all out there on the street by themselves," he said. "Then they get picked up as free agents. It just would be total chaos."

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The worsening situation has led Andersen's chief executive, Joseph F. Berardino, to speak publicly, often and very positively on behalf of the firm. That is something publicity-shy executives at Big Five accounting firms — Andersen is the smallest — usually avoid.

"This whole situation is a crisis," Mr. Berardino conceded in an interview on National Public Radio program yesterday morning. "My profession is in crisis, and my firm is being questioned. And we feel the best way to deal with it is to be very open and let people see the real Andersen."

The lawsuits follow revelations that accountants at Andersen's Houston office and its Chicago headquarters were intimately involved in decisions about how to account for transactions between Enron and secretive entities through which it was able to borrow undisclosed amounts. Last week Andersen fired the lead partner on the Enron account and suspended other partners in its Houston office for what it said was their role in shredding Enron-related documents last fall. If Andersen was even more deeply involved in the accounting that got Enron into trouble, the firm will be in more trouble.

Shareholders and creditors of Enron, which filed for bankruptcy in December after disclosing big debts that were kept off the balance sheet through murky partnerships, see Andersen as a well-capitalized firm that might help them to recover some of the money that was lost.

Andersen's United States business — the firm consists of member partnerships around the world — is a limited liability partnership, which means that if it is sued, individual partners generally will not be liable, said David J. McCabe, a lawyer at Willkie Farr & Gallagher in New York. (If lawsuits do name individual partners, as is likely, then those partners could have to dip into personal wealth to pay damages.)

Andersen also has capital that has been contributed by the firm's roughly 4,700 partners, who give back to the firm a portion of their annual compensation, but the amount is not publicly disclosed. It is virtually certain not to be enough to satisfy all the people who lost money on Enron, though.

"Professional corporations are generally not capital intensive," Mr. McCabe said. If the capital of the firm is depleted, partners can be required to pay in more to restore its financial health.

Each of the Big Five accounting firms has a significant amount, perhaps about \$500 million, of self-insurance, provided by subsidiaries that the accounting firms set up offshore because of lower capital requirements, said Mark L. Cheffers, chief executive of AccountingMalpractice.com. "It's probably different for each firm," he added. They also have catastrophic policies to help cover larger damages, but insurers might balk at paying if fraud is shown.

Insurance coverage will not save the firm if clients bolt, however, and some of Andersen's biggest audit clients were quite cautious last week in describing their relationship with the firm.

"We have good relations with the Kansas City office," said Al Butkus, a spokesman for Utilicorp United (news/quote), a Kansas City, Mo., company that is one of Andersen's largest clients. "We

are in the midst of organizing our review process and leaving any decisions open to the board to decide."

Indeed, many companies begin the process of reviewing their relationship with their current auditor at this time of year, accountants say. Auditors typically finish reviewing financial results for the year ended Dec. 31 by the end of March. Corporate boards review the auditor's work shortly thereafter and then decide whether to recommend to shareholders that the company keep the same accountant.

Some of Andersen's big clients said they planned to stick with the firm, at least for now.

"We'll continue to monitor the Enron situation closely," said Jim Sinegal, president and chief executive of Costco Wholesale (news/quote). He said that the decision to keep Andersen as the company's auditor would ultimately be up to shareholders, but added that the company "will support the people of Andersen with whom we work and continue to hold the services that we're provided with in the highest regard."

A spokeswoman for Georgia-Pacific (news/quote) in Atlanta expressed even stronger support. "We realize that it was one particular office that was involved and therefore have no intention of switching auditors," she said.

The mood inside the firm is uncertain, say former partners who keep in touch with their former colleagues. Some Andersen partners have begun to explore options elsewhere, but several headhunters said they had not yet seen many résumés from the firm.

Michael G. Dolan, an executive vice president at the search firm Cole Warren & Long in Philadelphia, said it is much too early for any exodus from Andersen.

Like everyone else, Andersen's people are probably waiting to see what happens next, he said. If they were going to search for other jobs, he said, he would expect to start seeing their résumés in about a month at the earliest. "It's kind of a holding period," he said.

One former partner said that Andersen's accountants were unlikely to flee lightly, having weathered other scandals. "The bottom line is that people there still feel very confident that they're going to be able to work their way out of this," he said.

Andersen has long been a gold standard in the industry, and its partners were known for both their competitiveness and their arrogance, Mr. Bowman said.

"They have a great brand name," he added, then paused. "Had."

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The New York Times

January 19, 2002

THE DIRECTORS

Enron's Board May Have Had Role in Dealings

By REED ABELSON

There is increasing evidence that Enron (news/quote)'s board, composed of many prominent and financially sophisticated people, was actively involved in crucial decisions that may have led to the company's downfall. While the board fired Andersen as Enron's auditor Thursday and contended it only learned of the serious concerns raised about the company's accounting and financial practices in October, the directors appear to have played a significant role in overseeing the partnerships at the center of Enron's collapse.

The board — which includes Wendy L. Gramm, a former government regulator and the wife of Senator Phil Gramm, Republican of Texas; John Wakeham, a member of the British House of Lords and a former British cabinet member; and Norman P. Blake Jr., the chief executive of Comdisco (news/quote), a computer services company — even went so far as to suspend Enron's code of ethics to approve the creation of the partnerships between Enron and its chief financial officer, according to the report of a preliminary investigation conducted at Enron's request by the law firm of Vinson & Elkins. The decision to waive the code was reported by several newspapers earlier this week.

The partnerships kept significant debt off Enron's books and masked much of what was really going on at the company. Criminal and civil investigations begun since the company filed for Chapter 11 bankruptcy protection last month are focusing intensely on Enron's transactions with these partnerships.

While outsiders have had few glimpses of what actually happened between Enron executives and its directors, the report's disclosures leave little doubt that the board was intimately involved in approving them. Questions have already been raised about the independence of the board, and many corporate governance experts say the directors appear to share substantial responsibility for what happened at Enron.

"The factual evidence we have at this point is that the board was fully informed," said Patrick McGurn, an executive with Institutional Shareholder Services, which advises large investors on corporate governance issues. None of the directors have said publicly that the board was misled by the company, he added.

The questions surrounding the involvement of board members also raise concerns over a special committee created to investigate what happened, according to corporate governance experts, because that committee includes a longtime member of the board — Herbert S. Winokur Jr., the head of a private investment firm.

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The strongest indication that the board was aware of the potential risks of setting up the partnerships in June and October 1999 was its decision to waive Enron's ethical code. The waiver was necessary to allow Andrew S. Fastow, then the chief financial officer, to serve as general partner of the partnerships. The board also adopted a series of guidelines for the partnerships to protect the company's interests, according to the report.

But such a waiver is extraordinary, according to corporate governance experts. Nearly every company in the United States has some sort of code of ethics, ranging from a statement of its values to specific rules governing conflicts of interest, said Thomas Donaldson, an ethics professor at the Wharton School of the University of Pennsylvania.

Charles Elson, the director of the Center for Corporate Governance at the University of Delaware, said the decision to waive the code of ethics made their approval of the transactions much more deliberate.

The board also reviewed the transactions involving the partnerships, according to the lawyer's report. Both the audit committee, which was run by Robert K. Jaedicke, a former accounting professor, and included Dr. Gramm and Lord Wakeham, and the finance committee, which was headed by Mr. Winokur, reviewed the transactions last year, according to the report.

When the board learned of concerns over the partnerships and their accounting treatment is unclear. As early as last February, an internal memorandum by Andersen says that the accountants planned to suggest that the board create a committee to oversee the partnerships.

The audit committee was never informed that Andersen said a committee should be created to review the fairness of the transactions, said W. Neil Eggleston, one lawyer representing the outside directors.

In August, a letter from an Enron vice president, Sherron S. Watkins, raised significant concerns about the partnerships. While Enron executives and Andersen were alerted to those concerns, the board was not told about the letter until Dr. Jaedicke was briefed on the Vinson & Elkins report in October, Mr. Eggleston said. At Dr. Jaedicke's request, the lawyers gave an oral summary to the audit committee, the lawyers' report said.

Two weeks later, the board announced the creation of a special committee to examine the controversial transactions. But with the exception of William Powers Jr., the dean of the University of Texas School of Law, the members had all played some role in creating the partnerships or reviewing the transactions. The special committee is now composed of Mr. Powers, Mr. Winokur and Raymond S. Trough, a longtime outside director who joined the board in late November.

Some corporate governance experts said they were concerned by Mr. Winokur's presence on the committee. He was on the board when it decided to suspend the code of ethics, and as chairman of the finance committee he was directly involved in the approval of one of the partnerships. Mr. Winokur is also one of the directors who reviewed the company's dealings with the partnerships.

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Two of the three directors on the committee had no role in the events in question, said Mr. Eggleston, who added that Mr. Winokur, an independent director, allowed the committee to accomplish its task more quickly and provided continuity.

Enron directors were among the mostly highly paid for their services, according to Pearl Meyer & partners, a New York compensation consulting firm. The average director was paid nearly \$400,000 in cash and stock in 2001, using the value of Enron stock on the date of its annual meeting, Pearl Meyer estimated.

But troubling questions surround the board's independence. Lord Wakeham, for example, received \$72,000 for his advice on Enron's European operations. Mr. Winokur was involved in a company doing business with Enron, while Dr. Gramm and other directors were associated with organizations that received charitable donations from Enron. Dr. Gramm said she could not accept equity for her services and directed the company to put that deferred compensation into a mutual fund.

Some of the Enron directors have also been criticized for selling stock in the company, a practice that has resulted in a separate lawsuit contending insider trading. The outside directors, including some who left the board, have retained lawyers, signaling that they believe that their interests, and their legal defense, may diverge from those of the company. It is not known whether individual directors have retained legal counsel. While directors traditionally are insured against lawsuits, the insurance company may have grounds to cancel the policy if it argues the company was not forthright.

The facts surrounding the board's involvement in Enron's collapse are not yet known, and no one knows exactly what information Enron executives shared with the directors. But the decision to waive the code of ethics may figure prominently in the dissection of what happened, Mr. Donaldson said. "When we do autopsies on corporate Watergates like this, we always find that there were rules, and people knew they were breaking them," he said.

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The New York Times

January 19, 2002

The United States of Enron

By FRANK RICH

Wasn't that the best?" said a laughing Ann Richards this week, when I asked her reaction to President Bush's effort to hide behind her skirt when questioned about Enron. "It was so silly. Why didn't he just say Ken Lay was a strong supporter and gave him a half-million dollars and is a good friend, and he's really sorry Ken's in these terrible circumstances?"

Good question. As the world knows now, George W. Bush told two lies when first asked about his ties to the top guy in what may prove the largest corporate flimflam in history. The president said (1) that he only "got to know" Mr. Lay in 1994, when in fact their relationship goes back at least to 1992; and (2) that Mr. Lay "was a supporter" of Governor Richards, when in fact Mr. Lay told TV's "Frontline" last year that he "did support" Mr. Bush over Ms. Richards in their Texas race.

This is the president who promised to usher America into "a new era of personal responsibility"?

What makes the dissembling so strange is that there is no evidence of any administration illegality in the Enron affair. And yet each day brings a new half-truth or seeming cover-up. Appearing on CNN last Saturday, Lawrence Lindsey, the top Bush economic adviser and a former Enron consultant, seconded the president's effort to pin Ken Lay on Ann Richards, but somehow forgot to say what would become public four days later — that he had overseen an administration study of the impact of Enron's travails in October. Earlier, Mary Matalin had visited the Imus show to defend her boss, Dick Cheney, but instead of vowing to open the books on the secret meetings between Enron and the vice president's clandestine energy task force, she asserted that Enron got "not one thing" from the administration's energy plan (actually it got plenty) and tried desperately to dismiss the entire ruckus as lacking an intern's "blue dress."

Hard as it is to believe, it was only 10 days ago that Ari Fleischer declared, "I'm not aware of anybody in the White House who discussed Enron's financial situation." Now we're painfully aware that the only White House inhabitants who may not have discussed it are the president, Barney and Spot — or so we must believe until future investigators turn up a smoking pretzel.

Washington, meanwhile, is busy debating whether Enron the Scandal is as hot as Whitewater. This should be a no-brainer. While The Wall Street Journal published an encyclopedic series of tomes to parse a low-rent Arkansas land scam to a public that never did quite understand it, everyone instantly gets an epic fraud in which arrogant high-fliers stacked the deck to fleece thousands of peons to the tune of zillions.

For a quick cultural index of this story's allure, check out the hundreds of hotly contested Enron lots on Ebay, where the bankrupt company's stock certificates have gone for north of \$200 — a multiple of 300 times the last known value of a share of the stock itself. And, Ms. Matalin notwithstanding, this scandal is not sex-free. Not only did Enron approach Penthouse and Playboy to try to enter the porn business, as The Times has reported, but we learn in Fortune that "rumors of sexual high jinks" in Enron's executive suites "ran rampant." A nation that doted on

the soap operatics of "Dallas" may have at long last found a worthy sequel in "Houston." Once the "sexual high jinks" kick in, it could play 24/7 on cable, with or without Paula Zahn.

The Washington wisdom that Enron has no legs — that it's not a political scandal, merely a financial one — is based on the premise that the Bush administration didn't ride to Ken Lay's rescue once disaster struck. But what about the favors performed for Enron before the meltdown? That's as political as you can get, particularly since, unlike Whitewater, this scandal implicates both parties and the corrupt campaign finance system that makes them look like interchangeable vending machines for their often overlapping patrons.

Though the Bush administration has been in office only a year, Enron's oily fingerprints are all over its actions as well as its résumés and stock portfolios. Mr. Lay helped hand-pick the head of the government agency in charge of regulating his own business and stood to gain a \$254 million corporate tax rebate in the administration-blessed stimulus bill (despite the fact that Enron used almost 900 offshore "subsidiaries" to avoid paying any income taxes at all in four of the last five years). The Enron old-boy network may even have played a backdoor role in the life-and-death matter of stem cell policy. When President Bush announced his stem cell "compromise" in August, many top researchers criticized it as an obstacle to medical progress. But miraculously the administration was able to produce an instant endorsement from John Mendelsohn of the M. D. Anderson Cancer Center in Houston — who we now know is an Enron board member whose institution received \$600,000 in Enron lucre.

The Clinton Democrats had eight years of Enron exposure, and while never receiving remotely the sums that the Republicans did, nonetheless had their own contacts (and presidential golf outing) with Mr. Lay. We already know, thanks to a 1997 article in Time, that Bill Clinton nudged Mack McLarty to lend the administration's weight to an Enron bid on a \$3 billion power-plant project in India, and that the Democrats received \$100,000 from Enron just four days before the Indian government came through. Will Joe Lieberman, who (like two-thirds of his committee) took Enron money, revisit his own party's Enron history as well as that of the G.O.P.? According to a 1995 report in The Nation, Robert Rubin's association with Enron didn't start last year at Citigroup but dates back to his pre-Treasury career at Goldman, Sachs. Enron's Washington office is currently headed by another former Clinton Treasury appointee.

Then again, who in either party hasn't cashed an Enron check? No fewer than 71 senators and 188 congressmen have been on the Enron gravy train. All but 5 of the 56 members of another investigative committee, House Energy and Commerce, got Enron or Arthur Andersen dough. The country's chief law enforcement officer, John Ashcroft, has recused himself from the case because he too received Enron cash — though even that ethical gesture looks suspicious, given his failure to stay out of Justice matters involving such other contributors as the N.R.A. and Microsoft. Another Congressional investigator, Billy Tauzin, Republican of Louisiana, was the single biggest House recipient of Arthur Andersen campaign money. Phil Gramm, the ranking Republican on the Senate Banking Committee, and his wife, Wendy (a former federal regulator now on Enron's board), could pass for one of Enron's wholly owned Cayman Island subsidiaries.

Harvey Pitt, the Bush administration's chief at the S.E.C., was actually an Arthur Andersen lawyer. After this week's revelation that top Andersen executives knew of funny business at

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Enron as early as February 2001, you have to wonder whether Mr. Pitt should be a witness in an S.E.C. investigation rather than its overlord. Was he representing Andersen at the time it first detected Enron's misbehavior? Was he in the loop? The stonewalling may have already begun, since neither the S.E.C. nor Andersen, when queried late this week, could say just when Mr. Pitt was in the accounting firm's employ.

Whom can the country turn to for an honest investigation? Democrats and Republicans alike are so beholden to accounting-industry money that they scuttled an attempt by Arthur Levitt, the former S.E.C. head, to regulate conflicts of interest in companies like Andersen two years ago. "If ever there was a case for a special counsel, this is it," says Governor Richards, but that idea certainly has no takers in Mr. Ashcroft's Justice Department or among grandstanding Democrats. "We haven't come anywhere close to that point yet," said Mr. Lieberman, never one to surrender a spotlight without a struggle.

A top aide to Henry Waxman, another Democratic inquisitor, has called the Enron scandal "the perfect storm," and a storm this perfect is certain to muddy Democrats as well. Enron has arisen like the ghost of over-the-top Christmases past, as a jolting throwback to the untethered America of the dot-com bubble. The greed of its perpetrators, and of the enabling politicians of both parties who took their cut before the wipeout, looks even uglier against the stark backdrop of those less well-connected Americans who are fighting our war.

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The New York Times

January 19, 2002

Enron's Vision (and Values) Thing

By JAMES S. KUNEN

As a partner in the communities in which we operate, Enron believes it has a responsibility to conduct itself according to certain basic principles." Thus begins the "Vision and Values" statement of the company whose bankruptcy, moral and otherwise, has become infamous.

A statement of Vision and Values, setting forth lofty goals and bedrock beliefs, is an absolute must for the modern corporation. The "V&V," as it's called, pleases investors and customers, helps create a single identity for separate operating units, and supports employee morale by reminding one and all that the company strives to do good, not just do well.

In recognizing the need to display a V&V, Enron, though unique (one hopes) in some other ways, was in step with the rest of American business.

At Enron.com, the company's Web site, one learns that as a "global corporate citizen" Enron intends to conduct itself in accord with four capital- V Values: Respect, Integrity, Communication and Excellence. This is fairly standard stuff, but a more detailed reading may provide some insight into Enron's corporate psyche.

Take respect: "We treat others as we would like to be treated ourselves." Fair enough. But Enron elaborates: "We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness and arrogance don't belong here." Oh my. Who brought up ruthlessness, callousness and arrogance? As a corporate communications editor, I've read hundreds of companies' V&V statements, and nowhere have I seen a single reference to ruthlessness, callousness or arrogance — let alone all three.

Well, at least Enron's leaders thought it important to produce a statement of values. Imagine what they might have done had they found themselves without this moral compass.

Then again, maybe adherence to ethical conduct really should go without saying. Every company's statement ends up rehashing the same things, anyway: We will maintain the highest ethical standards, treat our employees with respect, encourage teamwork, make quality products, respect the environment. . . . As opposed to what? We will maintain fair- to-middling ethical standards? Treat our employees like old shoes, foment backstabbing, make shoddy products and lay waste the environment?

I know one writer who, while struggling to draft one of these corporate credos, threw up her hands in despair and observed: "Why not just come right out and say it? 'We will strive to make as much money as we can without going to prison.' "

She was joking, of course. But had Enron's leaders adopted her statement and lived by it, their employees and shareholders might be a lot better off today.

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James S. Kunen is author of "How Can You Defend Those People?" and works in corporate communications.

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The Washington Post

Chairman Told Workers Stock Was 'Bargain'

Lay Advised Enron Employees to Buy 'Bargain' Stock Last Fall

By Peter Behr

Washington Post Staff Writer

Saturday, January 19, 2002; Page A01

In an e-mail chat with concerned employees Sept. 26, Enron Corp. Chairman Kenneth L. Lay called the company's slumping stock price "an incredible bargain" and said the upcoming financial report for the third quarter "is looking great." Enron's accounting practices were legal and proper, he added.

Lay's testimonial to Enron employees came a little more than a month after he received warnings from Enron Vice President Sherron Watkins of a potential accounting scandal at the Houston energy company – and then called for a review of Watkins's charges by Enron's law firm. Less than a month after the e-mail exchange, Enron jolted investors by reporting a \$638 million quarterly loss and the first of an increasingly devastating series of changes to its financial statements.

Lay, Enron's founder, bought some stock himself in August, although it isn't known whether he later sold it, and the company declined yesterday to discuss the question.

His e-mail exchange frames a critical issue for Enron and for Lay himself, as he prepares for Senate testimony Feb. 4 on his company's collapse: How much of Enron's financial erosion was clear to him in mid-September, when he was urging employees to keep buying the stock?

Enron's bankruptcy filing Dec. 2 and the final disintegration of its stock price wiped out the company retirement savings of an unknown number of the 20,000 people who worked for Enron at its peak. From a high of \$90 in September 2000, the stock price dropped to \$25 on Sept. 26. It took another plunge in October as Enron's problems mushroomed, leading up to the company's Dec. 2 bankruptcy filing.

Lay's upbeat advice to employees in September was "unconscionable," said Eli Gottesdiener, an attorney representing present and former Enron employees who are suing the company. "He is essentially sending people off the cliff," said Gottesdiener, who yesterday provided a copy of Lay's e-mail conversation, which had been supplied by one of his clients.

Enron employees were free during most of last year to sell shares they had purchased in their 401(k) company savings plan. The exception was a two-week freeze on the account beginning Oct. 29 when Enron shifted plan managers. That freeze should never have been permitted, with the company's stock in free fall, Gottesdiener says.

Enron matched employee savings, contributing \$1 for every employee's \$2, but the company match was in Enron shares that could not be sold until an employee reached 50 years of age. As of the end of 2000, nearly 60 percent of the 401 plan's assets were in Enron shares.

In the September talk, Lay told employees that he was strongly urging senior executives to buy more Enron shares.

"Some, including myself, have done so over the last couple of months and others probably will do so in the future. . . . My personal belief is that Enron stock is an incredible bargain at current prices and we will look back a couple of years from now and see the great opportunity that we currently have."

Lay's most recent disclosure to the Securities and Exchange Commission, filed Sept. 1 last year, shows purchases of \$2 million in Enron stock in the third week of August. He took advantage of a 1999 stock option grant which permitted him to buy the stock at an average price of about

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\$21.50 a share – well under the \$36 a share market price for the stock at the time. Any sales of that stock would be reported in subsequent SEC filings.

Between November 2000 and last July, Lay had sold \$30.3 million in Enron stock, under a prearranged sales program permitted by securities regulations. In 2000, he acquired 2.3 million shares of Enron stock through exercising options with a value of \$123.4 million. As of last Aug. 31 he owned a total of 14.9 million shares of his company's stock, worth \$523 million on that day but a fraction of that now, according to Thomson Financial.

Lay's conversation is a snapshot of a range of worries and criticism among the Enron workforce, coupled with one employee's gratitude for Lay's efforts.

One worker asked about Enron's use of "aggressive" accounting procedures and off-balance sheet partnerships and entities in creating the revenue figures on its financial statements – a central issue raised by Watkins. The worker noted that Enron's auditor, Arthur Andersen, had been heavily fined for accounting violations involving another Houston company. "You are a man of integrity," the employee said, asking for reassurance that such problems did not exist at Enron.

Lay replied that he and Enron's board would never approve the use of the special entities if they were not convinced by Enron executives, the Andersen firm and its outside law firm, Vinson & Elkins, that such arrangements were legal.

Another questioner asked pointedly about current accounting "tricks" involving calculations of the current value of long-term energy contracts and financial deals. What would happen when these deals "come home to roost," the employee asked.

Lay said the company's accounting practices followed industry standards and predicted years of steadily growing profit and stock gains.

A third employee asked about criticism that Enron's financial statements were hard to decipher. "How will we get the markets to trust the quality of our earnings?"

Lay answered, "If we somehow are filling holes in our operating income in this business it would be virtually impossible to continue doing that for six years."

Congressional investigators are trying to determine whether Enron was in fact "filling holes" in its current income reports by exaggerating revenue it expected to receive from long-term energy and financial derivatives contracts involving its complex partnership and affiliate networks.

An Enron spokesman declined to discuss Lay's comments to employees. Lay's attorney Earl Silbert said Lay was in Houston, concentrating on running Enron as it tries to settle with creditors and come through a bankruptcy reorganization.

Lay and his wife, Linda, plan to sell two homes and a building lot in Aspen, Colo., for \$16.2 million, said his broker, Joshua Saslove of Joshua & Co. They will keep their principal residence at the ski resort, Saslove said.

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The Washington Post Friends, Kin Ruled Out Prosecutors

By Paul Duggan

Washington Post Staff Writer

Saturday, January 19, 2002; Page A07

AUSTIN – After he was sworn in Dec. 13 as U.S. attorney for southern Texas, Michael T. Shelby, a career prosecutor who has specialized in white-collar corruption cases, wasted no time diving into what he thought would be the most intriguing criminal investigation of his life. Eleven days earlier, in the largest corporate collapse in the nation's history, Houston-based Enron Corp. had filed for bankruptcy protection, raising numerous questions about the company's practices and top executives.

On the day he took office in Houston, Shelby said in an interview this week, he ordered the chief of his fraud division to issue subpoenas for Enron records and told prosecutors to arrange a meeting with Securities and Exchange Commission officials in Washington. "We wanted to peruse the SEC's files and basically get our investigation moving forward as quickly as possible," Shelby recalled.

But today, a month after gearing up to spearhead the Justice Department's criminal probe of the Enron debacle, Shelby, 43, and his 89-lawyer staff are out of the loop. In a move that legal experts called highly unusual, the entire U.S. Attorney's Office in Houston has been recused from the case because too many of its lawyers, including Shelby, have personal ties to current or former employees of the once-giant energy trading company.

The Justice Department's decision to assign the investigation to a task force of prosecutors from other jurisdictions illustrates the difficulties that law enforcement officials, members of Congress and others face in conducting clearly impartial inquiries into Enron. Before the company's demise, which wiped out many of its employees' retirement funds, Enron had long been a big financial contributor to politicians of both major parties, notably President Bush.

Attorney General John D. Ashcroft, who received Enron donations when he was in the U.S. Senate, has removed himself from the investigation. A federal judge who had been overseeing 46 lawsuits against Enron has recused herself, citing her acquaintances with two lawyers in the cases. And U.S. House and Senate members, some of whom plan to take part in Enron hearings by at least 10 committees, have been scrambling to give away hundreds of thousands of dollars in campaign contributions from the company.

In Shelby's office, the problem was not politics, but family ties and friendships.

On the same day he ordered the subpoenas, Shelby said, he assigned two staff lawyers to investigate whether the Houston office's involvement in the Enron case would create any potential conflicts of interest. He said the two lawyers are "ethics officers," specially trained in "the nuances and technicalities" of the Justice Department's rules of professional responsibility. "I was obviously very aware of my own situation," said Shelby, whose brother-in-law, a lawyer, was an Enron employee and "suffered a significant financial loss as a result of the collapse of the company's stock." Shelby said he instructed the ethics officers to question the rest of the lawyers in the office to determine whether any others had personal ties to Enron, which laid off about 4,000 employees at its Houston headquarters.

Meanwhile, the prosecutor's office proceeded with the beginning phase of the criminal probe. But at the same time, the information being gathered by the ethics officers suggested that Shelby's staff would not be involved in the investigation for long.

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"We found that a number of people [in the office] have direct or indirect relationships" to current or former Enron employees, Shelby said. Although he declined to specify how many prosecutors in his office have such ties, he said "it's not even close to half" the staff.

"There are people whose husbands worked there and who suffered losses in their retirement plans," Shelby said, declining to elaborate. "And, of course, those losses are imputed to the spouses who work in our office. And there were other people who had different situations. . . . I'll only say that there was an identifiable group of people who were affected in different ways by the collapse."

And it was a group large enough, he said, to raise concerns about the appearance of a conflict of interest for the office as a whole.

He said he and his staff "tried to figure out some way we could keep the case in this office by building a wall between the investigation and these individuals, including myself." But they decided there was no way to avoid the appearance of a conflict.

Based on the ethics officers' findings, Shelby said, Assistant Attorney General Michael Chertoff, head of the Criminal Division, also determined that the Houston office should be removed from the investigation. The decision was made Jan. 10, the same day Ashcroft recused himself.

While it is not unusual for individual prosecutors to recuse themselves from cases, "I've never seen an entire office step aside and say we're not going to touch this investigation," said the Rev. Robert F. Drinan, a Georgetown University law professor and chairman of the American Bar Association's committee on professional responsibility. But he applauded the move.

"For once I can say that the Bush people got it right," said Drinan, a Democrat who served five terms in the U.S. House from Massachusetts in the 1970s. "They deserve praise for good sense." The Justice Department investigation, overseen by Chertoff and Deputy Attorney General Larry Thompson, will be conducted by a task force headed by prosecutor Leslie Ragon Caldwell, chief of the criminal division in the U.S. Attorney's Office in San Francisco, a Justice Department spokesman said. He said the task force, still being assembled, will be based in Houston, but not in Shelby's office.

Although he was "professionally disappointed" by the recusal, Shelby said, "I completely understand the rationale" for it. He said the Enron investigation "needs to go forward expeditiously, aggressively and without the appearance of a conflict. The United States needs to get to the bottom of [Enron's conduct] and determine whether any crimes were committed, and if they were, who committed them."

He added, "We don't want anybody to come back later and try to invalidate the whole investigation by saying, well, the motives of the prosecutors in this case were less than pure because they were looking out for their own relatives who lost money."

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The Financial Times

Cheney lobbied India on Enron's behalf

By Peter Spiegel in Washington, Michael Peel in London and Adrian Michaels in New York
Published: January 18 2002 19:31 | Last Updated: January 18 2002 23:32

Dick Cheney, the US vice-president, spoke to Indian government officials last June in an effort to help Enron recoup large debts on an investment in an Indian power plant, the White House said on Friday.

Ari Fleischer, spokesman for President George W. Bush, said Mr Cheney raised the issue of the plant in Dabhol because of US taxpayer exposure to losses in the investment. The project had been insured by the Overseas Private Investment Corporation (OPIC), a taxpayer-funded government agency that provides political risk insurance to American companies investing in developing countries.

"The United States taxpayers have an exposure to risk and loss through OPIC," Mr Fleischer said. "It's not uncommon for [companies] to have exposures which do require contacts between American officials and government officials in other countries to minimise those risks to taxpayers."

The discussions occurred on June 27 when Mr Cheney raised the subject with Indian opposition leader Sonia Gandhi, according to e-mails obtained by the New York Daily News. Two other e-mails indicate Mr Bush was also to raise the subject with Atal Bihari Vajpayee, but the plans were scrapped, the Daily News reported.

Last month, Enron and its fellow US investors in the plant, General Electric and Bechtel, sought to recoup roughly \$200m of their investment in the plant by filing a claim with OPIC. They argued the Indian government expropriated the plant after Enron invested more than \$1bn in the \$2.9bn project.

Enron pulled out of the project after the Maharashtra State Electricity Board in western India ceased drawing power from the plant in May, saying it could not afford the electricity tariff, and stopped payment of bills. Maharashtra had agreed to be the sole buyer of electricity from the plant.

Mary Matalin, a spokeswoman for Mr Cheney, told the Daily News that Enron had not asked the vice-president to raise the issue, saying he asked Ms Gandhi about the status of the plant because the item was including in briefing papers. She said Mr Cheney did not remember the conversation.

In a separate development, leading accounting firms gave a cautious welcome to the Securities and Exchange Commission's proposals for stricter regulation of breaches of professional ethics that fell short of criminality.

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"We think that the proposals are leading in the right direction," Ernst & Young said in a statement. "They should serve to strengthen the profession's quality monitoring and disciplinary processes in ways pretty much unprecedented in the profession's 100 year history."

KPMG, which was one of three Big Five firms that fought hard against the SEC's plans to tighten auditor independence rules in 2000, also said it supported "the aims of the proposal".

Accounting professionals said they are encouraged Mr Pitt said nothing about alleged conflicts of interest involved in doing consulting work for audit clients. Leading firms attacked Arthur Levitt, Mr Pitt's predecessor, for his insistence that firms' desires to gain and retain lucrative consulting contracts risked jeopardising the independence of audits. xref Woman in the news, Page 7 Bad week for auditors, Page 8 www.ft.com/enron

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The Financial Times

Enron's fall may spark change in rating process

By Jenny Wiggins in New York and Peter Spiegel in Washington

Published: January 18 2002 22:54 | Last Updated: January 19 2002 07:10

Moody's Investor Service, one of the top credit rating agencies in the US, is considering significant changes to the way it evaluates corporate debt following widespread criticism of its handling of the Enron collapse.

Critics say the rating agencies, including Standard & Poor's and Fitch, reacted too slowly after the US energy trader revealed huge debts in previously undisclosed off-balance sheet partnerships. Enron's bonds were trading at junk levels even as the company was rated investment grade.

Frances Laserson, of Moody's, said the company acknowledged that "the pace of ratings changes is too slow to reflect the true nature of credit risk" and said it was preparing to issue a "special comment" with proposed changes in a matter of weeks.

Under consideration at Moody's are more aggressive rating changes, including a rapid decrease in a rating in reaction to adverse news rather than a slow dropping of grades over a longer period.

Moody's is also considering shortening the rating review cycle from several months to a period of weeks.

Such changes would probably introduce greater volatility into its ratings, a move that could bring opposition from some investors, but Moody's said it would invite comment from issuers, investors and investment banks. "We would never introduce wholesale changes to our ratings process without a market dialogue," said Ms Laserson.

Louise Purtle, a corporate strategist at Deutsche Bank, said that while there had been widespread calls for changes at the rating agencies, the move could raise the financing costs of issuers and complicate matters for asset managers, who make portfolio changes based on ratings movements.

In a separate development, Judge Arthur Gonzalez, the federal judge presiding over Enron's bankruptcy hearing in New York, approved the company's sale of its energy trading business to UBS Warburg.

Meanwhile, the White House said on Friday that Dick Cheney, US vice-president, spoke to Indian government officials in June in an effort to help Enron recoup large debts on an investment in an Indian power plant.

Ari Fleischer, spokesman for President George W. Bush, said Mr Cheney raised the issue of the plant in Dabhol because of US taxpayer exposure of more than \$600m in losses in the investment.

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He added that Mr Cheney was not asked by Enron to discuss the topic with Indian officials.

The project was insured by the Overseas Private Investment Corporation (Opic), a taxpayer-funded government agency that provides political risk insurance to American companies investing in developing countries. Opic had also made loans to the development, as had the Exim Bank, which helps finance projects that promote US exports.

The Bush administration has come under questioning from Congress about its dealings with Enron because of close ties between the company and several administration officials. Kenneth Lay, Enron chief executive, was a large financial backer of Mr Bush's presidential campaign and is a friend of Mr Cheney's.

The discussions occurred on June 27 when Mr Cheney raised the subject with Indian opposition leader Sonia Gandhi, according to e-mails obtained by the New York Daily News.

Mr Bush was to raise the subject with Atal Bihari Vajpayee, India's prime minister, during a visit in November, but the idea was dropped.

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The New York Times

January 20, 2002

Multiple Safeguards Failed to Detect Problems at Enron

By RICHARD W. STEVENSON and JEFF GERTH

WASHINGTON, Jan. 19 — The system of safeguards that was put in place over the years to protect investors and employees from a catastrophic corporate implosion largely failed to detect or address the problems that felled the Enron Corporation (news/quote), say regulators, investors, business executives and scholars.

The breakdown in checks and balances encompassed the company's auditors, lawyers and directors, they say. But it extended to groups monitoring Enron from the outside, like regulators, financial analysts, credit-rating agencies, the media and Congress, which in the coming week will open a blizzard of hearings into the company's downfall.

The company's demise seems sure to bring not just legislative changes but sweeping reviews by regulators, accounting and law firms and corporate boards, all in search of how to assure that investors, employees and other constituencies can have faith in what companies tell them.

In Enron's case, the questions extend to the political influence wielded by the company. But increasingly the focus has turned to the entire framework of legislation, regulation and self-governance in which it operated.

"This was a massive failure in the governance system," said Robert E. Litan, director of economic studies at the Brookings Institution, the research organization. "You can look at the system as a series of concentric circles, from management to directors and the audit committee to regulators and analysts and so forth. This was like a nuclear meltdown where the core melted through all the layers."

It could be months before criminal, civil and Congressional investigations unearth all the facts of Enron's collapse, and there is likely to be plenty of blame to go around.

But much of the early attention has focused on the performance of Enron's accounting firm, Arthur Andersen, whose primary function was to assure that the company was accurately and completely disclosing its financial results and condition.

At the back of Enron's last annual report were two statements from Arthur Andersen. One attested to Arthur Andersen's opinion that Enron's internal accounting system "was adequate to provide reasonable assurance as to the reliability of financial statements." The other stated its opinion that Enron's financial reports "present fairly, in all material respects, the financial condition" of the company and its subsidiaries. The statements — a version of which appears in the annual reports of all healthy publicly traded companies — amounted to a Good Housekeeping Seal of Approval for Enron's books.

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Arthur Andersen may have had reason to view Enron through a flattering lens, given its symbiotic relationship with the company, one sure to be examined in depth in the corporate autopsy. At the same time that it was acting as Enron's auditor, it was seeking and getting lucrative consulting work from Enron, mirroring a trend among the five big accounting firms.

Andersen was also successfully lobbying against the Securities and Exchange Commission's effort two years ago to limit just that type of dual role; some regulators felt it created a conflict of interest by raising questions about whether an auditor would challenge the management of a company from which it sought more business.

Moreover, Enron turned over to Andersen some responsibility for its internal bookkeeping, blurring a fundamental division of responsibilities that companies employ to assure the honesty and completeness of their financial figures. Further obscuring the line between an independent auditor and corporate management, many of Enron's financial executives had moved there from Andersen.

Other safeguards had little effect. When Andersen was subject to a peer review of its general auditing practices last year under the industry's self-regulation program, its competitor Deloitte & Touche gave it a clean bill of health.

In the end, Enron was forced to restate earnings for the last five years by nearly \$600 million, mocking Andersen's assurances that the original numbers were complete and accurate. Questions raised in a whistleblower letter made public this week suggest that more reported earnings will have to be re-examined as the company and its creditors unravel the web of partnerships it set up to carry much of the company's debt. Enron dismissed Andersen as its auditor this week.

Arthur Andersen's chief executive, Joseph F. Berardino, has defended his firm's conduct and denied wrongdoing.

The Government

From a government and regulatory perspective, Enron, as one of its executives said late last year, thrived in a "regulatory black hole" that the company labored to create.

At the Federal Energy Regulatory Commission, Enron lobbied in the 1990's for a rule that exempted trading in electricity contracts from reporting requirements.

The lack of scrutiny by the energy regulatory commission was one reason that William A. Rainier, the chairman of the Commodity Futures Trading Commission, told Congress in 2000 that he was "deeply concerned" about a bill that would exempt energy trading from his commission's review because dealers in energy derivatives had no other regulator. His objections were largely ignored, and the exemption, heavily backed by Enron, became law.

The 2000 law built on a 1993 ruling by the futures commission that exempted energy trades. The chairwoman at the time was Wendy L. Gramm. Soon after she left the commission, Ms. Gramm became a well-paid director of Enron.

Because Enron was publicly traded, its financial reports were subject to scrutiny by the Securities and Exchange Commission, at least in theory. In practice, the commission has enough staff to review corporate reports only on a limited basis, and Enron's have not gotten a thorough vetting by the commission at least since 1997, people familiar with the commission's work said.

Because one of its main businesses was buying and selling contracts to supply electricity to utility companies, Enron was required to file quarterly reports with the energy commission. A review of the reports last year by The New York Times (news/quote) revealed inconsistencies in the way Enron subsidiaries accounted for some transactions. But commission officials acknowledged that they did not closely examine the Enron filings.

Enron was not shy in making its views known on Capitol Hill, at the White House and among the regulatory agencies — or in spreading campaign contributions around to Republicans and Democrats alike to ensure it would get a hearing. Since 1989, Enron has given \$5.95 million to the two parties, with 74 percent going to Republicans, according to figures compiled by the Center for Responsive Politics, a watchdog group.

"Money allowed the Enron leadership to come to town," said Charles A. Bowsher, who as comptroller general of the United States during the Reagan administration led the General Accounting Office, Congress's auditing and investigative agency. "Everyone says they didn't get anything, that the secretary of the treasury turned them down, that the secretary of commerce turned them down," said Mr. Bowsher, who himself worked for Arthur Andersen, decades ago. "But if you look back over the last five years, what they did get was no oversight."

The Boardroom

The board of directors has ultimate responsibility for any company's performance and conduct. Within the board, special responsibility falls on the outside directors, whose job is to cast a skeptical eye on management and to oversee issues that speak to the company's credibility, including its financial audits. Enron's board consists of Kenneth L. Lay, the chairman and chief executive, and 14 nonmanagement members. The company's former chief executive, Jeffrey K. Skilling, was a member until he resigned in August.

The close ties between management and the outside directors also raise questions about the board's independence. Twice in 1999 — on June 28 and on Oct. 12 — the board approved a waiver of the company's conflict of interest rules to allow Andrew S. Fastow, the chief financial officer, to set up private partnerships that would do business with Enron, according to a review by Enron's law firm, Vinson & Elkins.

Those partnerships and others are at the heart of the inquiry into whether company executives profited at the expense of shareholders and employees. Enron has estimated that Mr. Fastow

made more than \$30 million from the two partnerships set up in 1999. The partnerships masked Enron's mounting debts.

Enron's outside directors were among the the best paid. Enron has also made donations to causes associated with some directors. For example, Enron and Mr. Lay, through foundations they control, gave nearly \$600,000 to the University of Texas M. D. Anderson Cancer Center over the last five years. The center's president, John Mendelsohn, and its president emeritus, Charles A. Lemaistre, are on Enron's board.

The Legal Advice

A company's outside lawyers can also be an important check on corporate misbehavior. Enron was the largest client of Vinson & Elkins, one of the largest law firms in Houston.

The ties between the firm and its client were close. James V. Derrick Jr., the executive vice president and general counsel of Enron, joined the company from the firm. As Enron grew bigger and more sophisticated, the firm's billings rose substantially.

The firm gave advice to Enron about the partnerships the company was setting up as it remade itself into a trading company in the late 1990's. It was asked by Enron to review those partnerships after Mr. Lay received a letter from a senior Enron executive, Sherron S. Watkins, raising questions about the company's financial structure.

In her letter to Mr. Lay, Ms. Watkins specifically suggested that the company not use Vinson & Elkins to review the issues she was raising, noting the overlapping roles the law firm would then be playing. "Can't use V&E due to conflict — they provided some true sale opinions on some of the deals," she wrote.

When the firm reported back to Enron in October, it concluded that the issues raised by Ms. Watkins "do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors."

Only later, as the company began to collapse, did a special committee of the board hire another firm, Wilmer, Cutler & Pickering, to review the company's structure.

Vinson & Elkins said it had acted properly at all times.

"In a very general sense the law firm is highly confident, very confident that everything it did in its representation of Enron and any of its engagements was performed to the highest of ethical and professional standards," said Joe Householder, a spokesman for Vinson & Elkins.

The Financial Seers

Enron's collapse has focused new attention on the Wall Street analysts, whose judgments about stocks are widely assumed to be driven as much by a desire to help their firms win investment banking business from the companies they follow as to give investors sound guidance.

Not only were most of the big Wall Street firms bullish on Enron over the past few years as its stock went up, but they also kept the faith as cracks started to appear in Enron's foundations last summer and fall.

Analysts at firms like Goldman Sachs (news/quote), Lehman Brothers (news/quote), Salomon Smith Barney and UBS Warburg recommended the stock to investors well into the fall, after Enron's problems started to become public.

Early last year, Jim Chanos, president of Kynikos Associates, an investment firm that sells stocks short — that is, it bets that a stock is overvalued and will fall — decided to bet against Enron. To assure himself that he had not misjudged the company, he invited analysts from the big firms to come in and tell him why he was wrong.

"It's not that they didn't see what we saw," Mr. Chanos said. "They either chose to come to the wrong conclusion because it suited them for a variety of other reasons, or to put their faith in management."

Some experts have leveled criticism at the credit-rating agencies, which review the bonds and other debt securities issues by companies. One issue is that the companies being rated pay the agencies — Moody's (news/quote) Investor Service, Standard & Poor's and Fitch are the biggest — for their services. But the biggest problem, analysts say, is that the agencies have not had a good record of scouting out problems before they become apparent to investors.

In Enron's case, it was only the two months before the company entered bankruptcy last fall that the agencies were threatening to deem the company a serious credit risk by dropping it to a below-investment grade rating.

All the big agencies have defended their record on Enron. But the credit- ratings analysts, like their counterparts who rate stocks, are already coming under increased scrutiny.

The Reporters

While the press took note of Enron's high political profile and ties to the Bush campaign in 2000, the company's financial profile in the media was largely flattering until last year. In March, an article in Fortune by Bethany McLean delved into the unanswered questions about the sources of the company's profits.

Her article was published after Enron's spokesman and Mr. Fastow flew to New York to meet with two top Fortune editors in an unsuccessful effort to cast the company in a more favorable light.

But not until after Mr. Skilling's unexpected resignation in August did a sharply questioning tone become the rule in Enron coverage.

"I don't know if the press could have broken through" the maze of Enron's hidden finances, said Michael Useem, a professor of management at the Wharton School at the University of Pennsylvania.

But, Mr. Useem added, "a normal dose of skepticism might have been more in order."

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The New York Times

January 20, 2002

Inside Andersen, the Mood Is Tense but Not Despairing

By EDWARD WYATT

In Houston, at the epicenter of Arthur Andersen's woes, employees have sent out prayer requests by e-mail for themselves, colleagues and former Enron (news/quote) workers. In Toronto, the managing partner of Andersen's Canadian practice has spoken to hundreds of clients, seeking to reassure them that the company is steadfast.

And in offices around the world, Andersen accountants are saving documents — afraid, at least for now, to throw out anything related to a client audit.

The disclosures of the last week — that Andersen auditors shredded Enron documents during a government investigation, that the firm weighed and then rejected dropping Enron as a client nearly a year ago — have taken a toll on the 85,000 people who work for Andersen in 84 countries.

Outside the firm's headquarters building in Chicago on Friday, employees filed silently by a phalanx of reporters; the few who spoke said they had been instructed in a company memo not to talk to the press.

One employee, who refused to give her name, said the office mood was tense but that the feeling was that the firm's clients had mostly been offering support through a trying week. "It's better now than it was Monday," she said.

Similar feelings were being expressed privately at the highest levels of the company, according to one retired senior executive who was in contact this week with former colleagues still employed at Andersen.

"There's no question people are frightened," said the former Andersen executive, who spoke on the condition that he not be identified. "There is, of course, the financial exposure that the lawsuits pose. And the other factor is the blow to the reputation of the firm. People are wondering about the ability of the firm to recover from this. Anybody trying to say, 'Keep a stiff upper lip, we'll get through this' is being a bit fanciful."

Accountants at other firms say that among the Big Five accounting firms, Andersen's reputation for integrity has long been mightier than its market share. But in the eyes of competitors, Andersen sometimes wore that reputation a bit too proudly. As a result, the allegations against the company are now reverberating more loudly throughout the profession.

Among those feeling nervous are thousands of retired Andersen partners, many of whom depend on the firm's pension payments for income or who are owed shares of previously earned profits.

"Clearly in the event of a catastrophic payout related to Enron, those people will be affected," the former executive said. "You can't dismiss the possibility out of hand."

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Meanwhile, other former Andersen partners are no doubt counting their blessings — namely, executives of Accenture, the business formerly known as Andersen Consulting, which split from the accounting firm in a bitter divorce that began in 1997.

As a result of an arbitrator's decision in 2000, the consulting business was forced to give up the Andersen name and pay roughly \$1 billion to the accounting partnership.

While that battle and the current Enron litigation are nastier than the normal legal fights that face a company like Andersen, former employees say that big accounting firms are not unfamiliar with court fights.

"Litigation on things like this is part of the life of organizations like Arthur Andersen," said a former Andersen partner. "It's something those of us who have been around the company are used to. The initial salvo can be really bad, but as more information comes out, it starts to moderate.

"But clearly this is different than anything we ever saw," he acknowledged. "The media coverage is 10 times what we've seen in any other situation."

At Pennzoil Place, the landmark downtown Houston building that houses Andersen's office, some Andersen employees were reluctant to go outside and face the circuslike atmosphere created by camera crews and reporters.

"It's a very somber feeling around the office," said one midlevel Houston employee. "Everybody is walking around in a daze. It feels very much like a death or a divorce or something tragic happened. You walk down the hall and people don't even want to make eye contact with each other."

There have been no officewide meetings in Houston to address the events of the last week or to explain the measures being taken by Andersen to protect its image, including the firing of David B. Duncan, the lead partner on the Enron account, and the removal of four other Houston partners from their management responsibilities at that office.

Weeks ago, Enron's filing for bankruptcy protection began to take its toll on Andersen's Houston operations. As a cost-cutting measure, the firm required all employees to take vacation time from Christmas through New Year's Day, employees there said, the first such mandatory shutdown of the office in memory.

Elsewhere in Andersen's North American operations, employees said they were going about their business if not exactly normally then with only one eye on the events in Houston and Washington.

In San Francisco, Andersen employees said the company's local managers had been forthcoming about what they knew and had sought to reassure workers that the office was not likely to lose audit clients.

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The managers there also distributed a memo instructing employees not to discard any e-mail messages, documents or other paperwork — a directive so general that nervous employees have been retaining nearly everything, even documents that are clearly not directly related to an audit.

Still, one employee said, the mood in the San Francisco office was "pretty upbeat."

Russell Robertson, the managing partner for Arthur Andersen's Canadian offices, said he and his senior managers had spent the last few weeks speaking to hundreds of the firm's clients, as well as Canadian regulators, corporate board members and others, seeking to deal with any uneasiness they might feel about the firm.

"We're trying to cover all the people who would have an interest in our firm and our work," Mr. Robertson said. He described the purpose of the discussions as, first, "to ensure they are satisfied that we're not distracted by this," and second, to get the message across that Andersen in Canada remains well capitalized and financially stable.

Andersen employees in Mexico City said they, too, had been warned not to destroy any documents, but had been given little other information about what was happening in Houston or Washington and its potential effect on the operations in Mexico.

Meanwhile, there is plenty else to focus on, the employees say. The new tax rules have created a rush of business.

"Our clients are more worried about the fiscal reform and how they're going to pay the new taxes," said Benjamin Herrera, an Andersen employee. "But worried about our jobs? Not really."

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The New York Times

January 20, 2002

How 287 Turned Into 7: Lessons in Fuzzy Math

By GRETCHEN MORGENSON

for years, the Enron Corporation (news/quote) was known and admired as one of the nation's most innovative companies. Now, it looks as if the only innovations the company will be remembered for are the many labyrinthine schemes it used to mislead investors about its financial position.

It is not yet clear how early and often Enron substituted fantasy for reality in its reports to shareholders. But knowing the extent of the dishonesty is central to answering the question many people asked as they watched Enron implode. How could a company as big, profitable and powerful as Enron slide into oblivion so quickly?

Part of the answer is that Enron was neither as large nor as profitable as it claimed. But the company was a master of obfuscation in its financial statements, so investors were kept pretty much in the dark about its stature.

For example, the company said it was a highly profitable enterprise. But a determined investor looking closely at its financial statements would have found that even in the California power crisis, when energy costs were in the stratosphere and profits should have rolled in, Enron was earning only one-half of 1 percent on its sales.

Another half-truth concerned Enron's appearance last year at No. 7 on the Fortune 500 list of largest American companies. The company's \$101 billion in revenue placed it between the powerhouses Citigroup (news/quote) and I.B.M. (news/quote) on the list. But rising to that level occurred only because energy trading companies can record as revenue the total amount of their transactions, rather than the profits made on each trade as is typical at brokerage firms. If viewed this way, Enron's revenue would have been \$6.3 billion last year, pushing it to the bottom half of the list, at No. 287, wedged between Automatic Data Processing (news/quote) and Campbell Soup (news/quote).

Adding credibility to the view that Enron was more ephemeral than real was last week's announcement that UBS was taking over the company's vaunted trading business, and paying nothing up front.

"We don't know where reality sets in at Enron," said Robert F. McCullough, an authority on the electric utility industry at McCullough Research, a consulting firm in Portland, Ore. "We know that the operational numbers as far as we can follow them don't scan. We have 4,000-odd special-purpose entities off the balance sheet. We're having very grave doubts about the overall honesty of the company. The question is, How far down did that dishonesty extend?"

It may take a team of forensic accountants months if not years to unravel all the Enron entities and see where the \$12.5 billion that the company raised in the capital markets over the last 10 years went.

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Nevertheless, for investors hoping to learn from the Enron wreck, a look back at its recent financial statements, fuzzy though they were, does show several warning signs of some of the company's woes well before the bottom fell out last fall. Investors concerned that other Enrons may be lurking in the stock market's shadows can sharpen their pencils and conduct a few tests on financial statements to allay or confirm their fears.

Michael J. Maubossin, chief United States investment strategist at Credit Suisse First Boston, said Enron was, to some degree, a victim of its own growth promises. Even as the company was convincing investors that its impressive revenue growth would translate into extremely profitable businesses, Enron was unable to produce the returns that investors demanded.

"The reason people had enthusiasm for Enron was you could have made the case that they were in nascent markets that were going to develop into solid ones," Mr. Maubossin said. "But the economics were not there. As Enron needed more capital, the company went to more byzantine financial structures to try to achieve the growth it needed."

In Enron's days as a stock market darling, there was almost nothing it could say that investors wouldn't believe. One claim that caught the eye of Mr. McCullough well before Enron collapsed last year involved the commercial success of Enron Online, the company's online trading business. During 18 months that ended in the company's third quarter, even as other dot-coms went bankrupt, retrenched or simply vanished, revenue at Enron Online grew at an astonishing 12 percent a month.

A particularly doubtful assertion made by Enron Online was the so-called notional revenue it reported, Mr. McCullough said. For the first nine months of 2001, in news releases, Enron Online reported \$544 billion in notional revenue, or the total amount of the underlying gas and electricity that the operation's trades covered. Yet, this contrasts greatly with the energy purchases and sales that Enron reported in its filings with the Federal Energy Regulatory Commission for the same period. Those reports show just \$693 million in energy purchases and sales by the company. "We compare that \$693 million against \$544 billion and it's a surprising number," Mr. McCullough said. It is also a dubious number, he added. "A normal utility would have total electric revenues in the \$1-to-\$2-billion range, so the Enron number is roughly equivalent to the amount of electricity generated by 500 large utility companies. But they never put any of these numbers side by side so people would begin to question the numbers."

Few investors can be expected to have done the extensive work Mr. McCullough did to uncover suspicious figures in Enron's reports. But by comparing two figures found in Enron's annual reports, even a novice could have found reason to doubt the earnings the company was reporting in recent years.

According to Enron's 2000 annual report, which does not reflect the four years of earnings restatements the company announced in October, net income rose to \$979 million in 2000 from \$703 million in 1998, an increase of 39 percent. Total earnings for the three years came in at \$2.575 billion.

As is now known, these profits were almost completely manufactured. But even before the dire restatement of last fall, investors on the lookout for wide discrepancies between a company's reported earnings and its retained earnings — the profits that it made after all expenses and costs, like stock dividends, were paid — would have noticed a gulf at Enron.

For 1998 through 2000, Enron's net retained earnings, after subtracting losses from its trading activities, totaled just \$474 million, roughly \$2 billion less than its reported profits.

What this exercise illustrates is the amount of puffery that can go into a company's income statement. Retained earnings, found in a company's statement of changes in shareholder equity, are not as closely watched by investors as are a company's net earnings, but they are less easily manipulated.

"This is the type of analysis anyone could have done on Enron one year ago but nobody would have believed it," said an institutional money manager. "Shareholders can do it right now with other companies that have accounting issues or with any company that reports pro forma numbers."

Understanding that Enron's profits were not nearly what the company had said they were helps to explain its quick demise. But plenty of uncertainty remains about why the company was so starved for cash that it had to borrow almost \$6 billion in the six weeks after its third-quarter earnings bombshell and leading up to its bankruptcy filing.

Some of these borrowings may have been forced on the company by other lenders worried about the possibility of Enron's collapse. On Nov. 19, Enron disclosed that a downgrade on its debt rating required it to repay a \$690 million note earlier than it had planned. Nevertheless, Mr. McCullough said, it is not clear that all \$6 billion went to such payments.

Indeed, the company's financial statements show evidence of a cash squeeze early last year even as Enron was reporting growing profits. For example, in 2000, Enron said its net cash provided by operations totaled \$4.8 billion. But Mr. McCullough pointed out that the total included \$5.5 billion in deposits that Enron required of customers in California because of the spike in energy prices there, money that the company had to repay later. That put Enron's cash flow at negative \$700 million. Deduct the proceeds from asset sales — one-time activities that were not part of the company's core business — and Enron's cash flow was a negative \$2.56 billion in 2000.

In the first nine months of 2001, the company did a bit better, producing positive cash flow of \$953 million. Even so, that is not a great showing when compared with Enron's revenue. "Against cumulative sales of \$101 billion in 2000 and \$138.7 billion in the first three quarters of 2001, this is an amazingly small amount of cash," Mr. McCullough said. "When you see one of the fastest growing corporations in a cash shortage, you have to ask: Where did that cash go?"

With a definitive answer to this question a long way off, Mr. McCullough is willing to make an informed speculation about why Enron unraveled as it did.

Based on Enron's financial statements, the company was obviously presenting a very strong picture on extremely weak fundamentals. Once executives had promised profitability, they had to worry about keeping up the appearances of a moneymaker. While its revenue was growing quickly, this was manageable. But when the growth tailed off, the promise of profitability became impossible to deliver.

For the first three quarters of 2001, revenue at the company increased 132 percent from the same period in 2000. Normally, cash flow from such impressive growth would be enough to cover any temporary cash shortfalls.

But isolating each period shows a different picture. Revenue growth at Enron in the second quarter flattened abruptly, and in the third quarter, revenue actually fell by \$2.5 billion. Operations at the company's wholesale group for the Americas, which accounted for most of Enron's sales, were also slowing. Income before interest and taxes in this segment of the company declined to \$582 million in the second quarter of 2001 from \$661 million in the first quarter, Mr. McCullough said. Income rose again in the third quarter, to \$717 million.

At the same time, Enron was returning \$2.35 billion in deposits to its California customers.

"When we have four quarters of level revenues at wholesale Americas, one really does wonder whether continued growth was needed to maintain the fiction of financial profitability," Mr. McCullough said. "It seems to be a situation where they are running twice as fast to stay where they are. Their financial problems might have been intervening in their day-to-day trading activities."

Enron may have found a way to paper over its problems, Mr. McCullough said, with an accounting technique known as "mark to market." That would have allowed it to realize immediately the earnings it forecast on energy deals even though the costs and revenue on those deals might stretch over long periods. A result would be high earnings but little actual cash coming in.

The inherent risk in such an arrangement is that the price of energy could fall. If that happened, the contract struck previously would become less valuable than the company had forecast, creating a loss on the deal. Salvation from having to show the loss could present itself, however, in an even bigger power contract at current prices.

The new contract, Mr. McCullough explained, would provide enough mark-to-market earnings to offset the loss on the contract struck when prices were higher. "With sufficient growth in volume, earnings can be positive in each year," he said, "while cash flows continue to deteriorate." But such an approach fails when sales growth falls, he said, "like any other pyramid scheme."

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The New York Times

January 20, 2002

Who Will Needle Regulators Now That Enron's Muzzled?

By NEELA BANERJEE

HOUSTON -- DARTH VADER. That was what Enron (news/quote)'s enemies called the company when its phalanxes of lobbyists swept through Washington and state capitals in the late 1990's, aggressively and meticulously arguing in favor of loosening the electricity industry from a century of government control.

While other power companies fought deregulation as a threat to their very existence, Enron was quick to see the opportunities, and it devoted much money and labor to shaping the progress of changes on the federal and local levels. As deregulation moved ahead, Enron thrived, its core trading operations bloomed and it emerged as perhaps the most important company in the energy industry before suddenly collapsing into bankruptcy.

Now that Enron has been silenced, what's next on the energy deregulation front? The debacle in California that resulted in wide power shortages and a utility bankruptcy fanned powerful doubts about the necessity of tinkering with a system that delivers something as vital as electricity. Enron's collapse has set off murmurs on Capitol Hill, in the news media and among industry opponents of deregulation that the nationwide experiment was the cause of a financial scandal that becomes seamier by the day.

Whether that will lead politicians or regulatory agencies to rein in deregulation will become evident in the coming weeks and months, as the House of Representatives discusses an electricity restructuring bill and as the Senate takes up its energy bill.

"The feeling among a lot of energy companies is, 'Boy, Enron was working really hard to open up this market, and who will do this now?' " said Jeff Keeler, a former lobbyist for Enron who now works as a consultant to energy concerns. "Enron carried a lot of the water, and because it was out front, took a lot of the blows."

In fact, for all the self-generated hype about its influence, for all the envy of competitors and detractors, Enron, it turns out, failed to score many victories. The reinvention of the power industry has progressed far more slowly and has many more regulatory constraints than the company would have wanted. One of its goals, open access to the nation's transmission lines, is stalled in many regions.

Questions have already arisen about Enron's involvement in deregulation, climate-change policy and the Bush administration's energy plan. Representative Henry A. Waxman, the California Democrat, is circulating a list of 18 items in the Bush energy policy, which was released in May, that he says have Enron's fingerprints on them. He and other members of Congress have petitioned the White House for transcripts of meetings between Vice President Dick Cheney and Enron's chairman, Kenneth L. Lay, about energy policy. The last meeting occurred just days

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before the Enron bubble burst. So far, the requests have been rebuffed. The General Accounting Office is considering suing the administration to force it to release the transcripts.

Mr. Waxman and another Democrat, Edward J. Markey of Massachusetts, both on the House Energy Committee, are also asking that a pending bill on electricity restructuring be delayed while Congress examines whether deregulation helped bring about the Enron fiasco.

Curtis L. Hébert Jr., a former chairman of the Federal Energy Regulatory Commission who is now a vice president at the Entergy Corporation (news/quote), a power company in New Orleans, said: "I think you're going to see with Enron some of the same mind-set as with the price spikes in California. You'll see a much more methodical and reasonable approach to deregulation."

In the deregulation debate, though, one man's reasonable approach is another's morass. Entergy and the Southern Company, based in Atlanta, have resisted deregulation in their regions mainly because they wanted to hold on to their monopoly status, other power company officials and regulators said. Many industry experts say Enron's downfall tips the balance in the national debate over deregulation toward companies like Entergy and Southern, which was the second-largest contributor, after Enron, to the Republican Party in 2000.

Southern's position against legislation addressing global warming may also be strengthened by Enron's demise, according to Mr. Keeler and lobbyists for other power companies. Enron backed policies that would have limited power plants' emissions of pollutants and gases thought to be linked to global warming. Enron stood to gain from such limits, because it could have developed instruments for swapping emissions credits.

And because it owned natural-gas pipelines, Enron would have benefited from any push to build more power plants that used natural gas, which produces fewer emissions than coal. Opponents of emissions caps, who are rife in the domestic power industry, plan to paint any such legislation as the "Enron bill," according to Inside EPA, a newsletter that monitors federal environmental policy.

Former federal regulators, lobbyists and executives of Enron's erstwhile competitors argue that the Enron scandal was a result not of deregulation, but of lax oversight, hubris and ambition. "This may not be intellectually defensible, but it's politically predictable," said Joe Bob Perkins, executive vice president for wholesale businesses at Reliant Energy (news/quote), a power generation and trading company in Houston. "I think it is a whole lot less likely that we will get a consensus on bills that could help deregulation."

The vast amount of work remaining on deregulation is perhaps the clearest proof that Enron's record in lobbying was mixed at best. "I don't think it was that anything Enron wanted, they got," said James Hoecker, a former chairman of the Federal Energy Regulatory Commission.

For almost 20 years, the federal government and many states with high electricity prices have been seeking to transform a power industry widely viewed as inefficient and plodding. Enron,

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when it was still only a natural-gas company, went through deregulation of the natural-gas industry in the 1980's, which gave it a sharper understanding than most utilities had of the issues involved in electricity restructuring. When power deregulation was being actively discussed on the state and federal levels in the mid-1990's, Enron accelerated the discussion and tried to shape it. The company has never shied away from spending whatever it took. In the first six months of 2001, Enron spent \$825,000 lobbying Congress on a wide range of issues, according to a disclosure report Enron filed with Congress.

Other industry lobbyists seldom met with Congressional staff members or, when they did, had little to offer but their insistence on things being done in a certain way, said one senior Congressional staff member who spoke on condition of anonymity. But Enron came in with clear, informative presentations that had a logic to them. Their experts were on hand to answer complex questions, and they followed up on requests for more information. "Enron was very good at getting people to talk about certain things," the Congressional aide said. "They were very substantive and they were assertive."

Yet Enron's success dwindled with time, partly because the company was no longer the loudest in the small chorus extolling deregulation. Competitors envied Enron's head-start and derided its know-it-all arrogance. But they soon began to emulate its sophisticated energy trading and marketing businesses. As a result, a number of companies, including Calpine (news/quote), Duke Energy (news/quote), Dynegy (news/quote), Reliant and Williams, emerged with the money and political heft to push for deregulation.

"A lot of Enron's influence had already passed even before the scandal," said Mary Doyle Kenkel, a Washington lobbyist for the Cinergy Corporation (news/quote). "They hadn't been as vocal or in your face in the last couple of years."

Enron wanted Congress to adopt legislation that would quicken the pace of deregulation. Yet such legislation has languished for six or seven years, and seems unlikely to pass this year. The company pushed hard for the Bush administration to include a provision in its national energy plan saying the federal government would exercise eminent domain, or seize private and state lands, to build more power lines and beef up the transmission grid. Such new transmission projects would have brought down the price of power and made it easier for Enron to compete with local utilities. But the administration, after initially arguing for such a change, backed down in the face of opposition from Western states.

Enron wanted the Bush administration to adopt climate change policies. But the White House chose to ignore the issue, largely because of the arguments made by the coal industry and several utilities, led by Southern, according to power company lobbyists in Washington.

Many industry observers have suggested that Enron scored a coup when President Bush appointed Pat Wood as chairman of the Federal Energy Regulatory Commission, succeeding Mr. Hébert. Mr. Wood ran the Public Utility Commission of Texas, and Enron endorsed his ascent. But Mr. Wood proved quickly that he had few ties to Enron. He has supported greater access to the electricity transmission grid, which Enron — and many others — also favored. But the effort

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at the commission to improve access to the network began long before he rose to the chairman's office.

At the same time, Mr. Wood has taken steps that vexed Enron and other large power traders and marketers. In June, he voted to put in place a system in the Western states that prevented power prices from climbing sharply, a system that Enron and others contested. Later in the year, the commission proposed to eliminate any cap on refunds that power companies might be compelled to pay if there was evidence that they had rigged markets or gouged power buyers.

"I guess a regulator who is doing his job is the one who has both sides mad at him," one power company executive said.

Enron's true success may have been the ease with which it avoided scrutiny of securities regulators. The Securities and Exchange Commission paid scant attention to the partnerships that proved its undoing, mainly because Enron did not fit the definition of a traditional utility, industry experts said.

Indeed, to many people, the company's collapse had little to do with electricity deregulation and more to do with how its innovation and novelty, its complex financial and information products, pushed it beyond the comprehension of regulators, analysts and shareholders.

"I don't think this has anything to do with deregulation, because I didn't really see Enron as an energy company," said Mr. Hoecker, the former Federal Energy Regulatory Commission chairman. "To me it was more of a dot-com, in that it was all about information, facilitating the trading of energy by others, and this was the last dot-com crash."

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The New York Times

January 20, 2002

The Enron Debacle Follows a Now Established Format for Scandal

By TOM REDBURN

To come to life fully, every complex business or political scandal needs certain essential elements. A courageous whistleblower. Shredded or missing documents. Ties to people in power. Pain for the powerless. Offshore accounts are a big plus. And it is almost always the case that regulators failed to act, but promise to fix the problem so it will not happen again.

Last week, the Enron (news/quote) affair, if it had not already, acquired all these trappings, and more. But plenty of questions remained about exactly what happened, about who was to blame for Enron's spectacular collapse and about the dealings the company had with Washington — Congress and the White House alike.

EARLY ALARMS FROM A WHISTLEBLOWER Congressional investigators disclosed that Sherron S. Watkins, a vice president at Enron, sent a warning letter in August — two months before the company announced more than \$1 billion in accounting errors — to Kenneth L. Lay, Enron's chairman. "I am incredibly nervous," Ms. Watkins wrote in her unsigned letter, "that we will implode in a wave of accounting scandals." She also voiced her concerns to the company's auditors at Arthur Andersen, where she used to work.

Mr. Lay ordered Vinson & Elkins, Enron's law firm, to look into the charges; the firm concluded in October that no further investigation was necessary. Documents indicated that Mr. Lay disposed of some Enron stock within days of receiving Ms. Watkins's letter. In October, he was urging Enron employees in a company Web chat to buy shares.

PROBLEMS MOUNT FOR ANDERSEN The accounting firm fired David B. Duncan, the partner in charge of Enron's audit, saying that he led "an expedited effort to destroy documents" after he learned that the Securities and Exchange Commission was investigating Enron's books. Mr. Duncan told Congressional investigators and Justice Department officials that he was only following orders from Andersen's headquarters in Chicago. Andersen also stripped partners in its Houston office of management responsibilities.

An internal memo surfaced showing that Andersen officials discussed as early as last February whether they should drop Enron as a client. It described officials fretting — as Ms. Watkins did months later — about "conflicts of interest" because the company's chief financial officer was being paid to manage private partnerships that kept Enron debt off its books.

Andersen had another worry: whether the large fees that the firm received from Enron for accounting and consulting services — anticipated then to nearly double to \$100 million a year — might lead to questions about the firm's impartiality in auditing Enron's books.

Some experts suggested that Andersen may not survive the scandal intact.

ESCAPING TAXES Enron avoided paying corporate income taxes for four of the last five years, records showed, relying on a variety of techniques, including hundreds of subsidiaries in tax havens like the Cayman Islands. The tax-haven subsidiaries enabled Enron to create partnerships to eliminate taxes. Now, they may hinder efforts by investigators to find the names of other participants in many of the partnerships that Enron established to help keep debt off its books.

POLITICAL CONNECTIONS Though the focus last week was on business issues, questions continued to be raised about the Bush administration's ties to Enron. It was reported that Vice President Dick Cheney had intervened for the company with officials in India, hoping to resolve problems with an Enron power project there that has become a white elephant. The White House noted that the Clinton administration had backed the project, too.

The administration also defended the decision by Lawrence B. Lindsey, the president's chief economic adviser, to lead an analysis of the possible impact on the economy of Enron's collapse, though he had been a paid consultant to the company before joining the administration. At least 15 high-ranking officials disclosed that they owned Enron stock when they joined the administration.

With Congressional hearings scheduled this week and numerous investigations under way, lawmakers were forced to defend political contributions from Enron. While some of the money was returned, none of the lawmakers involved in the investigations, who as a group received more than \$700,000, chose to recuse themselves.

There was one casualty, far from the Capitol: the top Texas utility regulator, who formerly served as Enron's president in Mexico, resigned under political pressure.

REGULATORS PROMISE REFORMS Amid one of the biggest accounting debacles in decades, the chairman of the S.E.C. recommended that the largely self-policed accounting profession be overseen by a group dominated by outside experts. But the proposal by the S.E.C. chairman, Harvey L. Pitt, faced critics who said it would not ensure that auditors remained independent from their clients.

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The New York Times

January 20, 2002

The Rich Are Different. They Know When to Leave.

By LOUIS UCHITELLE

USINESS booms are famous for hiding underlying problems in an economy. It takes a recession to make them obvious. Now, like melting snow, this recession is uncovering a glaring inequality in the system the United States has gradually adopted over the last 20 years to prepare its workers for retirement.

The Enron Corporation is the showcase. Its top executives are walking away with money in their pockets for their own retirement, while their employees have watched their pension savings disappear because Enron's stock price plunged.

But Enron is not the only place where inequality exists. With much less fanfare — and in the absence of corporate misbehavior — top executives at other big companies have been similarly insulated from the losses that recession and reversal are imposing on their workers.

In the 1980's and 90's, millions of workers were persuaded that when they invested in stock plans for their retirement, they were gaining access to the same rising market that has traditionally benefited the wealthy. It seemed a way to make access to retirement security more equitable. But when prices fell, lower-income people began suffering in ways that higher-income people have not, because top executives have better information, more diversified ways to save and, above all, company-funded pension plans that are less and less available to ordinary workers.

In other words, workers gained an ability to profit from a stock market boom alongside the wealthy, but not an equivalent ability to withstand a downturn. "What we are seeing is a retirement safety net for top executives, whereas ordinary workers, in the name of freedom to manage their own investments, are left without a safety net," said Michael Sandel, a Harvard political scientist. "Worse than paradoxical, is there not something unfair in such a system?"

That question is only beginning to surface as workers experience the downside of investing their retirement savings in their employer's stock. They were happy to do so while stock prices surged in the 1990's, when they bought into an increasingly popular view pushed by the Clinton administration and by many corporate leaders. That way of thinking held that a well-informed worker, free to invest his or her own savings, would reach age 65 with a larger pension than the company could provide by financing a fixed-payment retirement plan. The same reasoning played a role in the movement — now dormant — to privatize Social Security.

Pat Cleary, a vice president at the National Association of Manufacturers, a lobbying group, puts the argument for such plans succinctly: "There are a lot of millionaires out there at all levels, white and blue collar, who became millionaires by investing in their own companies' stocks. We would not want to discourage that."

Few were discouraged as long as stock prices rose. The percentage of workers who depended on 401(k) style savings plans rose to 27 percent in the late 1990's from 16 percent in 1989, while the

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percentage who relied on company-funded pension plans fell to 7 percent from 15 percent. And the amounts that people invested in their employer's stock also rose, reaching 19 percent of the nearly \$2 trillion held in 401(k) plans.

Now the recession, and the Enron crisis, are shaking people up, particularly those earning less than \$60,000 a year, who make up more than half the work force. Their 401(k) contributions represent virtually their entire savings, pension experts say. And at many companies the portions invested in the employer's stock are disappearing.

At Enron, 15,000 workers have lost \$1.3 billion of the \$2.1 billion that was in the company's 401(k) plan a year ago.

IN addition, tens of thousands of workers at other big companies — Lucent, for example, General Electric, McDonald's, Coca-Cola — have held their collective breath as these companies' stock prices fell by more than 20 percent in the last year. All four, like Enron, have 401(k) plans heavily invested in their own stock.

But officers at the top of these companies have much more room to maneuver. "The reason that highly compensated top executives do not get hit like ordinary people," said Annika Sunden of the Center for Retirement Research at Boston College, "is that the highly compensated are also highly diversified, much more diversified than the middle income employee who is encouraged by his employer to own the company's stock. And they are much less dependent than the ordinary worker on a pension as the source of retirement income."

Pearl Meyer, president of Pearl Meyer & Partners, an executive compensation consulting firm, maps the world of top executives. For one thing, she says, they know before their employees do when their company is in trouble. They can sell big portions of their stock holdings before the trouble becomes public and the stock price plunges, as Enron's did, falling in a few weeks from more than \$30 a share to less than \$1 before it was removed from the New York Stock Exchange last week. Getting out ahead of the tidal wave is one way to describe the actions of Kenneth L. Lay, Enron's chairman, and other top Enron executives.

BUT even if the executives of a suffering company sell none of their shares on insider knowledge, they have other ways to cushion themselves for retirement. These executives, Ms. Meyer says, receive 67 percent of their compensation in the form of company stock. So they are at risk. But the total compensation is \$10 million a year for the average top executive at the 200 big companies she studied. So more than \$3 million still comes to each in cash, and that means the executive can diversify investments far more than the ordinary worker can.

Financial advisers, paid for by the company, help the top executive diversify and get into sophisticated investments. Most have also built up \$5 million to \$10 million in real estate investments, usually in the form of two or more expensive homes, Ms. Meyer said. And the riskier the business an executive runs, the more conservative he or she tends to be in making outside investments. "I find that executives in the most volatile industries buy bonds," Ms. Meyer said.

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If all else fails, the top executive has a safety net — the same company-funded pension that ordinary employees are gradually losing as companies shift them to 401(k)-style contribution plans, which require workers to make payroll contributions. Companies frequently match part of the employee's contribution, often with company stock that can't be quickly sold.

The company-funded pension plans for top executives are cash, not stock arrangements requiring a contribution from executives. Not only top executives get them, but many managers earning upward of \$200,000 a year, Ms. Meyer says. The retirement payout ranges from 60 percent of an executive's pre-retirement pay after 30 years down to 25 percent for an executive with 15 years. The pension payments are in cash.

Richard A. McGinn was on the very high end of this spectrum when he was ousted as Lucent's chief executive in 2000 at age 52 and began to receive a pension of \$870,000 a year, not far below his final year's salary. That was the year that Lucent's stock fell to \$15 from \$77 (it is now below \$10). The stock plunge shrank the savings of thousands of Lucent workers who had built up \$11 billion in the company's 401(k) plan, 17 percent of it in company stock. The 401(k) has been gradually overshadowing a company-financed pension plan for employees.

What Lucent's experience reflects "is a broader shift in our society away from a willingness to share the consequences of bad times, toward making individuals face the risks of economic downturns on their own," Mr. Sandel, the Harvard political scientist, said.

With Enron spotlighting the consequences, the National Association of Manufacturers is reviewing its views — and so far sticking with them, Mr. Cleary said. Anything that encourages personal savings is good for the economy, he argues. More directly, when employees have savings in company stock they are more loyal, more committed to their work, more likely to raise product quality. And using stock rather than cash to match employee contributions to 401(k) plans is often the least expensive route for a company.

Mr. Cleary says companies are telling him, "Let's not foul all the 401(k) plans that are working because one went wrong."

BUT apart from how well these plans might be made to work — perhaps through a law limiting the amount of a company's own stock in its 401(k) plan — there is another, more basic, criticism of the shift toward requiring people to save for their own retirement. Given that most households have less than \$60,000 a year in income, their savings in 401(k) plans average only \$20,000.

That is far from enough to pay for retirement beyond what comes from Social Security, says Karen Ferguson, director of the Pension Rights Center. She would require employers to contribute much more than their workers to 401(k) plans.

There lies the road back to company-funded pension plans.

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The Washington Post

For Enron Families, Dreams and Faith Lost

By Anne Hull

Washington Post Staff Writer

Sunday, January 20, 2002; Page A01

PORTLAND, Ore. -- While the evening news carries a story about Enron's chairman having sold more of his personal stock than previously disclosed, Wayne Stevens makes a supper of chowder, biscuits and pie. He hears his wife coming through the front door.

Cathie Stevens is a customer representative at Pacific General Electric, a Portland-based utility company owned by Enron Corp. The day's office chatter was heavy on scandal.

Wayne Stevens listens, ladling up his soup. Destroyed records, fired accountants, insider stock sales. It just keeps coming.

Together, the Stevenses have 28 years of employment with PGE. After Enron bought their company, in 1997, they watched the value of their company stock more than triple. The quarterly investment statements that arrived in their battered old steel mailbox in rural St. Helens showed that they had \$720,000 for their retirement.

When Enron filed for bankruptcy last month, all but \$2,300 of the Stevenses' retirement money vanished. "Right down the rat hole," says Wayne Stevens. Now they grapple with their financial ruin.

They eat supper quietly. Wayne Stevens is 60, and Cathie is 57. Their house is simple, but their land, in darkness now behind them, is magical. The 24 acres have been in Wayne Stevens's family for 102 years. In the spring, when the first stalks of trillium come up, it will be particularly beautiful.

"That's when we'll sell our place, when the property looks the best," he says.

Enron may go down as the largest bankruptcy in American history, but the lesson is especially painful here in the Pacific Northwest. Houston, where Enron was headquartered, is a city of Cadillacs and 10-gallon swagger and Chapter 11 filings. Portland is simply the home of PGE, a stable utility company founded in 1889 that has provided steady employment to 2,700 employees, some of whom had started there after high school.

Besides a modest pension plan, PGE offered a 401(k) plan that allowed employees to contribute up to 15 percent of their income, with the company matching in PGE stock. "It never moved a lot, but you could count on it," Wayne Stevens says.

When Enron bought PGE in 1997, PGE stock was trading at \$27 a share. With the merger, PGE stock was converted to Enron stock, and employees could still contribute as much as 15 percent of their pay to their 401(k) plans. The company matched up to 6 percent in Enron stock. This seemed like good news: Enron was a Wall Street meteor. By 2000, three years after the merger, Enron was trading at \$85 a share. The Stevenses decided to invest 100 percent of their 401(k) money in Enron stock.

Wayne Stevens, who was a \$60,000-a-year foreman at the PGE-operated Trojan nuclear plant in Rainier, remembers taking off his radiation suit and coming into the break room, where his co-workers would be bent over a computer, checking the Enron stock price.

"These were guys who never cared about the stock market," Stevens says.

In addition to contributing the maximum 15 percent to their 401(k) funds, the Stevenses were buying \$600 a month in Enron stock. Cathie Stevens, who had been so poor as a teenager that she picked strawberries for clothing money, even flipped her annual bonus money back into the purchase of Enron options.

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A PaineWebber counselor visited the nuclear plant during the peak of the frenzy and advised employees not to sink all of their money into one company, but diversifying ran counter to the Stevenses' values. "We are not people who do a lot of moving around," Cathie Stevens says. "We are gonna sit with it -- you know, believe in a company. They've been so good to us." Starting in late 2000, while the Stevenses were pouring money into Enron, executives in Houston began selling off \$1.1 billion in shares they held. By August 2001, the stock price had dropped to \$40.

Wayne Stevens remembers getting an e-mail from Enron Chairman Kenneth L. Lay reassuring PGE employees that the company was stable. Those sentiments were echoed by PGE's chief executive in Portland, a much-trusted leader named Peggy Fowler who had started with PGE as a chemist in 1974. The Stevenses decided to stick with Enron.

Even when Enron announced last fall that it had overstated its profits and was reducing shareholder equity by \$1.2 billion, Wayne Stevens still had faith. "What's that kind of money to a \$70 billion company?"

But real panic set in by October. While Enron's stock price was tumbling, the company announced that it was bringing in a new administrator for its 401(k) plan and that all account activity would be temporarily frozen.

"We understand that you are concerned about the timing of the move to a new Savings Plan administrator and the restricted access to your investment funds," read the e-mail the Stevenses received. "Remember that the Enron Savings Plan is an investment vehicle for your long-term financial goals."

The lockdown would become the subject of several lawsuits. Enron would say it lasted only 10 trading days, but the Stevenses said they couldn't access their accounts for several weeks. By the time they could, an Enron share was worth \$9.98.

On Dec. 2, Enron filed for bankruptcy.

Around the same time, Cathie Stevens received her year-end performance review, in which she was commended for giving "120 percent" at work. By then, her Enron stock was worth 33 cents a share.

'Like Monopoly Money'

The fever worked on all of them. They can see that now. But the numbers were transfixing. Enron's blue-and-green "Money in Motion" quarterly investment statements reconfigured the dreams of people who had never imagined much to begin with.

Each day lately has brought fresh allegations of corporate wrongdoing -- records shredded, debts hidden, figures manipulated -- but Tim Ramsey is thinking about his own culpability.

The 55-year-old electrical troubleshooter ignored his financial planner's advice, keeping 100 percent of his 401(k) money invested in Enron stock. He purchased more Enron shares with his savings and annual bonus. His quarterly statement dated Sept. 5, 2000, read: "Your total balance is \$1,021,247.59."

With 33 years of service with PGE, he could see retirement just around the corner, and he couldn't resist jumping the gun a little. He bought a Suburban.

His wife, who was a waitress for 27 years, was more skeptical.

"It was like Monopoly money," Donna Ramsey remembers thinking. She urged her husband to shift part of their investment to a stable fund. He would agree and make the switch with a few clicks of the computer mouse.

Then he would quietly transfer everything back into Enron, later telling his wife that the stock was too hot to miss out on.

"All of this BS about how good they were doing," he now says, sitting on the couch next to his wife at their house in rural Dundee, 30 miles north of Portland. "I had tunnel vision, along with a lot of other people."

His wife measures her words. "I'm ignorant of finances," she says, "but anyone who I talked to says you don't put all your eggs in one basket."

Her husband, a strapping man with a full head of silver hair and a Western belt buckle, looks down at his dog.

As of this week, his retirement savings hovered around \$10,000.

"I told him we started out in the hole when we first got married," Donna Ramsey says. "'Course, we were 35 years younger then."

Their financial adviser is suggesting that they sell their house.

"The horses," Donna Ramsey says, of their two Arabians. "I know they should go, too."

Tim Ramsey still has his \$225,000 pension. Northwest Natural Gas Co., an Oregon firm, has agreed to buy PGE. Ramsey's plan is to keep working. He will get up in the morning in the pitch black and put on his boots, just as he did before. "Back to square one," he says.

'But See, I'm 57'

Wayne Stevens recently became a plaintiff in one of several lawsuits brought against Enron by employees who lost millions in their 401(k) accounts. But he isn't living like a man who expects a windfall.

On this January night, he keeps the thermostat set at 62 degrees. He recently fit the house with energy-efficient light bulbs. "Saves us \$10 to \$15 a month," he says.

He retired from PGE last year with a \$65,000 pension. If he had sold his stock then, as the Enron executives did, when the shares were trading at \$85, he and his wife would not be facing the uncertainty that now rules their lives.

All of this had them looking out at their land.

They will sell off a parcel at a time. The creek where a local church held baptisms. The dam Wayne Stevens built, where their daughters swam in the summer and skated in winter. The cedar footbridge near the rock outcropping he calls the Canyon, where the trilliums would first show themselves each spring. The 500 firs he and his wife planted together 30 years ago.

All of that now just reminds them of what they can no longer afford to keep.

The Enron executives, attorneys and auditors may be the focus of congressional investigations and inquiries by the Justice Department and the Securities and Exchange Commission. Cathie Stevens has her own tribunal in mind.

Her voice has no malice, but it trembles: "I wish I could see them stripped and sitting on the sidewalk."

A redness flushes across her cheeks.

"I would like to see their bank accounts emptied, like me," she says. "But see, I'm 57. I can't start over. I don't make a million dollars a year, now do I?"

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The Washington Post

Democrats, GOP Debate The Effects Of Enron

Some Say Scandal Not a Political Issue

By Thomas B. Edsall and Dana Milbank

Washington Post Staff Writers

Sunday, January 20, 2002; Page A05

AUSTIN -- Those attending the annual Republican National Committee meeting here expressed confidence that the scandal surrounding Enron Corp.'s bankruptcy would not become a political liability -- and outlined defenses in case it does.

Elected officials and party faithful at the GOP gathering made three arguments why the collapse of the well-connected company would not sway voters in November's midterm elections: The controversy is corporate, not political; the Democrats also have uncomfortable ties to the company; and Democratic scandalmongers may face a voter backlash as Republicans did during the impeachment-tinged election of 1998.

"Enron is an issue but not a political issue," Republican National Committee Deputy Chairman Jack Oliver said. "Enron is an issue of trying to solve problems so they never happen again." That view, expressed by many here in Austin, found some agreement in an unlikely place: the parallel Democratic National Committee meeting in Washington. "At home I have not heard anyone discuss the connection between Enron and politics," said Nassau County (N.Y.) Executive Tom Suozzi. Attending the conference from across the country, Los Angeles City Attorney Rocky Delgadillo concurred: "People in Los Angeles connect Enron with the bad energy companies that jacked up prices and caused blackouts. I don't think they've made the leap to politics yet."

Still, Democrats said the investigation of Enron by Congress and the Justice Department's criminal inquiry can only serve to reinforce an image of Democrats as the party of the little guy and Republicans as the party of big business. Even before the Enron debacle, President Bush was perceived in polls as closer to corporate interests than to those of common citizens. Regardless of GOP complicity, the case of Enron -- in which thousands of workers lost their savings while executives cashed out -- serves as a sort of shorthand for a Democratic class-strife message. "At the instinctive level, people understand big business is a Republican constituency," Rep. Anthony D. Weiner (D-N.Y.) said at the DNC meeting. "Enron will be the word on the floor of the House and Senate for the next year. It will be a noun, it will be an adjective, it will be a verb. You will see the Enronization of everything. . . . I think Enron will linger like a cloud over this election."

The close margins in the narrowly Republican House and narrowly Democratic Senate make predictions for November's contest inherently unreliable. Many other factors will be at work and could easily overshadow Enron. Democrats will blame Republicans for the loss of budget surpluses and for the recession; Republicans will say Democrats want to raise taxes. Top Bush political adviser Karl Rove even argued on Friday for using Bush's handling of the anti-terrorism campaign to the GOP's electoral benefit.

In the upcoming legislative session, Democrats believe the Enron taint will aid their program. They say they will use Enron to block any new effort to pass the GOP's stimulus package, which would have helped Enron. They will attack the Bush energy proposal as a product of Enron influence. And they will use Enron to push for passage of campaign finance reform, which is close to earning a vote in the House. They may also use Enron hearings to make the case for tougher financial regulations.

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"Enron is a metaphor for the Republican administration: cooking the books, covering up, the top guys taking their money off the table and leaving the working folks holding the bag," said DNC Chairman Terence McAuliffe. "I am going to challenge [RNC Chairman Marc] Racicot to join me in lobbying for campaign finance reform."

New RNC communications director Mindy Tucker said the GOP has nothing to fear. "We want to talk about Enron, we want to talk about the investigation, we want the American people to know what happened," she said. "There are a lot of things we are doing on Enron that we will be talking about that will be part of the message."

Racicot, elected RNC chairman in Austin, made the same point: The Enron matter is business, not politics. "There obviously may have been some mistakes made here in terms of management judgment, but my view of it is so far that there is no evidence suggesting there is anything to be concerned about in terms of an abuse of discretion by a public official at any point in time," he said.

Yet, even while offering those confident words, Racicot was forced to spend much of his time at the meeting explaining how he would handle his continued employment with a Texas law firm with a lobbying arm in Washington and a host of corporate and trade association clients that included Enron until recently. Racicot, who has said that he would no longer lobby on behalf of clients and that Enron is no longer a client, said he would embrace the chance to testify to any of the 10 congressional committees investigating Enron: "I don't have the least bit of concern or reticence about that."

A few Republicans, such as Bush strategist Rove, see the possibility for gain if Democrats push too hard on Enron. "If anybody tries to turn this into a political circus, it's going to backfire on them," he said. "Remember, these deals that are the core of Enron's problems occurred in '97, '98, '99 and 2000. So the people are going to say, 'Why didn't the regulators catch it then?' " when Democrats held the White House.

The RNC has already moved to remind the public that, politically speaking, Enron was an "equal opportunity employer." Enron chief executive Kenneth L. Lay may have been Bush's biggest political patron, and the disgraced company is tied to the White House through former consultants and shareholders, but Democrats have awkward affiliations, too.

Thomas "Mack" McLarty, former chief of staff to President Bill Clinton, lobbied for Enron, as did former Gore aides Jack Quinn and Greg Simon and Clinton treasury and regulatory officials. In 1993, Vice President Al Gore attended a fundraiser chaired by Lay for a Senate candidate, and in 1996 Clinton invited Lay to the White House to honor him as a "corporate citizen."

The RNC also pointed out that six of the top 10 recipients of Enron money in the House are Democrats and that half of Senate Democrats have received Enron contributions. Senate Majority Leader Thomas A. Daschle (D-S.D.) received \$7,000. Several of those contemplating investigations of Enron, including Sen. Joseph I. Lieberman (D-Conn.) and Rep. Henry A. Waxman (D-Calif.), have taken contributions from the company, the RNC noted.

But that is not stopping Democrats from attempts to make Enron a political advantage. The Democratic Senate Campaign Committee sent out a news release Friday decrying North Carolina Senate candidate Elizabeth Dole's "too-cozy relationship with Ken Lay," including a September fundraiser. Florida Democrats made noise about Gov. Jeb Bush's appearance for a fundraiser at the home of a former Enron president.

Right here in the president's home state, the Enron scandal has hurt Rick Perry, Bush's GOP successor in the governor's office. On Friday, Perry accepted the resignation of Max Yzaguirre, a former Enron executive Perry had picked to run the state Public Utility Commission. Lay

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donated \$25,000 to the Perry campaign the day after Perry named Yzaguirre to the post. Perry has said he would not return a total of \$200,000 he has received from people with ties to Enron. Republicans can expect to hear more of the same. "It's not as complicated as we're making it," said Prince George's County Executive Wayne K. Curry, a Democrat. "You just go into the barbershops and beauty parlors and say, 'They're their guys.' "

Staff writer David S. Broder in Washington contributed to this report. Milbank reported from Washington.

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The Washington Post

Politicos Scramble to Unload Enron, Andersen Contributions

By Edward Walsh

Sunday, January 20, 2002; Page A05

The debris from the implosion of Enron Corp. is still falling, and the politicians can't move fast enough to get out of the way. The latest include two of the most prominent women in American politics: Sen. Hillary Rodham Clinton (D-N.Y.) and Republican Elizabeth Dole, who is running for the Senate in her native North Carolina.

Clinton announced Friday that she will donate almost \$8,000 in campaign contributions from Enron and its former accounting firm, Arthur Andersen, to a fund that has been established for Enron employees who have lost their jobs and retirement savings.

According to the Center for Responsive Politics, Clinton received \$950 from Enron officials during her Senate campaign. Clinton said she also received \$7,000 in contributions from Andersen employees. Earlier, New York's other senator, Charles E. Schumer (D), said he was donating \$68,857 he received from Enron and Andersen to the Enron employees' fund.

The Democratic and Republican national committees, the parties' congressional campaign committees and numerous politicians of both parties have made similar announcements in recent days.

Dole, who hopes to succeed retiring Sen. Jesse Helms (R-N.C.), said she will donate to the Enron employees \$5,000 of about \$20,000 raised at a Houston fundraising event. The \$5,000 was a contribution by Enron Chairman Kenneth L. Lay and members of his family, according to Jay Warshaw, a Dole campaign spokesman. He said no other Enron employees were among the approximately 25 people who attended the Sept. 20 event at Houston's Four Seasons Hotel.

Warshaw said Dole was scheduled to speak to a Christian women's group in Houston when Lay, "at the last minute," offered to organize the fundraiser. "Mrs. Dole is not comfortable keeping the money, and better than returning it, she is giving it to the Enron employees," he said.

North Carolina Democrats questioned why Dole is not donating the entire \$20,000 to the employees' fund. They also questioned the timing of the fundraising event, which was held nine days after the Sept. 11 terrorist attacks, when Dole announced she was suspending all campaign activities.

Warshaw responded: "It's absolutely appropriate to donate every dime she raised from Enron employees to Enron employees. It came to \$5,000." As for the timing of the event, he said, "There was no public politicking or stumping going on at that time."

A Thumbs-Up for Bush and the GOP

As Congress returns, a relatively upbeat public gives broad approval to President Bush's leadership and a vote of confidence to Republicans, according to a poll released last week by the Pew Research Center for the People and the Press.

Bush's overall job approval score is at 80 percent, and 60 percent approve of his handling of the economy despite the recession. On the two top priority concerns, protecting the United States against terrorism and strengthening the economy, Republicans are credited with having better ideas than the Democrats. The GOP has a 3 to 1 advantage on terrorism issues and a nine-point advantage -- 43 percent to 34 percent -- on the economy.

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Democratic congressional leaders also are rated positively, but by a 54 percent majority, and Democrats maintain their traditional advantage on Social Security, regulation of managed-care companies and provision of prescription drugs.

But Bush's heavy emphasis on education has paid off for the GOP, giving it a three-point lead on the schools issue, which usually has cut for the Democrats.

The survey found considerable optimism among those who may go to the polls in the midterm election. By 44 percent to 17 percent, those interviewed said they expect economic conditions to get better this year. Fully 65 percent said they expect their personal finances to improve.

One potential worry for Bush and the GOP: Almost as many (46 percent) say the president could be doing more to help the economy as those (48 percent) who say he is doing all he can. When the poll was taken in mid-January, only 1 in 5 of those interviewed said they were following the Enron bankruptcy-political influence story closely.

Staff writer David S. Broder contributed to this report.

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The Washington Post Testimony Is Sought On File Shredding

House Panel to Call Andersen Officials

By Susan Schmidt and Kathleen Day

Washington Post Staff Writers

Sunday, January 20, 2002; Page A05

A House subcommittee will require top officials from Andersen LLP to testify Thursday about the accounting firm's destruction of Enron Corp.-related documents last fall, after the firm knew Enron was being investigated by federal regulators.

"We will invite them and if they decline the invitation we will subpoena them," Ken Johnson, spokesman for the House Energy and Commerce Committee's oversight and investigations subcommittee, said yesterday.

Andersen's chief executive, Joseph Berardino -- or a designee, such as the company's general counsel, Andrew Pincus -- is at the top of the list of invitees, Johnson said. Also on the list are Nancy Temple, an Andersen lawyer who wrote a memo Nov. 10 telling Andersen employees to preserve documents, and David Duncan, who was Andersen's lead auditor on the Enron account until last week. Andersen fired Duncan for what it said was the improper destruction of documents.

The subcommittee also is considering inviting Michael Odom, another Andersen auditor on the Enron account, Johnson said.

"We just received the invitation and we will respond to the committee in a timely manner," Andersen spokesman Patrick Dorton said.

Temple's Nov. 10 e-mail suggests that Andersen's legal department did not explicitly tell auditors to start preserving documents related to Enron's audit until nearly three weeks after Enron had disclosed that the Securities and Exchange Commission was looking into its finances.

By then, the firm's Houston office had destroyed large numbers of documents related to its audit. She sent the e-mail to tell the Enron team that Andersen had received an SEC subpoena two days earlier and that no documents should be destroyed.

"One of the first things we must do in preparing to respond to this subpoena and the lawsuits is to take all necessary steps to preserve all the documents and other materials that we may have relating to the claims that are being filed," wrote Temple in the Nov. 10 message, portions of which were made available to the Post by a source close to the investigation of Andersen and Enron.

"To do this we must first insure that all documents and materials already in existence are preserved and that nothing is done to destroy or discard any documents or materials now in your possession," she wrote.

A day earlier, Temple, who was based at Andersen headquarters in Chicago, had alerted Duncan by phone -- leading Duncan's assistant to tell the Enron team to "stop the shredding."

"After we received the subpoena, Nancy Temple promptly notified the team by voice mail and then followed up with an e-mail," Dorton added.

A month earlier, on Oct. 12, Temple had e-mailed the Enron auditors a copy of Andersen's document retention policy, which calls for the retention of some documents and the destruction of others. A week later, around the time Enron disclosed that the SEC was starting an inquiry into its accounting practices, she e-mailed the policy to Chicago executives with whom Duncan's group was consulting on how it had handled the audit.

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Andersen has said that Duncan called an "urgent meeting" on Oct. 23 to organize the destruction of Enron-related records.

Duncan's lawyers have said their client was following instructions from company lawyers in dealing with documents. Sources familiar with the position Andersen will take at the hearing disputed that, saying, "Duncan used Temple's Oct. 12 e-mail as an excuse to destroy documents." Neither Temple nor her lawyer could be reached for comment.

Enron on Oct. 16 disclosed a huge third-quarter loss and a \$1.2 billion write-down in stockholders' equity, leading to a plunge in Enron's stock and lawsuits by shareholders. On Oct. 22, the company acknowledged that the SEC had begun an inquiry into its accounting practices, which was upgraded to a full investigation a week later.

"The press stories relating to Enron have led to an increasing number of lawsuits in recent days. Although the initial lawsuits that were filed did not name Andersen as a defendant, we have learned of one new lawsuit that does name Andersen and there have been press reports of a second suit," Temple wrote in the Nov. 10 e-mail.

Dorton said Temple had acted to preserve documents after Andersen was subpoenaed.

"It would be standard to issue a document preservation instruction after receipt of a subpoena," he said. "That is part of what lawyers do."

Under federal law, it is a felony to "corruptly" persuade another person to destroy records with an intent to impair their "availability for use in an official proceeding." The law says the proceeding "need not be pending or about to be instituted at the time of the offense."

As soon as an accounting firm knows that a company it audits is under government investigation, the firm's general counsel or compliance officer would typically send a notice reminding employees of the need to preserve documents related to the inquiry, said Georgetown Law School professor Milton Regan, who specializes in corporate legal ethics.

"As soon as a company knows that a government inquiry has begun," he said, "that requirement of preserving documents would override any internal document retention policy."

Staff writer David S. Hilzenrath contributed to this article.

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The Washington Post

Chairman Told Workers Stock Was 'Bargain'

By Peter Behr
Washington Post Staff Writer
Saturday, January 19, 2002; Page A01

In an e-mail chat with concerned employees Sept. 26, Enron Corp. Chairman Kenneth L. Lay called the company's slumping stock price "an incredible bargain" and said the upcoming financial report for the third quarter "is looking great." Enron's accounting practices were legal and proper, he added.

Lay's testimonial to Enron employees came a little more than a month after he received warnings from Enron Vice President Sherron Watkins of a potential accounting scandal at the Houston energy company -- and then called for a review of Watkins's charges by Enron's law firm.

Less than a month after the e-mail exchange, Enron jolted investors by reporting a \$638 million quarterly loss and the first of an increasingly devastating series of changes to its financial statements.

Lay, Enron's founder, bought some stock himself in August, although it isn't known whether he later sold it, and the company declined yesterday to discuss the question.

His e-mail exchange frames a critical issue for Enron and for Lay himself, as he prepares for Senate testimony Feb. 4 on his company's collapse: How much of Enron's financial erosion was clear to him in mid-September, when he was urging employees to keep buying the stock?

Enron's bankruptcy filing Dec. 2 and the final disintegration of its stock price wiped out the company retirement savings of an unknown number of the 20,000 people who worked for Enron at its peak. From a high of \$90 in September 2000, the stock price dropped to \$25 on Sept. 26. It took another plunge in October as Enron's problems mushroomed, leading up to the company's Dec. 2 bankruptcy filing.

Lay's upbeat advice to employees in September was "unconscionable," said Eli Gottesdiener, an attorney representing present and former Enron employees who are suing the company. "He is essentially sending people off the cliff," said Gottesdiener, who yesterday provided a copy of Lay's e-mail conversation, which had been supplied by one of his clients.

Enron employees were free during most of last year to sell shares they had purchased in their 401(k) company savings plan. The exception was a two-week freeze on the account beginning Oct. 29 when Enron shifted plan managers. That freeze should never have been permitted, with the company's stock in free fall, Gottesdiener says.

Enron contributed \$1 for every \$2 employees put into their savings, but the company match was in Enron shares that could not be sold until an employee reached 50 years of age. As of the end of 2000, nearly 60 percent of the 401 plan's assets were in Enron shares.

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In the September talk, Lay told employees that he was strongly urging senior executives to buy more Enron shares.

"Some, including myself, have done so over the last couple of months and others probably will do so in the future. . . . My personal belief is that Enron stock is an incredible bargain at current prices and we will look back a couple of years from now and see the great opportunity that we currently have."

Lay's most recent disclosure to the Securities and Exchange Commission, filed Sept. 1 last year, shows purchases of \$2 million in Enron stock in the third week of August. He took advantage of a 1999 stock option grant which permitted him to buy the stock at an average price of about \$21.50 a share -- well under the \$36 a share market price for the stock at the time. Any sales of that stock would be reported in subsequent SEC filings.

Between November 2000 and last July, Lay had sold \$30.3 million in Enron stock, under a prearranged sales program permitted by securities regulations. In 2000, he acquired 2.3 million shares of Enron stock through exercising options with a value of \$123.4 million. As of last Aug. 31 he owned a total of 14.9 million shares of his company's stock, worth \$523 million on that day but a small fraction of that now, according to Thomson Financial.

Lay's conversation is a snapshot of a range of worries and criticism among the Enron workforce, coupled with one employee's gratitude for Lay's efforts.

One worker asked about Enron's use of "aggressive" accounting procedures and off-balance sheet partnerships and entities in creating the revenue figures on its financial statements -- a central issue raised by Watkins. The worker noted that Enron's auditor, Arthur Andersen, had been heavily fined for accounting violations involving another Houston company. "You are a man of integrity," the employee said, asking for reassurance that such problems did not exist at Enron.

Lay replied that he and Enron's board would never approve the use of the special entities if they were not convinced by Enron executives, the Andersen firm and its outside law firm, Vinson & Elkins, that such arrangements were legal.

Another questioner asked pointedly about current accounting "tricks" involving calculations of the current value of long-term energy contracts and financial deals. What would happen when these deals "come home to roost," the employee asked.

Lay said the company's accounting practices followed industry standards and predicted years of steadily growing profit and stock gains.

A third employee asked about criticism that Enron's financial statements were hard to decipher. "How will we get the markets to trust the quality of our earnings?"

Lay answered, "If we somehow are filling holes in our operating income in this business it would be virtually impossible to continue doing that for six years."

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Congressional investigators are trying to determine whether Enron was in fact "filling holes" in its current income reports by exaggerating revenue it expected to receive from long-term energy and financial derivatives contracts involving its complex partnership and affiliate networks.

An Enron spokesman declined to discuss Lay's comments to employees. Lay's attorney Earl Silbert said Lay was in Houston, concentrating on running Enron as it tries to settle with creditors and come through a bankruptcy reorganization.

Lay and his wife, Linda, plan to sell two homes and a building lot in Aspen, Colo., for \$16.2 million, said his broker, Joshua Saslove of Joshua & Co. They will keep their principal residence at the ski resort, Saslove said.

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The Washington Post

Ex-Enron Executive Quits as Texas Utility Regulator

Associated Press
Saturday, January 19, 2002; Page A04

The legal and political fallout from the biggest corporate collapse in U.S. history continued yesterday as a former executive of bankrupt Enron Corp. resigned as Texas's top public utility regulator and officials in several other states pursued lawsuits and investigations of the once mighty energy trading company.

In Austin, Max Yzaguirre, former president of Enron de Mexico, quit as head of Texas's Public Utility Commission, seven months after being appointed by Gov. Rick Perry (R). Democrats and public interest groups recently raised questions about the appointment, which came a day before Enron's chairman, Kenneth L. Lay, made a \$25,000 contribution to Perry's political campaign.

Perry, a former lieutenant governor, is running for a full term as the state's top executive after inheriting the governorship when George W. Bush resigned to become president. Perry called the timing of Lay's donation "totally coincidental" and said Yzaguirre is "a qualified individual . . . to serve in the PUC."

In announcing his resignation yesterday, Yzaguirre said he and his family have been subjected to "a series of negative attacks, which have nothing to do with my job performance and which seemed to be politically inspired."

Before Enron's collapse, the Houston-based company and its executives had long been big financial contributors to politicians of both major parties, including Bush, who has received more than \$500,000 in Enron donations in his political career.

Since Enron's bankruptcy filing on Dec. 2, the company's questionable accounting practices and the financial dealings of its top officials have come under investigation by Congress and several federal agencies, including the Justice Department.

Also, because the collapse of Enron's stock wiped out at least \$1 billion from the retirement funds of teachers, firefighters and other public employees across the country, states are joining a class-action lawsuit, hoping to recoup some of the money. "We owe it to these public servants to get back as much of their money as we possibly can," Ohio Attorney General Betty D. Montgomery said.

The attorneys general of Georgia, Ohio and Washington state have asked a federal court in Texas to make them the lead plaintiffs in existing investors' securities fraud litigation. Others seeking to lead the class action include agencies overseeing pension funds in Florida and New York City, and the university pension fund in California.

In Florida, the state attorney general's office has subpoenaed Enron documents as part of a racketeering investigation into the sale of the company's stock to the state pension fund while the share price was plunging last year, investigators said yesterday.

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The subpoenas were served on Thursday, said Mary Leontakianakos, chief of the economic crimes section of the attorney general's office. Florida's pension fund lost \$320 million on its investment in about 7 million shares of Enron stock.

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The Washington Post

Tex. Prosecutors Disqualified From Probe by Personal Ties

U.S. Attorney Launched Inquiry Into Enron Only to Be Recused

By Paul Duggan
Washington Post Staff Writer
Saturday, January 19, 2002; Page A06

AUSTIN -- After he was sworn in Dec. 13 as U.S. attorney for southern Texas, Michael T. Shelby, a career prosecutor who has specialized in white-collar corruption cases, wasted no time diving into what he thought would be the most intriguing criminal investigation of his life.

Eleven days earlier, in the largest corporate collapse in the nation's history, Houston-based Enron Corp. had filed for bankruptcy protection, raising numerous questions about the company's practices and top executives.

On the day he took office in Houston, Shelby said in an interview this week, he ordered the chief of his fraud division to issue subpoenas for Enron records and told prosecutors to arrange a meeting with Securities and Exchange Commission officials in Washington. "We wanted to peruse the SEC's files and basically get our investigation moving forward as quickly as possible," Shelby recalled.

But today, a month after gearing up to spearhead the Justice Department's criminal probe of the Enron debacle, Shelby, 43, and his 89-lawyer staff are out of the loop. In a move that legal experts called highly unusual, the entire U.S. Attorney's Office in Houston has been recused from the case because too many of its lawyers, including Shelby, have personal ties to current or former employees of the once-giant energy trading company.

The Justice Department's decision to assign the investigation to a task force of prosecutors from other jurisdictions illustrates the difficulties that law enforcement officials, members of Congress and others face in conducting clearly impartial inquiries into Enron. Before the company's demise, which wiped out many of its employees' retirement funds, Enron had long been a big financial contributor to politicians of both major parties, notably President Bush.

Attorney General John D. Ashcroft, who received Enron donations when he was in the U.S. Senate, has removed himself from the investigation. A federal judge who had been overseeing 46 lawsuits against Enron has recused herself, citing her acquaintances with two lawyers in the cases. And U.S. House and Senate members, some of whom plan to take part in Enron hearings by at least 10 committees, have been scrambling to give away hundreds of thousands of dollars in campaign contributions from the company.

In Shelby's office, the problem was not politics, but family ties and friendships.

On the same day he ordered the subpoenas, Shelby said, he assigned two staff lawyers to investigate whether the Houston office's involvement in the Enron case would create any potential conflicts of interest. He said the two lawyers are "ethics officers," specially trained in "the nuances and technicalities" of the Justice Department's rules of professional responsibility.

"I was obviously very aware of my own situation," said Shelby, whose brother-in-law, a lawyer, was an Enron employee and "suffered a significant financial loss as a result of the collapse of the company's stock." Shelby said he instructed the ethics officers to question the rest of the lawyers in the office to determine whether any others had personal ties to Enron, which laid off about 4,000 employees at its Houston headquarters.

Meanwhile, the prosecutor's office proceeded with the beginning phase of the criminal probe including gathering Enron documents and interviewing people familiar with the company's workings.

"I didn't want to lose even a day," Shelby said. "I wanted this thing to go forward, because with investigations like this, people who are willing to produce evidence sometimes become less willing as time progresses. We didn't want to lose any opportunities to speak with people or get records."

At the same time, the information being gathered by the ethics officers suggested that Shelby's staff would not be involved in the investigation for long.

"We found that a number of people [in the office] have direct or indirect relationships" to current or former Enron employees, Shelby said. Although he declined to specify how many prosecutors in his office have such ties, he said "it's not even close to half" the staff.

"There are people whose husbands worked there and who suffered losses in their retirement plans," Shelby said, declining to elaborate. "And, of course, those losses are imputed to the spouses who work in our office. And there were other people who had different situations. . . . I'll only say that there was an identifiable group of people who were affected in different ways by the collapse."

And it was a group large enough, he said, to raise concerns about the appearance of a conflict of interest for the office as a whole.

He said he and his staff "tried to figure out some way we could keep the case in this office by building a wall between the investigation and these individuals, including myself." But they decided there was no way to avoid the appearance of a conflict.

Based on the ethics officers' findings, Shelby said, Assistant Attorney General Michael Chertoff, head of the Criminal Division, also determined that the Houston office should be removed from the investigation. The decision was made Jan. 10, the same day Ashcroft recused himself.

While it is not unusual for individual prosecutors to recuse themselves from cases, "I've never seen an entire office step aside and say we're not going to touch this investigation," said the Rev. Robert F. Drinan, a Georgetown University law professor and chairman of the American Bar Association's committee on professional responsibility. But he applauded the move.

"For once I can say that the Bush people got it right," said Drinan, a Democrat who served five terms in the U.S. House from Massachusetts in the 1970s. "They deserve praise for good sense."

The Justice Department investigation, overseen by Chertoff and Deputy Attorney General Larry Thompson, will be conducted by a task force headed by prosecutor Leslie Ragon Caldwell, chief

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of the criminal division in the U.S. Attorney's Office in San Francisco, a Justice Department spokesman said. He said the task force, still being assembled, will be based in Houston, but not in Shelby's office.

Although he was "professionally disappointed" by the recusal, Shelby said, "I completely understand the rationale" for it. He said the Enron investigation "needs to go forward expeditiously, aggressively and without the appearance of a conflict. The United States needs to get to the bottom of [Enron's conduct] and determine whether any crimes were committed, and if they were, who committed them."

He added, "We don't want anybody to come back later and try to invalidate the whole investigation by saying, well, the motives of the prosecutors in this case were less than pure because they were looking out for their own relatives who lost money."

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The Washington Post

State Boards Probe Andersen

Moves Linked to CPA, Public Concerns

By Kirstin Downey Grimsley and Renae Merle
Washington Post Staff Writers
Saturday, January 19, 2002; Page E03

The National Association of State Boards of Accountancy said yesterday that many state boards are probing allegations of accounting irregularities involving Arthur Andersen, the Big Five accounting firm that audited collapsed energy trader Enron.

The 54 boards have the power to pull accountants' licenses or discipline them, although they have been criticized in the past for rarely doing so.

"CPAs throughout this land are angry and distressed over the debacle, and the CPA's trusting public is looking to state regulatory boards to conduct a comprehensive investigation and, where appropriate, to terminate audit practice privileges," said David Costello, the association's president, in a statement.

Investigations of Andersen are reportedly underway in Texas, where Enron is based and where documents related to its accounts were destroyed at Andersen's Houston office, as well as in Connecticut, Arizona and Washington state.

"The state of Washington and the other boards expect we'll coordinate our efforts with federal agencies and self-regulatory organizations," said accountant Thomas J. Sadler, a member of the Washington Board of Accountancy and a regional director of the National State Boards of Accountancy.

Ken Bishop, executive director of the Missouri Board of Accountancy, said the board "is compiling information on the Enron case," though he added that Missouri law prohibited him from saying whether an actual investigation is underway.

Andersen is already under investigation in Arizona in relation to another matter, in which investors lost an estimated \$300 million in an investment scheme managed by the Baptist Foundation of Arizona. Andersen audited the foundation's books. State regulators have alleged the foundation was perpetrating a fraud.

In Connecticut, the State Board of Accountancy has launched an investigation at the request of Attorney General Richard Blumenthal. The company could ultimately be barred from working in the state.

Andersen has been in trouble in Connecticut before. The state blamed the accounting firm for the 1990 collapse of the Colonial Realty Company, eventually culminating in a \$3.5 million settlement and Andersen being barred from working in the state for a year, Blumenthal said.

"Our state has investigated and sanctioned this firm before, in connection with strikingly similar practices," Blumenthal said in a letter to the State Board of Accountancy. In the Colonial Realty

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case, Blumenthal said, Andersen destroyed an "unknown number of documents and electronic files" relating to the company's real estate ventures.

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The Washington Times

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Enron cash got access to Bush, but not results

Patrice Hill

THE WASHINGTON TIMES

Published 1/21/2002

Enron Chairman Kenneth L. Lay was instrumental in persuading President Bush during the 2000 campaign to say global warming is a problem, but the giant energy company later was frustrated in its efforts to get the administration to do anything major to combat it.

Enron's experience on global warming, which was one of the embattled corporation's top lobbying priorities, illustrates how big campaign donations can gain business executives access to political power at critical times, but they are no guarantee of action.

During the campaign, Mr. Lay, who with more than \$600,000 in contributions to Bush campaigns since 1993 is the president's top donor, prevailed upon his friend to discuss global warming with Fred Krupp, executive director of Environmental Defense, according to several sources with knowledge of the meeting.

Mr. Krupp and Mr. Lay knew each other from being on the board of the Heinz Center, an environmental think tank, with Alcoa Chairman Paul H. O'Neill, who was soon to become Mr. Bush's Treasury secretary and a strong advocate for dealing with global warming within the administration.

In the summer of 2000, Mr. Bush had not adopted a position on global warming. Mr. Krupp was pushing a proposal that he considered business-friendly to impose first-ever controls on the emissions of carbon dioxide thought to cause a warming of the Earth's atmosphere.

The proposal would cap the carbon emissions and three other pollutants produced by power plants, then allow the plants to buy and sell emissions credits to achieve the required reductions in the most economically efficient way.

Enron was an enthusiastic supporter of this "market" approach to cutting carbon emissions. It stood to benefit greatly as an operator of natural gas pipelines, because the carbon cap would force many coal-fired power plants to switch to natural gas, a cleaner-burning fuel with far less carbon emission.

Even more important, Enron hoped to become a major player in the system for trading emissions credits envisioned under the proposal. The energy giant's revenue increasingly came from its growing trading business, and it was already a major player in the futures markets for such commodities as electricity and gas.

The cap on power plants was a more limited version of the worldwide emissions trading system that Enron had lobbied top Clinton officials to include in the Kyoto global warming treaty rejected by Mr. Bush but championed by his opponent, Al Gore.

Mr. Bush liked the businesslike approach of the proposal, as well as its environmental appeal. Soon after the meeting, he started talking for the first time in the campaign about his concerns about global warming. And when he released his campaign's energy plan in the fall, it included the carbon-cap proposal.

White House spokeswoman Claire Buchanan said Mr. Bush adopted the proposal because "he

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believed it was the right policy" at the time, though he later withdrew it. She could not confirm Mr. Krupp's role in bringing the proposal to Mr. Bush's attention.

Enron and its environmental allies were ecstatic. Though it was not as ambitious as the Kyoto treaty, they viewed the cap as a practical way of achieving the emissions reductions that would be mandated by the treaty.

Mr. Gore and the Environmental Protection Agency under President Clinton had explored imposing a cap on carbon emissions, using existing authorities under the Clean Air Act. But they never proposed a mandatory cap.

The Kyoto treaty was unpopular in Congress, and lawmakers had barred the EPA from making any backdoor attempts to implement the treaty before the Senate ratified it.

By persuading Mr. Bush to address global warming as a problem and include the carbon cap in his campaign platform, Enron and its environmental allies believed they had bypassed the political obstacles posed by the Kyoto treaty and given new life to carbon controls in Congress. Indeed, by the time Mr. Bush took office a year ago, proposals to cap carbon were popping up everywhere in Congress. Even the Clinton administration, emboldened by the Bush proposal, had issued an eleventh-hour regulation to cap carbon with other power-plant emissions.

Enron hailed the increasingly friendly climate for carbon controls in a document laying out its lobbying strategy dated January 2001.

"Agreement between industry, regulators and environmental groups" has emerged on the need for controls, said the lobbying documents for the Clean Power Group, partly funded by Enron. "The Bush platform included a commitment to future emissions caps [and] implementation through a cap and trade program."

Enron judged most of the proposals that had cropped up as not stringent enough, however, because they would not force utilities to retire aging coal-fired plants that spew the most carbon into the air. Those coal plants produce about half the nation's power, and their retirement would create a huge market for cleaner-energy companies such as Enron.

The lobbying group, which also included Calpine, El Paso, Trigen Energy, NiSource and PG&E National Energy Group, drafted its own carbon-cap plan to force the retirement of more aging coal plants. It said its goal was to win the endorsement of the incoming administration and Republican moderates in Congress.

But Enron was soon to be disappointed. Mr. Bush had not discussed his carbon-cap proposal with conservative supporters, who were enraged that he included it in his campaign platform without consulting them. But the conservatives held their fire until after the election.

Conservative groups such as the Cooler Heads Coalition joined with coal interests and other businesses opposed to carbon controls to put tremendous pressure on Mr. Bush to withdraw the carbon proposal as soon as he took office. The proposal had gained Mr. Bush little support from environmental groups and had become a major liability with his core constituencies.

Conservatives won over a key ally in White House Economic Adviser Lawrence Lindsey, who believed the carbon cap would put a crimp on economic growth and energy development when the nation was enduring a scarcity of fuels.

Within months of taking office, Mr. Bush announced he was dropping the carbon-cap proposal, which he said had been a mistake, and for the same reasons he opposed the Kyoto treaty: It was not good for the U.S. economy.

"When Bush came out and said he wouldn't do it, Lay was floored," said one source close to the company. "The lesson from this is that money gets you access, but not results."

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The Washington Times

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Enron disclosure should be full, Republicans warn

Joyce Howard Price

THE WASHINGTON TIMES

Published 1/21/2002

Enron is not a political scandal, but some Republicans warn the White House it could become one if administration officials are not more forthcoming about their dealings with officials of the bankrupt Houston-based energy firm that is the subject of a criminal investigation and other probes.

"I don't believe this is a political scandal. I believe it is an accounting scandal, a legal scandal and a corporate corruption scandal. But if the information doesn't come out from government officials, it will become an artificial political scandal," Joseph diGenova, formerly a federal prosecutor in the Reagan administration, said yesterday on CNN's "Late Edition."

Sen. Fred Thompson, Tennessee Republican, echoed those views on CBS' "Face the Nation."

"From a political standpoint it's better to get everything out and get it over with," said Mr.

Thompson, the top Republican on the Senate Government Affairs Committee.

Democrats have been pressing the White House to disclose any and all contacts that President Bush, Vice President Richard B. Cheney or other administration officials had with executives of Enron.

Sen. Carl Levin, Michigan Democrat, renewed that call yesterday on CBS' "Face the Nation."

"I just think it's better for everybody to kind of lay out whatever connections — contacts — people had or have. If it's in the past, just simply say it just say it, get it over with, get it behind you," Mr. Levin said.

Before its collapse last year, Enron was the nation's seventh-largest corporation and contributed heavily to both Republicans and Democrats in political campaigns. Enron overstated profits, covered up debts and now stands accused of illegally blocking employees from selling shares of Enron stock from their 401(k) retirement accounts while the value of that stock plummeted.

A Justice Department criminal probe of Enron also focuses on accusations that top executives of the firm cashed out their stock while hiding massive losses. Enron is the subject of investigations by Congress, the Securities & Exchange Commission and the Labor Department as well.

Critics of the White House have focused on Enron officials' involvement in Mr. Cheney's energy task force. They also want information about Mr. Cheney's intervention with Indian officials in a bid to salvage Enron's troubled Dabhol power plant, partly financed by the U.S. government.

Mr. diGenova said it was "perfectly legitimate" for Mr. Cheney to help an American business deal with a foreign country, a view echoed by Secretary of State Colin L. Powell on "Fox News Sunday" and ABC's "This Week."

On NBC's "Meet the Press," Joseph Berardino, CEO of Arthur Andersen — the accounting firm that acted as both auditor and consultant for Enron — said his firm found no evidence that unlawful practices were behind Enron's collapse.

"To my knowledge, there was nothing we found that was illegal," said Mr. Berardino, adding:

"This is a company whose business model failed at its base, this is an economic failure."

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Andersen has come under fire since evidence surfaced that the firm was aware of Enron's debt-ridden partnerships as early as February and yet proceeded to give its client a clean bill of health in an annual report in April. Andersen signed off on accounting practices that hid billions of dollars in debt and led to a \$600 million reduction of four years' worth of earnings.

"Those books were not cooked," said Mr. Berardino.

Anderson has tapped former Sen. John Danforth, Missouri Republican, to conduct an internal investigation of its handling of Enron.

Pointing out that Mr. Danforth is also an Episcopal priest, Mr. diGenova commented, "He may have been hired to give them last rites."

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The Washington Post

Enron Case Offers Harsh Lessons

Wall Street's Growth Boosted Risk, Rewards

By Glenn Kessler

Washington Post Staff Writer

Monday, January 21, 2002; Page A01

The U.S. financial markets are lauded as the world's most open and efficient. But the spectacular collapse of Enron Corp. exposed weaknesses -- the results of subtle but important changes on Wall Street and in corporate America -- that analysts say came together to help topple the nation's seventh-largest company.

What are some of the lessons of Enron?

Current rules allow company executives to pad their nests with lucrative stock options, while leaving the retirement savings of ordinary workers at more risk. Wall Street analysts can support a company's management to the very end. And a company's financial statements may bear little resemblance to reality, even if they are approved by a blue-chip auditing firm.

The specifics of Enron's case, of course, do not apply to every publicly traded company or accountant or investment banker. Its collapse comes after a string of other major accounting failures, at companies such as MicroStrategy Inc. and Cendant Corp., which led to huge losses for investors in those stocks. Enron's demise also followed the implosion of dot-com stocks that were hyped by Wall Street analysts.

Bush administration officials, lawmakers and other experts say the Enron debacle will force an examination of what is broken in the system.

"The U.S. capital system, while far from perfect, still beats the alternatives," said Lawrence B. Lindsey, President Bush's chief economic adviser. "Hopefully, we will learn from experience."

In the past decade, as the U.S. markets have grown to giant proportions and become much more complex and volatile, the incentive systems on both Wall Street and in corporate America have changed as well -- for the worse, according to some experts.

Companies, which once raised money simply by taking out loans or selling stock, began to use complex and often obscure financial instruments to fund their operations. Corporate executives, prodded to show they had the same stake in a company's success as investors, began to be rewarded with stock options. But options paid off only if executives managed to boost a stock price and keep it there, generating pressure to craft earnings releases that met Wall Street's expectations.

On Wall Street, the roles of accountants and analysts also began to change. Accountants had to keep up with the ever-more complex financial structures of companies, but the fees for basic accounting did not keep up with the increased workload. So accounting firms moved into other lines of business that were more lucrative. Although several accounting firms say they still make money from basic audit services, industry experts say many firms have essentially relegated auditing to the lowly status of "loss leader," a money-loser to attract other business.

"Auditing has become a stepchild, a commodity, to get your foot in the door," said Samuel Hayes, a Harvard Business School investment banking professor.

Stock analysts once were prized for their in-depth research into the growth prospects of companies, with the best ones known for field work, such as visiting store managers across the country. But as companies began to demand more from investment bankers, stock analysts began to be viewed less as stock sleuths and more as rainmakers who could bring in business. And their

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compensation changed as well, with analysts who could sell a stock or bring in an investment-banking deal winning the biggest bonuses.

Markets function best when information is freely shared, not when it is known only to corporate insiders or hoarded by a few big players. The changing roles of executives, analysts and accountants had the effect of limiting the flow of data that could help investors make informed choices on what stocks to buy or sell.

"The main lesson of Enron is that disclosure -- honest and fair disclosure -- is crucial to the operation of the capital markets," said Alan Blinder, a Princeton University economist and former vice chairman of the Federal Reserve. "The U.S. argues that our greater disclosure standard gives us a competitive advantage. But Enron has given that argument a black eye." Enron, which for six years straight was voted "most innovative" on Fortune magazine's list of the most-admired companies, pioneered the trading of energy, such as natural gas and electricity. The company reported soaring revenue and quarter after quarter of rising profits, pushing its stock ever higher.

The glowing earnings reports told only part of the story. The company had constructed a maze of more than 1,000 partnerships, affiliates and other entities, which had the effect of hiding its growing debt from the public. Many stock analysts -- 16 out of 17 still calling it a "buy" or "strong buy" shortly before the company imploded -- did not bother to dig beneath the surface or raise fundamental questions about whether Enron was really making money.

On Nov. 8, Enron corrected more than four years of financial results, saying it had overstated profits by nearly \$600 million. Its stock price crashed and Enron sought bankruptcy protection on Dec. 2.

Blinder said there are two pillars of accounting that are essential to help investors understand a company's value: the balance sheet, showing assets and liabilities; and the profit and loss statement. The use of special-purpose entities by Enron, he said, appears to have been intended "to make those statements as misleading as they can be."

Securities and Exchange Commission Chairman Harvey L. Pitt, who last week called for new oversight of the accounting industry, said most financial disclosure is not timely and often is "dense and impenetrable."

"Today, disclosures are made not to inform, but to avoid liability," Pitt said.

Executives with stock options often do not have the same interests as ordinary investors, Hayes said. Option grants tend to permit selling only for short periods. "Executives are motivated to make sure prices are high when they can sell," he said. "They are subtly influenced by their own self-interest, which is not identical to other investors."

Companies in the 1990s thus became adept at "managing" their earnings, booking deals and contracts at just the right moments so revenues and profits would appear to keep rising and Wall Street would be impressed.

Former SEC chairman Arthur Levitt Jr., who unsuccessfully tried to overhaul accounting rules during the Clinton administration, said the "proliferation of managed earnings by corporate America" stemmed from the changing roles of auditors, lawyers, analysts, investment bankers, corporate directors and others in recent years.

"The system could have adjusted for any of one of them, but not the combination of all of them," Levitt said. "Overseeing and regulating our capital markets is like driving a car. You need to make constant midcourse corrections."

Enron has exposed another problem: the growing vulnerability of employee retirement savings to the whims of Wall Street. Companies moved away from "defined benefit" plans, in which they

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provided a fixed pension guaranteed by the federal government, and instead flocked toward "defined contribution" plans, such as 401(k) plans. Under the new system, companies contributed money to retirement funds -- often in shares of its stock -- only if employees put in money. The rest is often left up to the employee to invest. Many employees' savings were ravaged as Enron's shares fell. The company froze trades as it changed plan administrators, so employees could not even sell Enron shares that should have been freely tradable -- not the ones contributed by the company, but the shares employees bought in the plan with salary contributions. "It is a very bad financial package to have a person's pension tied into the company for which they work," Blinder said.

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The Washington Post

Andersen CEO Puts Blame on Enron Business

By David S. Hilzenrath

Washington Post Staff Writer

Monday, January 21, 2002; Page A01

The chief executive of Arthur Andersen, under fire for the firm's audits of energy trader Enron Corp., yesterday said that business reasons, rather than flawed accounting, caused Enron's collapse.

"An important point here is people want to focus on the accounting, and that's fair game, but a company has failed . . . because the economics didn't work," Joseph F. Berardino said on NBC's "Meet The Press."

Congress resumes hearings into Enron's collapse on Thursday and Andersen's accounting is to come under scrutiny. Andersen put its stamp of approval on years of Enron financial statements that overstated the company's profits by nearly \$600 million and understated its debts by more than \$1 billion. Shareholders who lost billions of dollars allege in lawsuits that the seemingly successful energy company used misleading accounting to hide its business troubles from investors.

Sen. Carl Levin (D-Mich.), chairman of a Governmental Affairs subcommittee, one of several panels investigating Enron, said on CBS's "Face The Nation" that his panel's focus includes "the failures of the auditors" and "the hoaxes that [Enron] pulled on their stockholders and on their employees."

Enron spokesman Mark Palmer said he hopes Levin "completes his investigation before he completes his opinion."

On the political front, Sen. Fred Thompson (R-Tenn.) yesterday called on the White House to release records of an energy policy task force headed by Vice President Cheney. Congressional Democrats and others have been seeking the records, which could shed light on policymakers' past contacts with Enron. The White House has refused, saying handing over the records would undercut executive privilege.

Thompson said the White House is not legally obligated to disclose the records, but said that from a political standpoint it would be better to "get everything out and get it over with."

Otherwise, he said on CBS's "Face The Nation," the administration's critics "are going to be nibbling at their heels forever."

On the business front, in a sign of the Enron debacle's deepening impact, Berardino suggested that Andersen may stop selling consulting services to companies it audits, a common practice that critics and regulators have argued could compromise the independence of the auditor. "We are looking at that issue and many others, and you'll see what we decide very soon," he said.

In 2000, Enron paid Andersen \$25 million for auditing and \$27 million for other services, according to a report Enron filed with the Securities and Exchange Commission.

Enron's disputed accounting involved its use of related partnerships that kept losses and debts off the company's books.

Berardino suggested that Andersen was not entirely surprised by the issues an Enron insider raised in an August letter to Enron Chairman Kenneth L. Lay warning that the company could "implode in a wave of accounting scandals." The letter prompted Enron to commission an inquiry by outside lawyers, which included interviews with Andersen personnel.

"[W]e obviously knew many of these issues," Berardino said. "We'd been involved with the company as these various investments were made."

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Enron, its board, their lawyers, and "many others understood these issues," Berardino said. The spokesman for Enron, which fired Andersen last week, said in an interview that Enron was relying partly on Andersen's advice.

An Andersen spokesman would not say yesterday how the firm plans to respond to a House Energy and Commerce subcommittee announcement Saturday that it would subpoena Andersen officials if they do not otherwise agree to testify Thursday about Andersen's destruction of Enron-related records. On NBC, Berardino noted that he had already appeared on Capitol Hill once, adding, "I'm sure I'll be back again."

On ABC's "This Week," SEC Chairman Harvey L. Pitt rejected the idea that the SEC should assume greater oversight of accountants instead of delegating the job to a new industry-funded body, as he proposed last week.

"The problem with having the SEC do this is that there isn't enough money and there aren't enough people for the government to undertake this responsibility," he said.

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The New York Times

January 21, 2002

Enron Chief Says His Sale of Stock Was to Pay Loans

By RICHARD A. OPPEL Jr.

WASHINGTON, Jan. 20 — Kenneth L. Lay, the chairman and chief executive of the Enron Corporation (news/quote), repeatedly used millions of dollars in Enron stock to repay loans made to him by the company last year as Enron shares declined in value, his lawyer said today.

The lawyer, Earl J. Silbert, said in a telephone interview that Mr. Lay had put up shares of his Enron stock as collateral for other investments, which he said he could not identify. As the value of Enron stock plummeted last year, he said, Mr. Lay anticipated that lenders would demand additional collateral.

So Mr. Lay's decision to dispose of Enron shares late in the year reflected a need to raise cash, not a concern about the health of Enron, and was not tied to a warning about the company's finances made by an Enron vice president, Mr. Silbert said today. He added that the majority of the transactions related to the credit had occurred before August. Three months later, Enron restated earnings and began its spiral into bankruptcy.

On at least 15 occasions between February and October of last year, Mr. Silbert said, Mr. Lay returned shares in Enron to the company to repay \$4 million he had received through a credit line.

Each time the loan was repaid, Mr. Silbert said, Mr. Lay subsequently borrowed the amount available and used a substantial portion of it to repay some of the money owed on his other investments. Sometime last year, the credit line was increased to \$7.5 million, Mr. Silbert said, adding that he did not know if Mr. Lay still owed any money to Enron.

If Mr. Lay is facing financial difficulties, he went through an extraordinary amount of money during the years when Enron was riding high. From 1989 through 2001, the total of his salary, bonuses and profits from stock options topped \$300 million, with most of that coming from 1998 through 2000.

Some of the nation's wealthiest men found themselves in trouble last year, after they either invested at the height of the market mania or failed to take profits and reduce their debt in good times, a mistake that became apparent when technology stocks in particular plunged in value.

For example, some members of the Bass family of Texas sold shares in Disney to raise some cash last year, and Craig McCaw, the telecommunications entrepreneur who foresaw the cellular phone market, has put up for sale houses, yachts, a wine collection and even an island as his holdings have declined in value.

Much of Mr. Lay's fortune was in Enron stock and options, now worthless, but his overall investment portfolio is unknown.

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Late last year, he still owned about \$8 million in stock in Compaq and Eli Lilly, and he has several properties. But around the time of Enron's demise, he put some property on the market and began selling some of those Compaq and Lilly shares as well.

Late last year, Mr. Lay put up for sale several houses and properties he owns in Aspen, Colo., the exclusive ski resort.

Lawmakers and Enron employees have harshly criticized Mr. Lay for promoting Enron's stock as the company's finances grew increasingly shaky last fall. In one case, Mr. Lay used an online chat on Sept. 26 to urge employees to buy Enron shares, telling them that the stock was "an incredible bargain" and predicting that the value of the company would increase 800 percent or more in the next decade.

The recent disclosure that Mr. Lay returned some stock to the company to repay a loan has fueled concern that he was exiting his position as he was encouraging others to buy.

Another lawyer, Robert S. Bennett, who represents Enron, previously disclosed that Mr. Lay used some stock to repay a loan late last year.

Mr. Lay exercised options on Aug. 20 and 21, which was shortly after a company vice president, Sherron S. Watkins, warned him that the company might "implode in a wave of accounting scandals."

She said it was in danger of being found out as an "elaborate accounting hoax."

Today, Mr. Silbert acknowledged that around Aug. 21, Mr. Lay disposed of some stock by using it to repay a loan. He emphasized that the disposal of those shares had nothing to do with the warning from Ms. Watkins. He also said that Mr. Lay exercised options to acquire 68,000 shares on Aug. 21, and he still owns those shares.

When Mr. Lay faced a financial strain, Mr. Silbert said, he took the course that showed the most confidence in the company. "When the stock of Enron went down and the value of the collateral went down," Mr. Silbert said, "you had two choices: sell the Enron stock, or pay down the loan. And he chose to pay down the loan rather than sell off his stock."

Mr. Silbert said that Mr. Lay's faith in Enron was also evident in how he had diversified his portfolio. To make other investments, Mr. Lay put up shares of Enron and borrowed against them — instead of selling the shares and paying in cash. That reflected Mr. Lay's belief that the Enron stock would appreciate, Mr. Silbert said.

The transactions between Mr. Lay and Enron will be included in regular filings with the Securities and Exchange Commission next month.

Proxies filed early last year showed that Mr. Lay had significant holdings in four companies in addition to Enron. That five-stock portfolio was a poor performer last year as the overall stock

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market sagged. The best stock in the group fell nearly 16 percent in 2001, while the worst two lost nearly all their value.

Mr. Lay, who recently resigned from the boards of Compaq and Eli Lilly, sold stock in those two companies, the best performers, in the final days of October.

He acquired 10,000 shares in Lilly in February at \$74.13 a share and sold 10,000 shares at a small profit, for \$77.75 apiece, in October. He sold nearly 125,000 shares of Compaq for \$1.15 million at the end of October. Combined, those sales generated nearly \$2 million.

Along with his dwindling stake in Enron, whose stock plunged from \$83 at the beginning of the year to under a dollar after its filing for bankruptcy, Mr. Lay's stakes dwindled in NewPower, which Enron helped finance, and i2 Technologies (news/quote), which provides business-to-business Internet solutions. Shares of NewPower have lost nearly all of their value, and i2's shares fell 85 percent last year.

In early 2001, Mr. Lay sold Enron shares on every business day, shares he had acquired by exercising options. Cumulatively, he made a profit of \$21 million on those sales. Enron's stock had fallen from a high of \$90.75 to half that amount, \$45.35, at the end of July, when Mr. Lay stopped selling shares.

"The reason he stopped selling was that he thought the stock was going to go up," Mr. Bennett said earlier this month.

After turning down previous requests, Mr. Lay has agreed to testify on Feb. 4 before a Senate Commerce subcommittee, which is investigating Enron's collapse, Mr. Silbert said yesterday.

In all, at least 10 Congressional committees are investigating Enron. The first hearings begin Thursday before the Senate Governmental Affairs Committee and a subcommittee of the House Energy and Commerce Committee. The House hearing will focus on Arthur Andersen, Enron's auditor, which admitted last week that employees shredded Enron-related documents beginning in late October, after the disclosure of a government investigation into Enron.

Today, Senator Carl Levin, Democrat of Michigan and chairman of one subcommittee investigating the company, said on the CBS program "Face the Nation" that in the wake of Enron's collapse, Congress would have to "significantly tighten" the nation's securities laws, giving the S.E.C. broad new powers.

Citing the disclosure last week that Enron paid no income taxes in four of the last five years, Mr. Levin also said, "We've got to change our tax laws."

On NBC's "Meet the Press," Andersen's chief executive, Joseph F. Berardino, said that Enron had collapsed because "its business model failed."

In an interview today, the lawyer for Ms. Watkins, Philip Hilder, said his client had been contacted by federal officials about testifying. Mr. Hilder said no date had been set, and he

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declined to elaborate on which government authorities had contacted her. In addition to Congress, the Justice Department and the S.E.C. are also investigating Enron's collapse.

Mr. Hilder said his client had initially complained to Mr. Lay by anonymously dropping a one-page note into a suggestion box. Mr. Lay had invited employees to leave their concerns in the box after Jeffrey Skilling, the chief executive, had unexpectedly resigned on Aug. 14. Those concerns were discussed at an employees' meeting led by Mr. Lay on Aug. 16 at a downtown Houston hotel.

But Mr. Hilder said his client had not been satisfied that her complaint had been fully addressed so had taken up Mr. Lay's offer to meet personally with any employee. According to documents released by Congressional investigators, her meeting with Mr. Lay was scheduled by Aug. 20, and they met on Aug. 22.

"His response was that he would have the matter investigated," Mr. Hilder said. "He treated her with courtesy and was very professional."

By the end of October, Mr. Hilder said, Ms. Watkins had two meetings with Mr. Lay in his 50th-floor office of the Enron skyscraper in Houston. During one meeting, Mr. Lay told her the company had created a special committee to investigate its financial problems. Mr. Hilder, while declining to offer details, suggested that the primary topic of conversation had been Ms. Watkins's memorandum.

"They were following up with concerns that she had previously raised," he said.

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The New York Times

January 21, 2002

Enron Fired Workers for Complaining Online

By ALEX BERENSON

The Enron Corporation (news/quote) fired at least two employees in the last two months for posting information or negative opinions about it on Internet message boards.

One of the fired employees, Clayton Vernon, had asked Kenneth L. Lay, Enron's chairman, during an earlier internal online discussion whether Enron had used aggressive accounting to overstate its profits. It is unclear whether Mr. Vernon's question to Mr. Lay, which came in September, two months before he was dismissed, played any role in his firing. But a coarsely worded message critical of Mr. Lay that Mr. Vernon posted in November under a screen alias was traced back to him in less than a day.

The second fired employee, according to Enron, was the person who revealed in early December on the Internet that Enron had paid \$55 million in retention bonuses to top managers and executives just before it filed for bankruptcy protection and laid off 4,000 workers on Dec. 2. The bonuses were sharply criticized by Enron employees, many of whom had their retirement savings wiped out by Enron's collapse. Enron declined to identify the second fired employee.

Enron also declined to comment on any other details of the two firings, and it would not say whether it had dismissed any other employees because of Internet postings. Mr. Vernon confirmed that he had been fired for postings that the company viewed as offensive.

"We're not going to discuss internal security actions," said Mark Palmer, a spokesman for Enron. "But we will say that we will protect very vigorously the corporation's property."

Both firings involved material posted in an online forum about Enron on Yahoo (news/quote), whose message boards are among the most heavily used on the Internet.

It was not clear how Enron identified the employees behind the postings. People who post messages on Yahoo often believe that they cannot be traced if they do not use their real names. But many companies have the technical means to track the online activities of employees who use company computers and servers.

In addition, Yahoo's privacy policy allows it to disclose personal information about people who post messages that it deems abusive or "invasive of another's privacy, hateful, or racially, ethnically or otherwise objectionable," or that reveals confidential corporate data.

Even so, a Yahoo spokeswoman said Yahoo had not given Enron any information about anyone who posted a message. Despite the disclaimer in its privacy policy, she said, Yahoo generally divulges personal information about users only in response to a court order.

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In any case, Enron apparently had little difficulty finding Mr. Vernon, who posted most of his messages from the company's Houston headquarters, where he worked designing computer-based models to estimate the value of Enron's energy trades.

A native of Midland, Tex., who describes himself as a political progressive, Mr. Vernon said that when he joined Enron in December 1999, he hoped that the company would be diverse and a meritocracy.

But in the course of two years working at Enron, he said, he "realized it was just another Houston, Texas, corrupt thing — that we grow in this town — where the rich white Republicans think they can write any law they want to at any time."

His frustration grew, he said, when Mr. Lay took part in an online chat within the company on Sept. 26 and brushed off Mr. Vernon's question about the way Enron had accounted for deals it had made with supposedly independent partnerships. Enron began to collapse after it became known in November that it had used the partnerships to overstate earnings by at least \$600 million.

By mid-November, with Enron's stock plunging, Mr. Vernon had begun to post dozens of messages a day on the Yahoo discussion board under the screen name "utlonghornrule," referring to the University of Texas, where he received a master's degree in economics.

His messages warned investors away from Enron's stock, and many sharply criticized Enron and Mr. Lay. "We were just sitting there with nothing to do," Mr. Vernon said of the period when he posted the messages. "We were just sitting there watching our stocks go down."

The final straw for him came Nov. 19, he said, when Enron canceled its Christmas party. At 5:16 p.m. that day, in a (not always grammatical) message sprinkled with vulgarities, Mr. Vernon wrote that Mr. Lay had "just cancelled the Enron christmas party so he wouldn't have to show up for his own party with armed bodyguards."

He went on, "Lied and said employees were ambivalent. Trust me, nobody believes a word" that Mr. Lay says, the posting said, using a vulgar epithet. "People have enjoyed the company spending a few dollars on them and giving them a chance to laugh and dance a bit. Esp since most of us adore our coworkers.

"Ken Lay is the sorriest sack of garbage I have ever been associated with, a truly evil and satanic figure."

Other people quickly posted responses defending Mr. Lay, including one who wrote, "1) You are an embarrassment to UT — so shut up. 2) You don't know what you are talking about — You don't run with the big dogs." Mr. Vernon said the style of that note led him to think that it was the work of a senior Enron employee.

It did not take long for Enron to find out the identity of "utlonghornrule." The day after his vituperative posting, Mr. Vernon said, he was called into a meeting with his manager and a top

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human resources officer. "My boss said, 'What were you doing?' and I said, 'I was frustrated,'" Mr. Vernon said. "They escorted me out immediately." He said he had been paid his salary, but no severance pay.

Mr. Vernon said he understood why he was fired. "I was using their equipment," he said, "I was in their building, and it was a flagrant violation of company policy to do what I did. I'm not going to litigate it. I don't think it was unfair."

He does not see himself as a whistle-blower, he said, and he is embarrassed by the language his anger led him to use — but he is still angry.

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Handwritten signature or initials, possibly "85", in black ink.

January 21, 2002

Lieberman Feels the Sting of Criticism Over Enron

By DON VAN NATTA Jr.

WASHINGTON, Jan. 20 — Senator Joseph I. Lieberman embodies how the Enron Corporation's collapse has tied the capital in political knots.

Already, Mr. Lieberman, the Connecticut Democrat who will strike the gavel on Thursday to open the new year's first Congressional hearing on Enron, has been buffeted by criticism from both sides of the aisle for his stewardship of one of the many Congressional committees investigating Enron's spectacular fall.

Republicans complain that Mr. Lieberman should recuse himself because his former chief of staff, Michael Lewan, was a lobbyist for Enron. Others have raised questions about campaign donations to Mr. Lieberman and political groups close to him from Enron and its accounting firm, Arthur Andersen. And some fellow Democrats are expressing dissatisfaction that Mr. Lieberman, who harbors presidential aspirations, has not made the Bush administration his prime target.

The bipartisan criticism of Mr. Lieberman reflects how deeply Enron, its campaign money and its deregulatory agenda have become imbedded in Washington's money culture these last dozen years.

Like many Fortune 100 companies, Enron, a Houston energy-trading company, spread largess all over Washington. Although it gave more money to Republicans, it gave plenty to Democrats, too, including Senators Charles E. Schumer of New York, Jeff Bingaman of New Mexico and John B. Breaux of Louisiana.

Enron has written campaign checks to three-fourths of the senators, and nearly half of the members of the House. Perhaps because of those donations, Democrats and Republicans have promised to aggressively investigate Enron's financial problems and their impact on thousands of employees for fear of looking soft on the company.

"They are all living in a glass house," Mary Matalin, the counselor to Vice President Dick Cheney, said of lawmakers on Capitol Hill. "How far are they going to go with guilt by contribution?"

Everyone agrees Enron's decision to seek bankruptcy protection, the biggest in American history, is a corporate scandal. While most politicians say it has the classic elements of a political scandal, too, they insist it is still too early to declare it one. Many elected officials on Capitol Hill are proceeding cautiously as they embark on lengthy and complicated inquiries.

"I think they are being cautious because they don't know all the facts," a Republican strategist, Charles Black, said. "This is a very complex thing. And there is no evidence that any elected official or government official did anything untoward. So they are right to be cautious."

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Mr. Lieberman was asked by a legal watchdog group to recuse himself because a group he co-founded, the New Democrats Network, had received \$25,000 from Enron. Critics have also pointed out that Citigroup, Enron's largest lender, is Mr. Lieberman's top donor, giving his campaigns \$112,000 since 1997, campaign records show. A longtime Republican strategist put it this way, "Lieberman's problem is simple — Enron's biggest creditor is his campaign's biggest contributor."

For his part, Mr. Lieberman has promised to conduct a fair and thorough inquiry that will not become "a witch hunt."

Enron, Arthur Andersen and Vinson & Elkins, a Houston law firm, are among the most generous contributors to Mr. Bush's 2000 presidential campaign. Enron has given more than \$700,000 to Mr. Bush since 1993; no company has given him more. In addition, Enron's chairman, Kenneth L. Lay, was one of the "pioneers," raising more than \$100,000 for Mr. Bush's campaign, and he and his wife gave a total of \$10,000 to Mr. Bush's Florida recount fund. Enron and Mr. Lay also contributed a total of \$200,000 to Mr. Bush's inaugural festivities.

While Enron's accounting problems worsened last September, Mr. Lay continued to raise money for candidates. He was host of a luncheon for Elizabeth Dole, who is running for United States Senate from North Carolina, at the Four Seasons hotel on Sept. 20. The event raised about \$20,000 for Mrs. Dole's campaign, but she has pledged to donate Mr. Lay's contribution — about \$5,000 — to the Enron employees' fund. Other candidates, lawmakers and campaign committees are busily returning Enron donations.

The Congressional panels are focusing on the reasons for Enron's collapse. They intend to investigate an array of issues, including retirement fund management, the oversight of energy trading markets and financial accounting and auditing.

The Senate Government Affairs Committee, whose chairman is Mr. Lieberman, will look at whether regulators could have done more to monitor the company's practices. The House Energy and Commerce Committee, led by Representative Billy Tauzin, Republican of Louisiana, has been the quickest out of the gate, with an investigation focusing on Enron and Arthur Andersen. Last week the committee released a letter from an Enron vice president, Sherron S. Watkins, that warned Mr. Lay last August about enormous losses and possible illegalities in several Enron partnerships.

Mr. Tauzin received campaign money from Enron and Arthur Andersen, but committee investigators have aggressively sifted through more than two million documents.

Congressional committees have sent out hundreds of subpoenas, causing concerns among Justice Department lawyers who say they are worried that key executives at Enron and Arthur Andersen may compromise any future prosecutions.

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The hazard lies in any grant of immunity to the witnesses testifying before any of the Congressional committees investigating them. Prosecutors would then have to show they did not use any of this testimony to find witnesses or to gather evidence against them.

This hurdle for the government became clear in 1991, when an appeals court reversed a conviction in the Iran-contra case of John M. Poindexter, the former national security adviser, and caused the independent prosecutor to drop all charges against Oliver L. North, saying prosecutors would not be able to show that the testimony used to convict Mr. North had not been affected by his testimony to Congress.

Brian Sierra, a Justice Department spokesman, said, "We're not going to comment on potential trouble down the road. We're aware of the need for Congressional oversight. We are going down the road of a criminal investigation. We'll work with Congress on this issue. If a problem presents itself, we'll work those problems out."

On the political front, Representative Henry A. Waxman of California, the ranking Democrat on the Government Reform Committee, has posed questions about Enron's contacts with several administration officials, including Mr. Cheney and Lawrence B. Lindsey, the president's economic adviser. But the committee chairman, Representative Dan Burton, Republican of Indiana, does not intend to hold hearings on Enron, a spokesman for Mr. Burton said.

The Congressional inquiries will focus mainly on accusations of corporate malfeasance, but investigators for several of the committees looking into Enron's political contacts can be divided into three general areas of inquiry, President Bush, Vice President Cheney and Texas legislators.

At a White House question-and-answer session with reporters, the president said that Mr. Lay had supported his opponent, Ann Richards, when he ran for governor of Texas in 1994. It is true that Enron had given money to both sides, but Mr. Lay and Enron gave more than three times more money to Mr. Bush than to Ms. Richards.

For years, Mr. Bush affectionately called Mr. Lay Kenny Boy, but recently at the White House the president referred to him as Mr. Lay.

In response to questions from Mr. Waxman, the vice president's counsel revealed that in 2001 Mr. Cheney met once with Enron executives and members of his staff four times to discuss energy policy.

Mr. Waxman released a report that identified 17 areas of the administration's energy plan, drafted by Mr. Cheney's task force, that had also been advocated by Enron.

Ms. Matalin, Mr. Cheney's aide, said that none of the provisions were given to the administration by Enron.

"Just because someone endorsed it, doesn't mean someone put it in there," she said. "This is just good energy policy."

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Enron's financial problems have reignited a push for Mr. Cheney to release a list of people who met with the energy task force last year. The White House has declined to release the list. The General Accounting Office will decide next month whether to go to court to require the administration to release it. Ms. Matalin said the administration was withholding the list "on principle" to protect the participants' privacy.

Representative Tom DeLay, whose district is in Houston and its suburbs, near Enron's headquarters, received \$28,900 since 1989 from the company.

Enron also hired as lobbyists two influential members of Mr. DeLay's inner circle, Ed Buckham and Karl Gallant. And Enron and Mr. Lay were also contributors to the Republican Majority Issues Committee, a group close to Mr. DeLay.

The Enron dealings of Senator Phil Gramm, Republican of Texas, and his wife, Dr. Wendy Gramm, a member of the Enron's board of directors and former head of the Commodities Futures Trading Commission, have also drawn scrutiny because of their involvement in regulatory issues affecting Enron.

But Enron also gave \$42,750 to Representative Ken Bentsen and \$38,000 to Representative Sheila Jackson Lee, both Texas Democrats.

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The Washington Post

At the SEC, A Lesson Needed In Full Disclosure

By Jerry Knight

Monday, January 21, 2002; Page E01

So far in the Enron debacle, the Bush Administration and the Democrats in Congress have demonstrated that they are honor graduates of the Bill Clinton School for Scandal.

The Democrats have resisted the temptation to let out the dogs. The Senate is probing and leaking with surprising restraint. The House members have not begun to bray like their colleagues did over Whitewater and Monica What's-her-name.

No one in the Bush White House has been caught in any Enron Corp. coverup. No one in the cabinet took the bait when the president's most generous political supporters suggested that it was payback time. No one has tried to derail the reforms that are demanded by any debacle. No one has done anything to provoke the Democrats into seeking their scalp.

No one except Securities and Exchange Commission Chairman Harvey L. Pitt.

Barely two months into the Enron scandal, Pitt is facing demands from Congress that he distance himself from the SEC investigation because of his previous job as a lawyer for Arthur Andersen, the accounting firm that was supposed to be auditing Enron's books, but also was shredding its dirty linen.

Sen. Jon S. Corzine (D-N.J.), the former chief executive of Goldman Sachs who knows the securities business better than anyone in Congress, is leading the list of lawmakers who want Pitt to recuse himself.

Don't expect Pitt to do it. He surely understands that removing himself from the investigation would amount to self-emasculation. What good is an SEC chairman who can't participate in what is likely to be the most important investigation the agency undertakes during his tenure?

The question of whether Pitt's conflicts of interest disqualify him from overseeing the Enron case is overshadowed by a far bigger issue:

If Pitt is "conflicted out" of the Enron investigation, is he objective enough to take charge of reforming the accounting regulations that permitted the nation's sixth-largest company to implode right under the noses of its snoozing auditors?

Pitt last Thursday sketched a proposal for revamping oversight of accountants who audit the books of public corporations. He wants to create an industry-funded and industry-influenced self-regulatory organization to discipline accountants.

Pitt's self-regulation plan looks so much like preemptive damage control for his old clients that it is amazing some White House spin doctor didn't take him aside and tell him, "Harvey, this is never gonna fly."

Investigators are nowhere near the bottom of the Enron scandal, and yet Pitt already has diagnosed the problem and prescribed the solution.

All you need to know about how tough Pitt's reforms are is that the proposal drew not a peep from any accounting firms and was immediately endorsed in principle by the American Institute of Certified Public Accountants, the industry organization for which negligence has made self-regulation by accountants a cruel joke on investors.

In fact, Pitt's plan was immediately attacked by just about everyone but the accountants themselves. "Unacceptable," Corzine said. "A step backward," said Charles Bowsher, the widely respected former head of the General Accounting Office. "Only 5 percent of the solution," said

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Howard Schilit, president of the Center for Financial Research & Analysis, a Rockville firm that specializes in uncovering accounting gimmicks.

The Consumer Federation of America said Pitt's plan fails to get to the heart of the problem: that auditors are not independent because they are paid by their clients not only for checking the books but also for far more lucrative consulting work.

"Auditor independence is not the cause of the problem," Pitt proclaimed.

That sounded more like the closing argument of a defense attorney than the reasoned judgment of an impartial juror who had weighed all the facts before reaching a decision.

No surprise. Pitt has spent much of the past 20 years defending the accounting industry from lawsuits and legislation, working for every one of the major accounting firms. Investors would be better able to evaluate Pitt's independence if he would observe the basic tenet of U.S. securities law: full disclosure. They deserve to know what accounting firms he worked for, what he did for them, and how much he was paid.

One of Pitt's major accomplishment for the accounting industry was his role in passing the Private Securities Litigation Reform Act of 1995, enacted to protect the industry from the kind of lawsuits it faced after the savings and loan scandal. Almost every one of the S&Ls that had to be bailed out by the taxpayers had been declared in perfect health by its auditors. After paying hundreds of millions for their failings, the accountants came to Washington and got the law changed.

Nowadays, suing auditors has become "almost impossible unless they do something egregiously stupid like destroying documents," said John C. Coffee Jr., a Columbia University law professor and securities law expert.

"The expected risk to an auditor from acquiescing in management's aggressive accounting has dramatically decreased and the expected benefits from deferring to management have increased," he said.

Since auditors were protected from lawsuits, he said, accounting abuses have gotten worse. In 1998, the SEC caught 150 firms cooking their books and forced them to restate their financial reports; by 2000, restatements were up to 238.

Accounting firms can make more money doing consulting work for corporations than they can by auditing their books, Coffee explained. Some firms, in fact, pay the chief auditor a bonus for persuading their client to buy other services, which is not exactly an incentive to play hardball. "Enron is the latest of a string of serious frauds that were the predictable consequences" of limiting lawsuits against auditors, said Donald Enright of Finkelstein, Thompson & Loughran, a Washington law firm that specializes in suing corporations on behalf of fraud victims. Making it harder to sue, he added, "emboldened some corporate managements to commit fraud and auditors to overlook it."

Pitt has long been the spokesman on the other side of that issue. He is so close to the accountants that in his first major speech as SEC chairman, he made one of the worst Washington stumbles since President Gerald Ford fell down the steps of Air Force One.

Addressing an accounting industry conference, Pitt repudiated the campaign for auditor independence started by his predecessor Arthur Levitt Jr.

Under Levitt, he scolded, the SEC hadn't "been a kinder and gentler place for accountants" but that will change. With the accounting industry's top lawyer in charge, the SEC will have a "continuing dialogue and partnership with the accounting profession, and we will do everything in our power to evidence a new era of respect and cooperation."

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The remarks were dubious policy and downright dumb politics to begin with and now that Enron has imploded they could easily become the downfall of Pitt.

It's ironic that Pitt should fall into this trap. Since he left the job of general counsel at the SEC in 1978, Pitt has positioned himself as a Washington player who got great press and could guide any clients through the political minefield.

Instead he stepped in it and now must use his media skills to rebut the appearance of advocating appeasement with the accountants.

Declaring at this stage of the investigation that the proper response to Enron shareholders being wiped out and Enron employees losing their pensions is to give the auditors another chance to clean up their act may be Pitt's idea of getting out in front of the issue. It's more like getting in front of a moving train.

Pitt's prescription to protect his cronies is totally out of step with the stance of the Bush White House. Everybody else has publicly taken a "let the chips fall where they may" approach to the Enron investigation. Behind the scenes they may be building their defenses, but they know better than to call a meeting of the Enron alumni in the administration and announce that they have solved the problem.

Yet that is basically what Pitt did. At his side when he announced his cure for auditing ailments was the SEC's chief accountant, Robert Herdman, the former vice chairman of Ernst & Young, one of the Big Five accounting firms.

If the auditors do not have enough influence already at the SEC, they will get even more if President Bush goes ahead with his plan to nominate two accounting executives to the SEC -- Paul S. Atkins, a lawyer who is a partner at PricewaterhouseCoopers, and Cynthia A. Glassman, an economist who is a principal at Ernst & Young.

You don't have to be a hotshot political handicapper to bet that neither of those nominations would get through the Democratically controlled Senate any time soon.

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Financial Times (London)

January 21, 2002, Monday London Edition 1

SECTION: THE AMERICAS; Pg. 5

LENGTH: 520 words

HEADLINE: **Cheney under pressure over contacts with Enron**

BYLINE: By GERARD BAKER, JOHN LABATE and ADRIAN MICHAELS

DATELINE: NEW YORK

BODY:

US Vice-President Dick Cheney yesterday faced calls to make public more details of his contacts with energy company officials when he was conducting a review of the Bush administration's energy policy last year.

A leading Republican member of Congress yesterday said Mr Cheney should drop his refusal to provide more than the most basic account of his contacts, which included an extended series of meetings with Kenneth Lay, the chairman of Enron, the bankrupt energy trading company.

Fred Thompson, of the Senate governmental affairs committee, told NBC television: "Let's get everything out and get it over with."

As revelations about the collapse of Enron proliferate, the vice-president is under growing pressure to provide a fuller account of his contacts with energy companies. Henry Waxman, the leading Democrat on the House governmental affairs committee, last week said that the energy policy review had resulted in policy recommendations that were exactly in line with those Enron had lobbied for.

The vice-president has so far resisted the pressure, citing his executive right to protect the privacy of those whom he consults. Earlier this month Mr Cheney told Mr Waxman he had met Mr Lay six times last spring, but declined to give more details.

Meanwhile, Harvey Pitt, chairman of the US Securities and Exchange Commission, was subject to mounting criticism that his planned reforms of accountancy regulation did not go far enough.

Mr Pitt last week launched a scathing attack on auditors and the auditing framework, promising a new regulator with enhanced disciplinary powers. The strength of his language, despite the Enron scandal, and the focus on Andersen, Enron's auditor, surprised many and marked a reversal of his previous

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conciliatory stance towards the accountancy profession.

However Jon Corzine, senator from New Jersey and former co-chairman of Goldman Sachs, said that Mr Pitt's planned new accountancy regulator would be "like having the foxes guard the hen house" - a reference to a proposal that accounting firms should contribute to the funding of the new regulator.

The intense political pressure to avoid another Enron debacle may cause Congress to take steps to strengthen the accounting regulatory system, possibly overriding any SEC initiative. "We have the power to do all this on our own but if Congress decides (to take action) we will work with them wholeheartedly," Mr Pitt told ABC television.

Joseph Berardino, Andersen's chief executive, continued his charm offensive yesterday.

He appeared on NBC television, as his firm continued trying to keep clients and save its reputation following revelations that Andersen staff in Houston had destroyed thousands of Enron documents.

Mr Berardino said that to his knowledge nothing illegal had been found in Enron's books.

"We have acknowledged in one (accounting) case, we did make an error in judgment and that was corrected. And in another case, some information had been withheld that was extremely important to the decision on accounting," he said.
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Financial Times (London)

January 21, 2002, Monday London Edition 1

SECTION: THE AMERICAS; Pg. 5

LENGTH: 1607 words

HEADLINE: Scandal-struck energy group in a Washington circus: The reach of the Enron scandal grows wider by the day. There are multiple civil and criminal investigations, whispers of high-level political influence, thousands of distressed employees and shareholders and an audit profession battling to salvage its reputation. Adrian Michaels, Gerard Baker and Peter Thal Larsen ask what will happen next: Is anyone going to jail?

BYLINE: By GERARD BAKER, SHEILA MCNULTY, ADRIAN MICHAELS and PETER THAL LARSEN

DATELINE: HOUSTON

BODY:

As yet, no one has been formally accused of any crime, but the Justice Department has started a criminal investigation that could lead to charges.

Present and former executives at Enron will be scrutinised for financial fraud. Andrew Fastow, the former chief financial officer who set up, ran and stood to profit from the company's controversial partnerships that kept debt off the balance sheet and helped to inflate earnings, might be vulnerable. Attention has also been paid to people such as Kenneth Lay, Enron's chief executive, Richard Causey, its chief accounting officer, and Jeffrey Skilling, the former chief executive.

Enron has been keen to stress that Andersen, its auditor, worked hand-in-hand with it on all the financial arrangements. Andersen says its Houston office destroyed thousands of Enron documents, some apparently after the firm received a subpoena from the Securities and Exchange Commission. That admission alone could open up individuals in Andersen to criminal charges.

David Duncan, the lead Enron auditor who was fired by Andersen last week and blamed for orchestrating the document destruction, has told investigators that he was following instructions from senior people at Andersen head office in Chicago.

What are the next steps in the US government's investigation?

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The Enron bankruptcy and its aftermath have produced that familiar and uniquely Washington phenomenon: a full-scale political, legal and media investigative circus. No fewer than seven congressional committees are studying the collapse, in addition to a criminal inquiry by the Justice Department, a Securities and Exchange Commission review and other departmental investigations.

On Thursday, the process moves into a higher political gear when the most prominent of the congressional panels, the Senate governmental affairs committee, conducts its first hearing of the year. The committee, led by Joseph Lieberman, a leading Democrat, will grill Enron and Andersen officials in the coming weeks.

On February 3, the circus will mount its biggest show so far when Mr Lay himself is scheduled to testify before the committee. In the meantime, other committees will crank up their investigative operations when Congress returns from its Christmas and New Year break this week.

Will the Enron collapse damage President Bush and his administration?

Enron was, politically speaking, the best connected company in America. It donated millions to both main political parties but was closer to Republicans, especially Mr Bush, who, when he was governor of Texas, referred to Mr Lay as "Kenny Boy". Half a dozen senior officials in the administration either worked directly for the company or held substantial amounts of equity in it.

Last week it emerged that Vice-President Dick Cheney spoke to Indian government officials in June in an effort to help Enron recoup large debts on an investment in an Indian power plant. The White House said he had not been asked to speak to India by Enron.

There have not been, though, any specific allegations that anyone acted improperly, still less evidence of wrongdoing. But corporate contributions are the life-blood of the American political system, and companies do not give money unless they think they are getting something in return. Enron clearly benefited from a number of policy initiatives, although its defenders claim the policies would have been implemented anyway and the company did not always succeed in winning changes.

The risk for Mr Bush - indeed, for all politicians who received donations from the company - is the sheer scale of the investigations now under way. No company can withstand the current level of scrutiny without yielding up embarrassing information, and the record of such investigations suggests they acquire a momentum of their own that can result in unpredictable consequences.

What will happen to the Enron businesses?

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Most of Enron's operations are on the block. While some will be sold, others will simply be closed down.

UBS Warburg, the investment bank, has taken over the employees and physical assets of Enron's energy trading arm, which was generally seen as its most valuable business. Although Enron will not own any equity in the trading arm, it will receive a proportion of the profits from the business for at least five years.

Advisers are also trying to sell most of Enron's international operations, which range from power plants in India to water distribution companies in the United Kingdom. Many of Enron's fledgling trading operations, which were set up to make markets in precious metals and broadband telecom capacity, are likely to be closed down.

This leaves Enron's gas pipelines. However, these have already been heavily mortgaged as Enron sought to stave off bankruptcy. Enron's lenders and Dynegy, the rival energy group, both have claims on the assets.

Will shareholders and the banks get any of their money back?

The true extent of Enron's debts remains unclear, and is likely to be the subject of numerous lawsuits over the coming years.

The value of Enron's assets is equally uncertain. On Friday, advisers to the company argued that the transfer of the trading venture to UBS could generate Dollars 1bn-Dollars 2bn over the length of Enron's profit-sharing agreement. However, it seems almost certain that Enron's equity will prove to be worthless.

The company's lenders are more hopeful. Citigroup, the financial services group, last week said it expected to recover half of its Dollars 460m (Pounds 317m) of unsecured loans. But as a recent legal challenge to JP Morgan Chase shows, even secured loans may not be as safe as they seem.

Can Andersen survive?

Enron's auditor admits it has never faced a worse crisis. Even before Enron, it had been in trouble for auditing books that were later the centre of inquiries at Sunbeam and Waste Management.

Joseph Berardino, chief executive, said yesterday he was meeting clients every day. Many of those clients have said they are monitoring the situation. This scandal is playing out while companies collate their annual reports and put the appointment of an auditor to a vote of shareholders. Managements almost never recommend a change of auditor at their spring annual meetings. Andersen will be desperate to make sure that stays the case. The next three months will

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be crucial.

Even Andersen's consulting work could be in peril if the name becomes too tainted. While any financial liability seems likely not to hit most of its partners, some are predicting that many valued staff will seek work elsewhere.

Professional services firms stand and fall entirely on the calibre of their staff and their client relationships. Mr Berardino has been on a public relations charm offensive.

If too many staff and clients defect, it may prove to have been in vain. Even a merger could be out of the question if Andersen is seen as damaged goods.

Will there be reform of financial reporting and regulation of accountants?

Harvey Pitt, the head of the Securities and Exchange Commission, last week proposed wide-ranging reform of the regulation of accounting.

He attacked what he saw as an indefensible record of audit failures, and said the accountants would no longer be able to run their own regulation.

He envisaged a new regulator, staffed mostly by people from outside the profession, with strong disciplinary powers. But his plan has been under fire for not going far enough.

Mr Pitt has also been criticised for not wanting to stop the firms undertaking audit and consultancy work at the same clients, a situation that might give rise to conflicts of interest. There is as yet no plan for changing how audits are funded, so auditors will continue to be paid by the managements they audit, creating a possible conflict before they even start.

The firms themselves have joined calls for large reforms to financial reporting and the situation is being reviewed by accountancy regulators and the SEC. The types of financial structures employed by Enron seem likely to be made more transparent in future, though no one is promising this will be changed quickly.

Is it time for pension reform?

Thousands of Enron employees have seen their life savings wiped out because Enron's pension scheme was heavily invested in the company's shares. The scandal has prompted numerous calls for reform, which President Bush acknowledged by initiating a review of pension law.

However, experts are divided on the likely impact of legislation, such as setting a ceiling on the amount of its own stock a corporate pension scheme can

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own. In the meantime, employees are likely to expect broader diversification from their company's pension plans.

Employees band together

The 4,500 employees laid off by Enron in the US are banding together in a coalition to engage outside consultants to help with such issues as retrieving unpaid severance, vacation, expenses and losses in their retirement fund, Sheila McNulty reports from Houston.

The Severed Enron Employees Coalition, led by a volunteer group of committee members, will identify and articulate such issues for former employees and explore all ways to resolve them, including engaging legal counsel.

This will enable those retrenched to present a united front in dealing with the bankruptcy court, bankruptcy trustee, other Enron creditors and Enron. It will also keep them informed of issues stemming from Enron's bankruptcy filing.

"Numbers give us clout and a chance to win," wrote Rod Jordan, coalition chairman, in an introductory e-mail to those affected.

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The Outlook
Enron Fallout May Cut Stock Prices in General
By Steve Liesman

New York -- Are all investors -- even those who didn't hold the stock -- paying for the collapse of Enron Corp.?

That's the question that some economists are pondering as they try to figure out whether the bankruptcy filing of the country's seventh-largest company has broader market implications.

The \$63.39 billion failure (judged by the assets in its most recent quarterly report) itself is small potatoes for an economy the size of the U.S., where 2001 gross domestic product exceeded \$10 trillion. In fact, the value of Enron's business equaled about 55 hours of output for the entire nation.

But more widespread economic loss could show up in a more indirect way: through a loss of investor confidence that lowers stock prices. In theory, equity prices reflect a built-in premium that varies depending upon the perceived level of risk. The higher the risk perception, the lower the security price to allow for greater returns. "If investors think financial information is somehow distorting and not portraying the underlying economics of a company, common sense says they will exact a premium," says Jim Leisenring, a U.S. member of the International Accounting Standards Board.

The most obvious additional risk is that investors now have a new notion of how large is large enough to be considered immune from bankruptcy. Enron's bankruptcy filing is almost as large as the two next biggest failures combined: Texaco Inc. in 1987 (\$35.89 billion) and Financial Corp. of America in 1988 (\$33.86 billion). There's more risk because the size of a company that is "too big to fail" has suddenly become larger, says Peter Bernstein, president of Peter L. Bernstein Inc., an economic consultant to institutional investors.

Enron's collapse is unique in the way it has so publicly and comprehensively highlighted risk for investors in every part of the market's supposed safeguards. "The Enron debacle has relevance beyond just Enron," says Byron Wien, senior investment strategist at Morgan Stanley. "It has made investors more apprehensive about investing and part of the malaise the market has experienced in the last several weeks is a reflection of that."

Internal company memos show that the board and the office of Chairman Kenneth Lay approved the off-the-books partnerships that ultimately led to Enron's fall. Twice the company waived its code of ethics to allow Enron's former chief financial officer to head several of these partnerships. So add some risk for the integrity of executives and directors.

Revelations that Arthur Andersen was aware of the partnership structures, acted as both external and internal auditor and shredded documents have made even the most skeptical investors

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rethink what little faith they placed in accountants. There's even a joke among traders that the next great investment play will be shorting a basket of stocks audited by Andersen. So add some risk for the integrity of the accountants.

A look back at the reports from stock analysts before the company's downfall makes clear that the stock analysts, supposedly highly qualified in corporate finance, didn't understand much of the way Enron earned its money and kept debt off its balance sheet. Worse, even after Enron's problems came to light, several analysts from top investment banks continued to recommend the stock while acknowledging the enigma had yet to be fully unraveled. Lehman Brothers analyst Richard Gross called Enron a "strong buy" while noting that as a result of an "opaque business, a complicated balance sheet and low returns on capital Enron trades as a matter of faith." So add some risk for the financial acumen of stock analysts.

It has also become apparent that the Financial Accounting Standards Board, which sets the accounting rules, has been working for 20 years to create a simple standard for disclosing these off-the-books transactions. But because of pressure from corporate interests and accountants, it hasn't succeeded. And it's now known that the Securities and Exchange Commission gave Enron waivers from two regulations that would have prompted detailed financial disclosures. So add some risk for the regulators.

That doesn't leave much for investors to rely upon.

To be sure, all of these problems have surfaced in scandals past. And there are those who argue that Enron is an isolated incident because it was the only company of its kind: a utility company creating new markets for electricity and broadband trading that engaged in sophisticated finance.

But is that really so unique any more? Corporate balance sheets increasingly look like those of financial institutions, with the use of derivatives, vendor financing loans, third-party equity stakes and stock options. In fact, because of the way companies use stock for employee compensation and, in the case of Enron and others, to guarantee corporate obligations, stock has transformed from a reflection of management's performance to a tool of management to enhance performance. So now, investors must judge whether managers are good widget makers and good bankers and investors. "As the firm becomes more complex," says Roger Ibbotson, finance professor at the Yale School of Management, "we are less able to understand easily what goes on."

And if investors can't trust the directors, executives, accountants or analysts to come up with good numbers, then everyone will pay a price -- or rather, a lesser price for stocks.

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Financial Times (London)

January 21, 2002, Monday London Edition 1

SECTION: LEADER; Pg. 14

LENGTH: 540 words

HEADLINE: **The day of reckoning**

BODY:

After one of the worst weeks in the history of accountancy, leaders of the profession still seem bent on resisting fundamental change. This is counter-productive. The more enlightened of them should embrace the need for reform and help to shape it.

It is difficult to overstate the damage done to the profession by the bankruptcy of Enron. The energy company's peak stock market valuation of Dollars 66bn, in September 2000, was partly based on inflated profits and a balance sheet that excluded crucial liabilities. Andersen, one of the "Big Five" firms, not only gave the auditors' stamp of approval to misleading accounts, but also scurried to shred evidence.

Andersen has fatally undermined the argument that the profession is bound to maintain high standards because it cannot afford to compromise its reputation. Based on this theory of enlightened self-interest, accountancy firms have enjoyed the freedom to sell more and more services to their audit clients, while continuing - in the US - to regulate themselves. Andersen is not the first to let down the users of accounts, notably shareholders. But the size of this collapse, its location in the sophisticated US market and the paucity of excuses make this scandal a turning point.

The profession must adapt if it is to restore confidence. First, it must accept tougher limits to the services it provides to audit clients. This is not the end of the world. Each of the big firms will still offer the full range of accounting skills, including tax advice and due diligence on acquisitions, generating billions of dollars in revenue. Assuming that bright people go into accountancy because they love numbers and are fascinated by business performance, neither recruitment nor staff retention should suffer. Indeed, after Enron, auditing should be the prime part of the firm: lucrative, fashionable and led by the most influential partners.

Second, the profession must accept that long-term tenure of audit contracts is not healthy. This fosters familiarity between company and auditor, diminishing the likelihood that hard questions will be asked. It also breeds complacency at the accountancy firm and overdependence for fee income on big,

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longstanding clients. A maximum period of five years should be imposed.

Third, there must be more outside scrutiny. After Enron, few believe that a self-regulatory system is adequate. Harvey Pitt, chairman of the Securities and Exchange Commission, is talking of a new accountancy regulator and quality controllers from outside the profession. The Big Five should co-operate with him to ensure this leads to better application of accounting principles. The danger is that new layers of supervision will make American accountants even more obsessed than they already are with obeying the letter, rather than the spirit, of the law.

Accountants are not the only ones to blame, of course. Other glaring failures at Enron include that of corporate governance. Shareholders' interests should have been protected by independent non-executive directors on the audit committee. They are keeping their heads down. Sherron Watkins, an employee, trod a lonely path as a whistle-blower. Audit committees have much to learn from her.

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Financial Times (London)

January 21, 2002, Monday London Edition 1

SECTION: LEX COLUMN; Pg. 16

LENGTH: 253 words

HEADLINE: **Moody's blues LEX COLUMN**

BODY:

Corporate collapses highlight familiar lessons. There are serious conflicts of interest in the accountancy industry - as well as in investment banking. Investors should be wary of companies that deliver dazzling earnings growth but lousy returns on equity - with or without off-balance sheet financing vehicles. And investors should rely less heavily on credit ratings agencies.

In response to the Enron debacle, Moody's Investors Service has announced a thorough review of the way it assesses credit quality. But it is not the only rating agency that emerges from the scandal with little credit. Ratings agencies do a reasonable job of assessing credit risk in stable times. But during a crisis, their actions tend to be a lagging indicator. This was true in Enron's case. In the final weeks, S&P took cover. Moody's bent over backwards to avoid acknowledging what the market screamed: that Enron was not an investment grade credit.

The review by Moody's of its procedures - including consultation with finance professionals - is welcome. It includes possible actions to improve the "timeliness" of rating actions such as a shorter review period. The worry of a more aggressive approach is greater volatility. But it is far from obvious that playing make-believe is preferable. Fund managers who make portfolio adjustments based on ratings changes might not like extra volatility. That is a good argument for them to make their own decisions on credit quality, rather than relying on ratings agencies.

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The Wall Street Journal
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Monday, January 21, 2002
Second Executive Tells of Andersen E-mail

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Version of Events Bolsters Fired Auditor's Account Of Shredded Documents
By Tom Hamburger and Jonathan Weil
Staff Reporters of The Wall Street Journal

WASHINGTON -- Bolstering the account of a fired Arthur Andersen LLP auditor, an executive in the accounting firm's Houston office told congressional investigators that an e-mail from headquarters reminding employees of Andersen's document-disposal policy was unprecedented, people familiar with his interview say. The Oct. 12 e-mail arrived shortly before Houston personnel began destroying papers relating to Enron Corp.

The account by Michael Odom, the head of risk management for the Houston office, is consistent with that given to lawmakers by Enron's lead auditor, David Duncan, who Andersen fired last week for overseeing the document destruction. It also helps lawmakers to focus their probe on the role top Andersen officials played in the downfall of Enron, one of the nation's biggest companies until it filed for bankruptcy-court protection last month amid questions about its accounting practices.

The document destruction, which continued after the Securities and Exchange Commission began inquiries into Enron's financial statements in late October, will be the subject of a hearing by the House Energy and Commerce Committee hearing Thursday. Messrs. Duncan and Odom and the Andersen lawyer who sent the Oct. 12 e-mail likely will be invited to testify.

Mr. Odom's lawyer, Peter Fleming, said his client is cooperating fully with investigators. "Mike Odom has done nothing wrong, and is unaware of any wrongdoing," Mr. Fleming said. Andersen has portrayed the shredding of documents as an isolated case of poor judgment and has disciplined several people in the Houston office, including Mr. Odom, who was stripped of his management responsibilities.

Andersen Chief Executive Joseph Berardino said on NBC's "Meet the Press" yesterday that Mr. Duncan was fired after "he displayed extremely poor judgment in the destruction of documents issue." Mr. Berardino blamed Enron's demise on a failed business model, not accounting errors. "A company has failed and it has failed because the economics didn't work," he said.

Mr. Duncan last week told congressional investigators that he ordered subordinates to begin destroying documents related to the Enron account after he received an e-mail from Nancy Temple, a senior lawyer in Andersen's Chicago office. The Oct. 12 e-mail -- sent to Mr. Odom, who passed it on to Mr. Duncan -- was a reminder of Andersen's longstanding document-retention and destruction policy, which called for the disposal of nonessential papers.

Both Messrs. Odom and Duncan told congressional investigators that they had never before been sent such a reminder, according to people familiar with their interviews. Ms. Temple was a

member of an "extended review team" of Houston and Chicago officials created to take a closer look at Enron as questions arose about its condition. Members of the team talked with each other several times a week, Mr. Odom told congressional investigators.

Mr. Duncan told investigators he didn't think there was anything wrong with destroying Andersen-owned documents because the SEC inquiry begun in late October concerned Enron, not Andersen. The shredding stopped on Nov. 9 when Ms. Temple left a voice-mail message for Mr. Duncan telling him that the SEC had issued subpoenas and that all documents must be preserved.

A person close to Mr. Duncan says he forwarded that voice mail to the entire Enron audit team and instructed his secretary to send an e-mail repeating the instruction. The next day, Ms. Temple reiterated the message in a follow-up e-mail to Mr. Duncan and others involved with the Enron account.

The implication of the account offered by Mr. Duncan and bolstered by Mr. Odom is that the document destruction began only when the office was reminded of Andersen's document-destruction policy by Ms. Temple and stopped only when the office heard from her again about the subpoenas.

But Andersen spokesman Charlie Leonard said Ms. Temple never instructed the Houston office to begin shredding Enron documents, nor did she intend to order them to stop the shredding, because she didn't know it was going on in the first place. The November messages from Ms. Temple constituted "an innocent and appropriate reminder from the legal department to the staff in Houston of what the procedures are when somebody receives a subpoena," he said.

The finger-pointing over document destruction is part of a larger battle over responsibility for Enron's collapse. Evidence uncovered by lawmakers suggests the Enron account was watched closely by officials at Andersen's headquarters.

For example, top Andersen officials have portrayed as routine a meeting convened on Feb. 5 to discuss whether to retain Enron as a client. Andersen's Mr. Berardino said yesterday it was "part of a normal process we go through every year" for all clients. But Mr. Duncan told investigators that he made a point of including top Andersen executives, including several via phone from Chicago, because he was concerned that the Enron account posed "significant risk," a person present when he was questioned said.

An Andersen spokesman said he didn't know why particular executives were invited to the meeting and declined to say whether routine retention meetings normally include several top executives. Other evidence points to active involvement in the Enron account by top Andersen executives. Enron CEO Kenneth Lay told employees in an online exchange on Sept. 26 that financial transactions being questioned at the time had all been approved by Andersen -- "in many cases, not only" by Houston-based auditors but also by "Andersen's headquarters office from some of the world's leading experts in these types of financing," according to a transcript released by lawyers for Enron employees suing the company over stock losses in their retirement accounts.

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The Wall Street Journal

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Monday, January 21, 2002

Accounting for Enron: Court Rules SEC Exceeded Authority With AEP Merger

By Kortney Stringer

Staff Reporter of The Wall Street Journal

In a decision that could upset other utility mergers, a federal appeals court concluded that the Securities and Exchange Commission overstepped its authority in approving the 2000 merger of American Electric Power Co. and Central & South West Corp.

The U.S. Court of Appeals for the District of Columbia ruled the SEC failed to prove the acquisition meets requirements of the 1935 Public Utility Holding Company Act, a law that reshaped the electric industry and continues to influence it. The act, which broke up far-flung utility companies and sought to prevent them from forming again, is administered by the SEC and has been more loosely interpreted in recent years. The \$4.37 billion acquisition by AEP, based in Columbus, Ohio, of Dallas-based Central & South West created the nation's largest multistate utility firm and second-biggest energy trader, behind Houston-based Enron Corp.

The ruling sends the case back to the SEC for further review.

The public-utility act, as originally interpreted, allowed mergers of utility holding companies only if their operations were in neighboring states and were connected along the same transmission lines, among other requirements.

In recent years, even the most tenuous electrical connection has been considered sufficient. The AEP's and Central & South West's utilities are separated by 100 miles and two whole states -- Missouri and Illinois. The merger created an 11-state giant stretching in an arc from Virginia to Michigan and down to Texas.

The SEC approved the merger in June 2000, even though the combination was challenged by municipal public utilities, which worried about the new company's size and potential market dominance.

The SEC agreed with AEP that the companies' systems are integrated because they have transmission-access rights to a single high-voltage line through Missouri. The SEC also said the AEP merger met the act's single-region requirement because it is now technically possible to centrally control the output of power plants spread across many states, which wasn't the case in 1935.

The appeals court said the SEC failed to explain its conclusions regarding the requirement for integrated transmission lines and to justify its finding that the acquisition will satisfy the requirement that operations be in adjoining states. The court's ruling said the SEC "may well be right that Puhca's region requirement is outdated in light of recent technological advances, but in view of the statute's plain language, however, only Congress can make that decision."

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Pat Hemlepp, a spokesman for American Electric Power, said the company believes it meets all the act's requirements, and it expects the matter to be resolved. "There are some deficiencies in background information . . . but we have demonstrated that we can meet the requirements of the Puhca," he said.

Critics of the merger feared the SEC's approval could accelerate massive consolidation. The American Public Power Association and the National Rural Electric Cooperative Association, two groups representing municipal public utilities, had filed the appeal to the SEC's decision, saying it ignored the single-system "integration test" established in the act.

In a statement, the two groups called the court's decision a victory for customers. "There was no foundation for part of the SEC's decision," said Alan H. Richardson, president and chief executive of the APPA. "This will serve as a restraint for some companies wanting to push the envelope even further than AEP and Central & South West."

Puhca was designed to break the grip of "power trusts" that emerged in the 1920s and eluded regulation by state utilities commissions. But some lawmakers and regulators now oppose the law, which they believe impedes the development of larger, more efficient markets.

The SEC, which views the Depression-era legislation as antiquated and duplicative of securities laws, had sought to end the agency's obligation to regulate utility holding companies. President Bush's energy plan and legislation currently before Congress call for repeal of the law. But repealing the law, without providing compensating regulation, is strongly opposed by municipal utilities and consumer interests, which claim it would mean a return to companies too big to be controlled.

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The Wall Street Journal

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Monday, January 21, 2002

Accounting for Enron: Congress Is Reviewing an SEC Exemption Granted Enron

In 1993, Agency Ruled Two of Firm's Utility Holding Units Needn't Register

By Michael Schroeder

Staff Reporter of The Wall Street Journal

WASHINGTON -- The Securities and Exchange Commission is coming under heat in Congress for a 1993 decision that freed units of Enron Corp. from complying with a utility holding company law that would have given regulators stronger oversight of the company's operations.

The SEC is reviewing a 1993 staff ruling to absolve the Enron units from registering under the Public Utility Holding Company Act, a 1935 law that gives the agency extensive supervision of corporate structure and business operations of registered utility holding companies, according to people with knowledge of the matter. If the decision is found to have been erroneous, it could change the way other utility holding companies are regulated.

Two Enron entities received waivers from the public utility holding company rules. In one case, Enron's Portland General Electric Co. unit in Oregon clearly qualified for an exemption that applies to holding companies that own and operate a utility in a single state. But in late 1993, Enron Power Marketing Inc., Enron's wholesale power-selling unit, successfully argued that it too shouldn't be regulated by the SEC.

In what isn't a clear-cut case, utility lawyers say that the SEC could have been within its authority to require Enron Power Marketing to register. Instead, an SEC staff attorney issued the Enron unit a "no-action letter," or waiver, without addressing the legal issues in the Enron unit's application.

On Capitol Hill, the Enron scandal has spurred a debate over sweeping power utility deregulation legislation, which among other provisions would repeal the utility holding company law. With debate on the legislation scheduled for next month in both the House and Senate, some Democrats vow to block the repeal unless the bills contain stronger consumer protections. They also say they will scrutinize the SEC's performance overseeing utility holding companies.

"In light of Enron, I think the Congress needs to thoroughly investigate the SEC's rather poor record of administering Puhca," said Rep. Ed Markey (D., Mass.).

Spokesmen for the SEC and Enron declined to comment.

The Depression-era law was passed to avoid the abuses committed by utility holding companies in the 1920s. Back then, holding companies had complicated "pyramiding" structures with subsidiaries owning other holding companies engaged in risky businesses unrelated to power generation. The activities led to utility bankruptcies and massive losses for shareholders who

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believed they were buying conservative investments.

The law directs the SEC to regulate the activities of large, multistate electric or gas utility holding companies and to limit their diversification into nonutility businesses. Under the law, the SEC enforces special accounting requirements, limits on utility mergers and expansion, and tough restrictions on affiliate relationships. Thirty-five companies are covered by the law.

"If Enron had been regulated under Puhca, I seriously doubt that the types of transactions that brought this company down would have occurred," Mr. Markey said.

While the SEC action on Enron's units predated many of the financial activities that led to Enron's downfall, Tyson Slocum, a utility expert at Public Citizen, a consumer advocate organization, argues that Enron developed into precisely the kind of utility holding company structure the law was designed to block. The Houston energy company, originally a utility that produced and transported natural gas and electricity, increased in complexity as it shifted its focus to energy trading. In its financial statements filed with the SEC, Enron lists more than 5,800 subsidiaries and affiliates.

Supporters of repealing Pucha say it has created anticompetitive regulatory barriers to new investment in electricity generation and transmission facilities. Repeal is expected to greatly accelerate mergers to consolidate the \$315 billion electricity and natural-gas sectors.

Indeed, the SEC has favored repeal for more than a decade, arguing its provisions duplicate existing disclosure rules or are better administered by the Federal Energy Regulatory Commission. But in the aftermath of the Enron debacle, critics of repeal may have gained the upper hand in the debate.

To address critics' issues, Rep. Joe Barton, the Texas Republican who chairs the House Energy and Commerce subcommittee on energy and air quality, has said if the utility law is repealed, there must be a strong "mechanism" for accounting, reporting and bookkeeping.

Bryan Lee contributed to this article.

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The Wall Street Journal

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Monday, January 21, 2002

Accounting for Enron: Enron Bankruptcy Poses Quandary for Law Firms

By Richard B. Schmitt

Staff Reporter of The Wall Street Journal

Enron Corp.'s filing for bankruptcy-court protection is posing a growing ethical quandary for law firms.

As Enron's main bankruptcy counsel, for example, New York law firm Weil, Gotshal & Manges stands to earn millions in fees. But another marquee Weil Gotshal client, Arthur Andersen LLP, is rapidly turning into one of Enron's biggest adversaries. Last week, the energy company fired Andersen and is now believed to be considering a suit against its former auditor for malpractice or fraud.

Weil Gotshal says that because it won't be representing Andersen in any matter involving Enron, there isn't any conflict of interest. But the U.S. trustee in the Enron case has asked the law firm to disclose more information about its roster of clients, including Andersen.

"We are trying to get sufficient information so people can determine whether the interrelationships are conflicts to be concerned about," said Carolyn Schwartz, U.S. bankruptcy trustee in New York. "Disclosure, while not a panacea, at least puts everything on the table."

The dilemma shows how, like the regulators who once lobbied for Enron, or the politicians whose pockets were lined with campaign contributions from the company, law firms involved in the Enron mess are scrambling to avoid potential conflicts of interests.

Such problems have become especially acute as law firms have grown and diversified in recent years, with the development of bankruptcy departments, once the purview of specialized legal boutiques, in large, full-service practices. The sheer size of the Enron case has made it almost impossible to find lawyers without some possible conflict.

As a result, law firms are getting special waivers from clients in order to get a piece of the action. Others are establishing elaborate firewalls to avoid the sharing of confidential information.

New York's Sullivan & Cromwell, which has done lobbying and commodities-regulation work for Enron, recently got special permission from the company to represent David Duncan, Andersen's former lead auditor on the Enron account, whom Andersen recently fired.

Davis Polk & Wardwell, one of Andersen's principal outside law firms in the Enron case, is also acting as counsel to one of Enron's biggest creditors, J.P. Morgan Chase & Co. Christopher Mayer, a Davis Polk partner, said both clients were fully informed and have consented.

Martin Bienenstock, a Weil Gotshal partner who is heading up the Enron case, said the firm isn't involved in examining any potential claims that Enron may have against Andersen. "All Enron-

Arthur Andersen matters will be dealt with by other attorneys," he said. He notes that Weil disclosed that Andersen was and is a client in court documents when Enron filed for Chapter 11 bankruptcy-court protection in December. He added that the firm expects to make additional disclosures soon in response to Ms. Schwartz's request.

Among other matters, Weil represented Andersen in connection with a bitter split with its Andersen consulting group a few years ago. The firm earned fees of roughly \$11 million in that matter. Its revenue last year was \$573 million.

Ethics rules prohibit law firms from filing a lawsuit against an existing client. Separate bankruptcy-court rules require that lawyers for companies in bankruptcy proceedings be "disinterested." A hearing to consider court approval of Weil, Gotshal as Enron's law firm is set for next week.

In 1994, Weil Gotshal had its fees slashed by a bankruptcy judge for failing to disclose potential conflicts in connection with its handling of the Chapter 11 case of apparel maker Leslie Fay Cos. The trustee in that case was Arthur Gonzalez, who is now the judge overseeing the Enron case.

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Monday, January 21, 2002

Accounting for Enron: Enron's Washington Friends Pressed India Over Power-Plant Project at Every Turn

By Michael M. Phillips

Staff Reporter of The Wall Street Journal

WASHINGTON -- When Richard Celeste gave his farewell speech as President Clinton's ambassador to India, he lectured Indians about the sanctity of contracts. It was clear to the audience he was referring to Enron Corp.'s frustration trying to build a \$2.9 billion power plant outside Bombay.

After presenting his credentials this summer, Ambassador Robert D. Blackwill wasted no time in warning the Indians that Enron's problems were at the top of the Bush administration's commercial agenda.

"I want to be frank," Mr. Blackwill told the Indo-American Chamber of Commerce and the Indo-American Society. "These disputes have darkened India's investment climate."

Across party lines and administrations, Enron has had an active ally in Washington throughout its battle with Indian officials over the Dabhol electric-power project. From the early 1990s, when Enron waded into its Indian quagmire, right up until it filed for bankruptcy protection last month, the Houston energy company counted on the U.S. government to argue its case.

At least one energy secretary, four commerce secretaries, three U.S. ambassadors and Vice President Dick Cheney are among the senior American officials who prodded the Indians to resolve the Enron dispute. President Clinton assigned a senior aide to monitor the project. President Bush has a Dabhol "working group" to help Enron's cause. From conception to collapse, the U.S. government pushed the deal, financed the deal and attempted to salvage the deal amid political bickering, unpaid bills and unproven allegations of bribery in India.

The administration's motives are muddied by Enron's close financial ties with senior members of both parties, including President Bush. Enron executives and employees have contributed nearly \$6 million to politicians since the 1990 election cycle, 74% of it to Republicans, according to federal data compiled by the Center for Responsive Politics, a campaign-finance watchdog group. Enron and its executives gave \$736,800 to Mr. Bush for his gubernatorial and presidential campaigns, as well as his presidential inaugural fund and election-recount war chest.

U.S. officials uniformly explain their assistance as a natural extension of American foreign policy, unrelated to the considerable political clout of Enron or its chairman, Kenneth Lay. Both the Clinton and Bush administrations have encouraged developing nations to open their borders to U.S. companies, and Enron's is the largest investment India has ever received.

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Frank Wisner, U.S. ambassador in New Delhi from 1994-97, argued Enron's case frequently and vociferously, including with the staff of then-Prime Minister Narasimha Rao. After leaving India, Mr. Wisner became a director of an Enron-affiliated company, Enron Oil & Gas, and he is chairman of the U.S.-India Business Council.

"I'd do it all over again," Mr. Wisner said of his advocacy. "It was the right policy. I only regret it didn't work, for India's sake as well as the investors." John Hardy, Enron's vice president of global finance, and Linda Robertson, head of its Washington office, didn't return calls seeking comment.

Enron's power plant is a saga of failure that began when the Indian government invited foreign investors to provide electric power for India's growing economy.

Mr. Lay joined then-Commerce Secretary Ron Brown on a trade mission to India in early 1995. Weeks later, Enron closed the initial funding on a deal that eventually would give it 65% of the Dabhol Power Co. General Electric Co. and Bechtel Corp. owned 10% each, and the local power company, the Maharashtra State Electricity Board, held the rest. The board also agreed to buy the electricity the plant would produce, an accord that became the heart of the project's downfall.

Two U.S. government agencies, the Export-Import Bank and the Overseas Private Investment Corp., teamed up to provide Dabhol \$642 million in financing guarantees and risk insurance. Both agencies describe the financing as exactly the kind of support they are supposed to give to American companies. Their money is in turn guaranteed by Indian banks, in the Ex-Im Bank's case, or the Indian state or central governments, in OPIC's case.

But not long after the deal was signed, a Hindu nationalist party, Shiv Sena, took power in Maharashtra state and canceled the project. The party accused its predecessors and Enron of corruption and complained that Dabhol's electricity was too expensive for the state power company. Then-Energy Secretary Hazel O'Leary was among the U.S. officials who traveled to India at that time and warned authorities that India was tarnishing its reputation with foreign investors.

Late in 1995, Enron and the state authorities struck a deal, with the company agreeing to lower rates. President Clinton had a senior aide monitor the project. At one point or another during the dispute, President Clinton's commerce secretaries -- Mr. Brown, Mickey Kantor and William Daley -- all took up Enron's case, according to Raymond E. Vickery Jr., who was assistant secretary for trade development under all three. "It was the leading U.S. foreign direct investment in India, and the status of the Dabhol power plant came up at virtually every mission," Mr. Vickery recalled.

In May 1999, electricity began flowing and financing for an expansion arranged, but the project didn't run smoothly. In May 2001, the state electricity board stopped paying its Dabhol bills in a dispute largely about pricing. A few months later, with the board \$240 million in arrears, Enron gave up and said it would gladly sell its stake in the project.

Enron's contacts with the U.S. government, which by then meant the Bush administration,

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continued through that period. In June, Vice President Cheney raised Enron's concern about being paid for electricity generated by Dabhol in a meeting in Washington with Sonia Gandhi, leader of the Congress Party, which now controlled Maharashtra. Another party leader accompanying Ms. Gandhi told reporters of the conversation afterward, and the White House confirmed it last week. White House officials said the vice president brought the subject up because it was in briefing papers prepared by the National Security Council, and because OPIC had money in the project.

"It is an important project to create jobs in America, and there's also a taxpayer exposure" through OPIC, White House spokesman Ari Fleischer said Friday. Indeed, Dabhol Power Co. filed a \$180 million insurance claim with OPIC last month, arguing that the electricity board's failure to pay its bills amounts to expropriation.

The Enron connections reached deep into the administration, however. OPIC released documents last week under the Freedom of Information Act revealing that the National Security Council leads an administration working group dedicated to Enron's cause in India; Treasury, State, Ex-Im and OPIC also are represented in the group. Mr. Fleischer confirmed a New York Daily News report that top Bush economic adviser Lawrence Lindsey had been told by the White House counsel to recuse himself from matters involving Dabhol because he had served a consultant to Enron.

In July, Christina B. Rocca, assistant secretary of State, discussed India's investment climate at a meeting of the Confederation of Indian Industries and announced that "many of India's problems in this regard can be summed up in the five-letter word, Enron."

On Oct. 15, as Enron was collapsing, Commerce Secretary Donald Evans hooked Mr. Lay up with Sig Rogich, a Las Vegas-based Republican public-relations man with connections to the Indian government. Mr. Rogich, an Evans friend, had been a special assistant to former President George H.W. Bush, and had worked on the Bush-Cheney campaign. The conversation was first reported in Newsweek.

Indian officials wanted Mr. Rogich to help them improve the country's image in the U.S., and Mr. Evans suggested Mr. Rogich talk to Mr. Lay about Enron's woes. Mr. Evans called Mr. Lay, Mr. Lay called Mr. Rogich, and Mr. Rogich says he raised Enron's complaints last month with senior Indian officials, including the powerful home minister, Lal Krishna Advani. Mr. Advani visited President Bush and other officials in Washington this month, but it isn't clear whether the Enron debacle came up during his trip.

Although Mr. Lay and Mr. Evans spoke about Enron's financial situation at the end of October, the Indian project apparently didn't come up between the two again until mid-November, when Mr. Lay called the secretary at his office to provide "an update" on Dabhol, according to Commerce spokesman Jim Dyke. A couple of weeks later Enron filed its bankruptcy-court petition.

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Monday, January 21, 2002
Enron Was No Friend to Free Markets
By Jerry Taylor

While it's still unclear exactly what caused the implosion at Enron, ideological playwrights are already busily casting the company in the starring role for their pet political morality plays. The most common scripts being written have cast Enron CEO Ken Lay as Adam Smith on steroids and the corporation itself as the avatar of irresponsible, run-amuck capitalism.

Those of us who've been involved in the energy debates of the 1990s know different. Enron was less the 21st-century incarnation of Robber Baronry than it was the latter-day inheritors of the mantle worn by Archer-Daniels Midland, the corporation that would hardly exist were it not for government favor and regulatory help.

Enron is most famously known for pioneering wholesale electricity and natural gas trading. Since ending the legally protected franchises that utilities had on those services was a prerequisite for Enron's strategy, the company lobbied aggressively for competition and "consumer choice" for gas and electricity services.

But while donning the garb of Ronald Reagan on the one hand, the company was donning the mantle of Ralph Nader when it came to the transmission and distribution side of the energy business. Enron, you see, was worried that the incumbent utilities would either under-price the non-utility competitors that Enron wanted on their trading floors or, alternatively, would charge such high prices for access to their transmission systems that non-utility gas and electricity providers would be unable to effectively compete for business.

So Enron insisted that electric utilities be forced by law to get out of the generation business, that strict price controls be set for the rates charged for access to the various transmission grids, and that the day-to-day operation of the electricity distribution systems be handed over to state officials who were directed to govern those systems at the behest of the system's "stakeholders" (read: Enron and friends). So Reaganite competition, according to Enron, required new micromanagerial rules about industrial organization and the de-facto nationalization of the transmission systems by officials who'd have to answer to Enron.

Many times over the past decade I found myself in meetings or on conference panels with Enron officials. On each and every occasion, the "jungle capitalists" from Houston were apoplectic over arguments that the grid should be deregulated like the wholesale power markets. They also ranted against the idea that companies should be able to charge whatever they wished for access to their property, that the grids should be left in private hands, or that government cannot know a priori how best to organize private enterprises and should thus refrain from imposing arrangements on the market.

While most legislators got a full dose of Enron's regulatory agenda, some were hearing from the company that, well, grid owners should be left alone to do as they wanted. Those legislators,

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however, came from regions where Enron had managed to buy the transmission systems in question before the debate was settled. So officials from Texas, Louisiana, and various parts of South America in charge of the gas pipelines that Enron had bought were hearing one story while the rest of the political world was hearing another.

That pattern of regulatory opportunism extended virtually everywhere, but perhaps no more so than on the environmental front. Enron, for instance, managed to pick up several near-bankrupt wind and solar power companies over the years and treated them like political lottery tickets. Wherever Enron went, pious campaigns for the virtues of renewable energy subsidies (in effect, subsidies for Enron) were sure to follow.

Likewise, Enron saw spectacular business opportunities in the trading of greenhouse gas emission permits and accordingly argued for aggressive action to address global warming. And given that natural gas would be less disadvantaged by carbon emission controls than would competitor fuels like coal and oil, Enron was more than happy to link hands with nearly every environmental activist that crossed its path to undertake war against America's carbon-based energy economy.

Whether it was de facto support of the Kyoto Protocol, the outspoken embrace of Clinton's proposed BTU tax (which would give Enron a competitive advantage in the marketplace), or the occasional attempt to secure a tax on oil imports (necessary back in the 1980s to save one of its pipelines in Florida), Enron was more than happy to hammer energy consumers with the power of government to fatten its own bottom line.

While Enron was adept in putting together these coalitions to expand the regulatory state, it was no slouch at more conventional raids on the public treasury. Since 1996, for instance, Enron managed to bag \$450 million to underwrite its investments in India, Brazil, and Guatemala through the auspices of the taxpayer-financed Overseas Private Investment Corporation. Another \$135 million was liberated from the Export-Import Bank over that same period to underwrite Enron's investments in Venezuela. There was virtually nothing that the corporation did that wasn't worth a handout from the taxpayers, according to Enron lobbyists.

On balance, Enron was an enemy, not an ally, of free markets. Enron was more interested in rigging the marketplace with rules and regulations to advantage itself at the expense of competitors and consumers than in making money the old fashioned way – by earning it honestly from their customers through voluntary trade. Indeed, Enron would probably still be a small-time pipeline company were it not for the statist conceit that consumers are better off under the regulatory boot of government than with the invisible hand of the marketplace. There's a morality play here all right, but it's the opposite from that being readied for a political theater near you.

Mr. Taylor is director of natural resource studies at the Cato Institute.

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Andersen CEO: Economics broke Enron, not misdeeds

By Kevin McCoy

USA TODAY

Enron's meltdown into the largest bankruptcy filing in U.S. history resulted from a fundamental economic failure, not illegality or suspect accounting, the head of its audit firm said Sunday.

"To my knowledge, there was nothing that we've found that was illegal," Arthur Andersen CEO Joseph Berardino said on NBC's Meet the Press.

"This is a company whose business model failed. The accounting reflects the results of business activities. And the way these events were being accounted for were clear to (Enron) management and to the board," Berardino added. "But at its base, this is an economic failure."

Berardino also tried to squelch speculation that the collapse of Enron -- which fired the Big Five accounting firm Thursday -- raised doubts about Andersen's survival.

"I don't think we're finished at all," he said.

Berardino revealed that Andersen is re-examining its policy of giving its clients simultaneous audit services and financial advice, a common accounting industry practice that has raised conflict-of-interest questions since Enron's Chapter 11 filing on Dec. 2.

Berardino spoke just days after evidence showed Andersen executives questioned Enron business practices at least as far back as February 2001. The debate focused on partnerships Enron used to shift millions in debt away from its balance sheet.

Reacting to the comments, a congressional investigator noted that scores of U.S. companies have gone bust during the past two years with few signs of the accounting questions that surround Enron.

The Enron collapse, the focus of a criminal investigation, is to be explored Thursday in the first two of numerous congressional hearings.

In other developments:

* The White House acknowledged that Vice President Cheney met with a top Indian political leader in June about a troubled energy plant chiefly owned by Enron.

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Administration officials said Cheney's discussion of the issue with Indian opposition party Congress leader Sonia Gandhi was proper because the India plant had been guaranteed by \$360 million from the U.S. taxpayer-funded Overseas Private Investment Corp.

Sunday, Democratic National Committee Chairman Terry McAuliffe accused the White House of political "stonewalling" for its initial failure to disclose the meeting.

* Last September, Enron CEO Kenneth Lay in an online chat urged employees to buy company stock, even though an executive had warned him about accounting problems.

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Andersen employees' morale rattled Firm might see recruiting troubles, higher turnover

By Stephanie Armour

USA TODAY

Employee morale at Arthur Andersen, Enron's auditor, is taking a beating as the accounting giant's reputation is tarnished.

Workers are grappling with tough questions about how the companies' predicament could imperil their own careers. Comments from current and former staffers at online site Vault.com reflect the mounting concern: "Where does the buck stop?" "You should be writing your résumé. Do it now before your credentials become worthless." "I wake up every morning thanking the Lord above I got out when I did."

Potential fallout:

* Increased turnover. Arthur Andersen has already seen turnover rates of about 25%, according to surveys by Atlanta-based Bowman's Accounting Report, a national publication on the accounting industry. That number is above the national rate, experts say, and will probably climb. Employees might worry future employment will be hampered if they stay.

"When the image of a company is tarnished, that leads to turnover," says Elaine Hollensbe, an assistant professor in management at the University of Cincinnati. "Employees may not want to be identified with a company when there's impropriety going on."

* Recruiting woes. The company had long drawn college students because of its reputation for intensive training. That could change, experts say, if the firm is seen as unethical. Others say students with upcoming jobs at the company are worried the offers might be rescinded.

"It's like planning to be a priest and finding out there's something wrong with the church," says Alec Horniman, in Charlottesville, Va., a professor of business administration at the University of Virginia Darden School of Business. "This is a first-class, blue-chip company where the currency is integrity. That currency has been challenged."

* Partner defections. Long-term partners have expressed concerns that they might not want to spend the next years embroiled in battles about the firm's survival, according to some industry experts.

"Will partners want to spend the next five years of their career there? In Houston, the mood is very, very dark," says Arthur Bowman, of Bowman's Accounting Report. "This is a firm that people had said was arrogant. Now, it's a firm where people's heads are down."

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Former and current employees declined to comment on the record. But much is at stake. The 89-year-old firm has been known for its conservative, self-assured corporate culture, an environment some analysts describe as hierarchical and orderly as Marines.

"Employees are comfortable; we're dealing with this matter in a forthright and candid way," says Arthur Andersen spokesman Patrick Dorton. "People are understandably distraught that a firm they love and do great work for is getting this kind of media coverage."

Predictions that the Enron debacle could be the company's downfall might spur employees to fight to restore its reputation. Others say it's too soon to tell.

"If the code of ethics isn't followed at the top, the blocks tumble," says Nan DeMars, an ethics behaviorist and author of *You Want Me To Do What?*, on workplace ethics. "People always championed Arthur Andersen. Now, they're embarrassed. Their confidence is shaken."

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USA TODAY

Agencies, panels set hearings on Enron

By Jayne O'Donnell and Jim Drinkard

At least three federal agencies and nine congressional committees are looking into aspects of Enron's collapse. Here's what they are examining and the tentative or expected dates of hearings:

Federal agencies

Justice Department: Criminal investigation of the company and its top officials.

Labor Department: Enron's handling of its workers' retirement benefit plans.

Securities and Exchange Commission: The adequacy of financial reporting to investors and capital markets, along with accounting issues raised by Enron's SEC filings.

Senate committees

Banking: Auditor independence, analyst objectivity and other issues relating to investor protection. Hearing: Feb 12.

Commerce: Multiple issues surrounding Enron's Chapter 11 filing. Hearing: Feb. 4

Energy and Natural Resources: Impact of Enron's Chapter 11 filing on competition in the natural gas and electricity markets. Hearing: Jan. 29.

Finance: Possible use of tax shelters by Enron to cover its financial state. Hearing: to be announced.

Governmental Affairs: The roles of Enron's board and auditor, Arthur Andersen, and its use of partnerships to conceal debt. Hearing: Jan. 24.

Health, Education, Labor and Pensions: The impact Enron's Chapter 11 filing had on pensions. Hearing: to be announced.

House committees

Education and Workforce: Laws governing employee stock ownership and pension funds. Hearing: to be announced

Energy and Commerce: Enron's records and filings with the SEC and auditors and Andersen's actions. Hearing: Jan. 24.

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Financial Services: Possible deception of investors and the company's failure to disclose information. Securities fraud and accounting irregularities, impact on commodity markets, reasons behind overstated earnings. Hearing: Feb. 4.

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Dawson, Michael

From: The New York Times Direct [nytdirect@nytimes.com]
Sent: Wednesday, August 15, 2001 6:57 AM
To: michael.dawson@do.treas.gov
Subject: Today's Headlines from NYTimes.com Wednesday, August 15, 2001

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The New York Times on the Web
Wednesday, August 15, 2001

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QUOTE OF THE DAY

"This would upset the apple cart."
-DR. ROCKY KOLB, an astrophysicist, on a finding that a basic law of nature, regarded as immutable, may be changing slightly over time.

<http://www.nytimes.com/2001/08/15/science/15PHYS.html?todaysh headlines>

NATIONAL

Up to 18 May Have Died of Overdoses in Houston

An unprecedented rash of drug deaths over the past few days in Houston has shed light on a nationwide rise in overdoses.
<http://www.nytimes.com/2001/08/15/national/15DRUG.html?todaysh headlines>

Immigrant Advocates Cite Problems With New Deportation Powers

Immigrant advocacy groups are accusing low-level immigration officials of summarily deporting refugees seeking asylum without allowing a hearing.
<http://www.nytimes.com/2001/08/15/national/15IMMI.html?todaysh headlines>

State Legislators Gather, With Budget Woes High on Agenda

At the National Conference of State Legislatures, lawmakers, and those who followed them, discussed and debated issues ranging from Medicaid to election reform.
<http://www.nytimes.com/2001/08/15/national/15STAT.html?todaysh headlines>

View After Cancer Surgery Is Good for F.B.I. Director
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INTERNATIONAL
=====

Macedonians Say They Meet Rules for NATO Troops

The combatants in Macedonia agreed to meet two of the major conditions for deploying 3,500 NATO troops, putting pressure on the alliance's leaders to act quickly to prevent the war from escalating.

<http://www.nytimes.com/2001/08/15/international/europe/15MACE.html?todaysheadlines>

City Israel Raided Is Oddly Jubilant

Despite its unmistakable show of force, many of Jenin's Arab residents celebrated Israel's dead-of-night, in-and-out raid on the northernmost West Bank city as if it were a Palestinian victory.

<http://www.nytimes.com/2001/08/15/international/middleeast/15MIDE.html?todaysheadlines>

I.R.A. Withdraws Its Disarmament Proposal

Just two days after Britain said that a lasting peace in Northern Ireland was "tantalizingly close," the Irish Republican Army's withdrawal of its disarmament plan propelled the faltering peace effort once more toward collapse.

<http://www.nytimes.com/2001/08/15/international/15IRIS.html?todaysheadlines>

Archbishop Promises to Obey the Pope and Leave His New Wife

<http://www.nytimes.com/2001/08/15/international/europe/15VATI.html?todaysheadlines>

A Sri Lankan Cabinet Minister Meets With Tamil Rebel Leaders

<http://www.nytimes.com/2001/08/15/international/asia/15TALK.html?todaysheadlines>

Zionism-and-Racism Item Off Meeting's Agenda

<http://www.nytimes.com/2001/08/15/international/15RACE.html?todaysheadlines>

MORE INTERNATIONAL NEWS:

<http://www.nytimes.com/pages/world/index.html?todayshheadline>

BUSINESS
=====

Tobacco Industry Still Advertises in Magazines Read by Youth

Three years after tobacco companies settled with states and said they would stop advertising in magazines with significant numbers of young readers, the ads continue to run.

<http://www.nytimes.com/2001/08/15/business/15MAGS.html?todayshadlines>

Enron's Chief Executive Quits After Only 6 Months in Job

Jeffrey Skilling, C.E.O. of the Enron Corporation, stunned Wall Street by announcing that he would quit after just six months in the job.

<http://www.nytimes.com/2001/08/15/business/15ENRO.html?todayshadlines>

Alltel in Hostile \$6.1 Billion Bid for Phone Rival

Telecom giant Alltel made an unsolicited \$6.1 billion takeover bid for CenturyTel Inc., a smaller rival that provides phone services in non-urban areas.

<http://www.nytimes.com/2001/08/15/business/15PHON.html?todayshadlines>

F.T.C. Begins Inquiry Into Unocal's Patents

<http://www.nytimes.com/2001/08/15/business/15GAS.html?todayshadlines>

Nissan Workers at Tennessee Plant Want Union Vote

<http://www.nytimes.com/2001/08/15/business/15AUTO.html?todayshadlines>

Waiting to Call Plays for I.B.M.

<http://www.nytimes.com/2001/08/15/business/15SAM.html?todayshadlines>

MORE BUSINESS NEWS:

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\-----/

TECHNOLOGY

Waiting to Call Plays for I.B.M.

I.B.M. is moving toward the retirement of Louis V. Gerstner Jr., its chairman and chief executive since 1993, in an exceptionally methodical fashion.

<http://www.nytimes.com/2001/08/15/business/15SAM.html?todayshadlines>

More Setbacks for Investors of AremisSoft

There is still no indication when the Nasdaq stock market will allow AremisSoft's shares to resume trading and let a price be set to determine just how much investors have lost.

<http://www.nytimes.com/2001/08/15/business/15PLAC.html?todayshadlines>

Applied Materials Reports Earnings Beat Expectations

Applied Materials reported third-quarter earnings today that beat Wall Street's expectations by 2 cents a share.
<http://www.nytimes.com/2001/08/15/technology/ebusiness/15CHIP.html?todayshadlines>

Delayed Report on Encryption Flaws to Be Presented
<http://www.nytimes.com/2001/08/15/technology/15CODE.html?todayshadlines>
Efforts to Ease Worries on New Net Addresses
<http://www.nytimes.com/2001/08/15/technology/ebusiness/15DOMA.html?todayshadlines>
Alltel in Hostile \$6.1 Billion Bid for Phone Rival
<http://www.nytimes.com/2001/08/15/business/15PHON.html?todayshadlines>

MORE TECHNOLOGY NEWS:
<http://www.nytimes.com/pages/technology/index.html?todayshadline>

POLITICS

=====
Condit Plans Fund-Raiser to Work on Image Before Re-election Bid

Representative Gary A. Condit appears to be trying to rehabilitate his image in time to run for re-election in his California district next year.
<http://www.nytimes.com/2001/08/15/politics/15COND.html?todayshadlines>

E.P.A. Postpones Decision on Revising Pollution Rules

The Bush administration delayed a decision on overhauling a major antipollution program as top officials tried to devise a new plan that could ease the regulatory burden on the energy industry.
<http://www.nytimes.com/2001/08/15/politics/15POLL.html?todayshadlines>

Bush Emphasizes Teaching of Values to Children

President Bush took his "Home to the Heartland" tour to Rocky Mountain National Park in Colorado to talk about the importance of teaching children values and creating "communities of character."
<http://www.nytimes.com/2001/08/15/politics/15BUSH.html?todayshadlines>

MORE POLITICS NEWS:
<http://www.nytimes.com/pages/politics/index.html?todayshadline>

SPORTS

=====
Bronx Little League in World Series

The boys of the Rolando Paulino All-Stars of the Bronx marched into the Little League World Series with a flourish: a 2-0 no-hitter over the State College American

All-Stars from State College, Pa.
<http://www.nytimes.com/2001/08/15/sports/15LITT.html?todayshadlines>

Martinez Does Heavy Work as the Yankees Win

Tino Martinez drilled a three-run homer off Tampa Bay rookie Joe Kennedy in the sixth, leading the wobbly Yankees past the Devil Rays.
<http://www.nytimes.com/2001/08/15/sports/baseball/15YANK.html?todayshadlines>

Rangers Establish Their Terms for Lindros

The Rangers have reportedly asked Philadelphia's Eric Lindros to wait an extra year before seeking unrestricted free agency. In exchange, Lindros would receive a higher base salary from New York.
<http://www.nytimes.com/2001/08/15/sports/hockey/15RANG.html?todayshadlines>

MORE SPORTS NEWS:
<http://www.nytimes.com/pages/sports/index.html?todayshadline>

ARTS

Enticed by Bright Light: A Show of Hockney's Photocollages

What's striking about the first major survey of David Hockney's photography is that the works resemble Hockney paintings and reflect his enthusiasm for Cubism.
<http://www.nytimes.com/2001/08/15/arts/design/15HOCK.html?todayshadlines>

A Peek Behind Sade's Veil of Heartbreak

Sade on Monday played her first New York City concert since 1993, and though she would never be so immodest as to mention it, she was returning as a prophet proved right.
<http://www.nytimes.com/2001/08/15/arts/music/15SADE.html?todayshadlines>

Preserving Two Chapters of America's Songbook

While there have been many memorable collaborations in the history of the American musical, a new one has ambitions that rival those of the most starry-eyed Broadway show.
<http://www.nytimes.com/2001/08/15/arts/music/15ARTS.html?todayshadlines>

MORE ARTS NEWS:
<http://www.nytimes.com/pages/arts/index.html?todayshadline>

NY REGION

Poll in New York Finds Rosier Views on City's Future

Many credit Mayor Giuliani for the city's improved fortunes, but few are paying much attention to the contest to replace him, according to a New York Times poll.
<http://www.nytimes.com/2001/08/15/nyregion/15POLL.html?todayshadlines>

Pataki Says He Will Sue Over Budget

Gov. George E. Pataki declared that he would sue the Legislature for passing a stripped-down version of his budget, which he believes is a violation of the Constitution.
<http://www.nytimes.com/2001/08/15/nyregion/15BUDG.html?todayshadlines>

Court Says Woman Can Bar Embryos' Use

The New Jersey Supreme Court said that seven embryos produced by a couple during their marriage could not be used to produce a child without the woman's consent.
<http://www.nytimes.com/2001/08/15/nyregion/15EMBR.html?todayshadlines>

MORE NY REGION NEWS:
<http://www.nytimes.com/pages/nyregion/index.html?todayshadline>

OP-ED

CNN: Foxy or Outfoxed?
By MAUREEN DOWD
The news that CNN was wooing Rush Limbaugh caused an explosion of kibitzing on Lucianne Goldberg's conservative Web site.
<http://www.nytimes.com/2001/08/15/opinion/14DOWD.html?todayshadlines>

School Vouchers Along the Color Line
By DAVID A. BOSITIS
It seems clear that black support for school vouchers is mainly a rejection of the status quo rather than an endorsement of this particular reform.
<http://www.nytimes.com/2001/08/15/opinion/15BOSI.html?todayshadlines>

Two Uneasy States of Independence
By KAI FRIESE
Today is Independence Day in India, but the celebration is of a nation besieged, from without and within, by competing nationalisms.
<http://www.nytimes.com/2001/08/15/opinion/15FRIE.html?todayshadlines>

Young and Old Thrive Side by Side
<http://www.nytimes.com/2001/08/15/opinion/15COLM.html?todayshadlines>
Stem Cells 101
<http://www.nytimes.com/2001/08/15/opinion/15WED1.html?todayshadlines>
Miscommunication in Moscow
<http://www.nytimes.com/2001/08/15/opinion/15WED2.html?todayshadlines>

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Dawson, Michael

From: G7 Daily Briefing Readers [briefing@g7group.com]
Sent: Friday, August 10, 2001 8:28 AM
To: G7 Daily Briefing Readers
Subject: G7DB: US Treasury & Argentina, US Politics, BoE - 8/10/01



G7DB.pdf

US Treasury and Argentina -- The Danger of High Expectations
-Vice-Economy Minister Daniel Marx meets with Treasury officials today.
-Economy Minister Cavallo promises Marx will return with new support.
-Are expectations for imminent aid too high?

US Politics -- Bush Goes for Limited Stem Cell Research
-Win for biotech.
-But pace of research will be slow.
-Will Congress expand federal funding for stem cell research now?

Bank of England -- QIR Paints a Dismal Picture
-Bank cuts growth and inflation forecasts.
-Report stresses "considerable uncertainties" and downside risks.
-What are the BoE's three leading worries?

US Treasury and Argentina -- The Danger of High Expectations

A team of Argentine government officials led by Vice-Economy Minister Daniel Marx is in

Washington today for meetings with officials from the IMF and US Treasury Department. But we don't expect an imminent announcement that meets market expectations. Economy Minister Domingo Cavallo's high stakes game of pressure seemed brilliant in the beginning. The pressure on US Treasury and the IMF was/is intense, no doubt. But he has succeeded in building a market expectation that would be hard to meet. Treasury hasn't changed its view. It believes additional aid would foster moral hazard. It believes Argentina is in trouble -- with or without a small aid package. As such, Treasury would like Argentina to first tap into its existing contingent credit lines with international banks before expecting any more multilateral funds. These credit lines were set up a few years ago for just this purpose: they allow the central bank to sell Dollar-denominated government bonds (with a repurchase clause) in exchange for Dollars in the event of a run on banks.

Possibilities:

1) An announcement urging Argentina to tap the credit lines to shore up reserves coupled with rhetorical support for Argentina's efforts. Cavallo fears that such an announcement would touch off a panicked run on deposits and could signify the beginning of the end (and he's probably right). This may not bother Treasury. Remember, there is consensus for debt restructuring.

2) To make use of the contingent credit lines a condition of new aid. New aid would be contingent on first using the credit lines with international banks to shore up FX reserves and on progress implementing the zero-deficit policy. (More information on the July budget numbers, expected in about a week, should give a better sense of the implementation to date.) Any aid package would not only be contingent on zero-deficit compliance, but would likely go toward providing liquidity to the banking system -- not to the treasury to shore up the fiscal accounts.

Bottom line: Cavallo has succeeded in building sky-high expectations for aid. Now the danger is that any support that does come from the US -- rhetorical or financial -- will come with enough strings attached to disappoint, rather than buoy, markets.

US Politics -- Bush Goes for Limited Stem Cell Research

President G.W. Bush's support for limited stem cell research will give a modest bounce to the biotech sector. But look before you leap. The pace of research will be slow, given that Bush stopped short of allowing federal funds to be used for those who want to create stem cell lines for experimentation. Bush referenced "sixty cell lines," in his speech. But only 10 have been referenced in scientific journals and the National Institute of Health has estimated just 30 stem cell lines. That means companies like Genron, already in this line of work, are well positioned. But companies looking to get a piece of the action may be disappointed for now.

Although Bush's permission for federal funding to stem cell research was limited, you can expect Congress to try to expand federal funding. Now that Bush has underscored the benefits of research in light of possible cures for diseases from Alzheimer's to Leukemia, you can expect members of Congress to seek to expand federal aid into new lines.

Bottom line: Bush's decision is limited in the short run, but opens the door for broader research down the road.

Bank of England -- QIR Paints a Dismal Picture

The Bank of England released its latest Quarterly Inflation Report Wednesday -- a sobering document that emphasized downgraded forecasts and downside risks. The QIR also shed some light on last week's surprising 25bp rate cut. While acknowledging that further monetary easing could over-stimulate domestic demand, the Bank's Monetary Policy Committee ultimately decided that "delaying any policy response risked deepening the downturn and pushing inflation below target." And viewed in the context of the August QIR, last week's rate cut comes into clearer focus.

Three themes course through the QIR:

- A spreading slowdown. While noting that "global economic prospects continue to depend heavily on developments in the United States," the QIR reveals an institution increasingly worried about weakness in Euroland and Japan. With European consumption growth softening because of increased inflation -- and with continental Europe facing

anemic growth into 2002 -- UK manufacturers are looking at sustained weakness in their leading export market.

- A cooling investment climate. As business fixed investment continues to fall, the Bank stressed three symptoms: "deteriorating business confidence, declining profitability and decelerating corporate bank borrowing." And with Sterling adding to the woes of British exporters, the BoE now expects GDP growth to hit 2% this year while struggling to exceed 2.5% in 2002.

- Inflation is off the radar screen. With commodity prices weakening -- and the growth in average earnings slipping back -- the QIR sees the outlook for inflation as somewhat weaker than in May. Moreover, the Bank expects RPIX to be quite volatile in the months ahead, before settling back to roughly 2% in early 2002. (Deputy Governor Mervyn King described this transition as a shift from "disco dancing" to the "waltz.")

Domestic demand remains the one bright spot on the UK economic landscape. Noting that "the labor market remains tight and unemployment has continued to fall," Wednesday's report argues that strong private and public consumption is helping to temper the effects of a global downturn. However, the BoE also sees the strength of UK domestic demand as a double-edged sword. While retail sales figures have been solid through Q2 -- and housing prices, household money and credit are all growing at nearly 10% y-o-y -- the Bank believes that the longer this trend continues, the sharper the inevitable correction will be.

The BoE points to three key downside risks in the months ahead. First, the global downturn could be longer and more severe than the Bank anticipates. Second, on the home front, "there is also the threat of a sharper rise in the personal savings ratio and more pronounced corporate retrenchment." Finally -- and the wild card in BoE policymaking -- a sharp fall in Sterling could raise the specter of imported inflation.

Bottom line: The gloomy tone of Wednesday's QIR leaves the door wide open for another BoE rate cut in Q4.

Between the Lines

Government Downgrades Economic Assessment

Japan's Cabinet Office lowered its overall assessment of the economy, saying that the economy is deteriorating "further." The monthly report admits that economic activities are meager across the board. Factory production and exports have declined "substantially." Capital investment is also declining, while private consumption remains feeble. The report identifies global economic slowdown as a major risk in the future. Finance Minister Shiohara and Economic Minister Takenaka reiterated their view that the Bank of Japan should take further steps to counter deflation. (Nikkei)

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Harvey, Reavie

From: Nancy Lazar [nlazar@isigrp.com]
Sent: Friday, January 11, 2002 10:25 AM
To: ISI Reader
Subject: ISI Morning Political Report with Audio

Importance: High



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In today's POLITICAL REPORT:

- * Enron Political Fallout
- * No Fiscal Stimulus Bill, But...
- * Waiting For The Chairman
- * EU May Threaten Trade Sanctions

Please let us know if you have any questions.

All the best,

Nancy Lazar
212/446-5633

ISI INTERNATIONAL STRATEGY & INVESTMENT MORNING POLITICAL REPORT

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11

A CANCER ON THE PRESIDENCY?

Hardly. We're reminded of a comment made years ago by an observer of political scandals, who turned John Dean's famous phrase about Watergate around and said that Whitewater was more like asthma than cancer for Clinton, often debilitating but rarely fatal. Enron will be more like a headache for Bush, but it is a huge political story, and here is some of the fallout:

- Barring evidence of Bush involvement, Enron will fall well short of Whitewater in terms of political damage to the President. **So far it's an embarrassment but not a scandal.**
- **Rather than the scandal angle, the more productive line for this inquiry for Democrats will be the campaign finance/influence buying angle.** Politically this will expose the Bush/GOP vulnerability of being too close to corporate interests. Legislatively, this emphasis will delay energy legislation and could give a boost to campaign finance reform, which has passed the Senate, and the discharge petition in the House is only three votes short of forcing a floor vote.
- The Jeffords party switch last year will make this a bigger political story, since Republicans would have been less inclined to pursue congressional hearings aggressively. It will be interesting to compare the number of Senate Enron hearings to the number of House hearings.
- **Score another victory for Treasury Secretary O'Neill's campaign to limit moral hazard risks caused by government rescues.** He's now let both Argentina and Enron go without assistance. Larry Lindsey made the point over the weekend that in few countries would the seventh largest company (and, we would add, one with strong political connections) be allowed to fail, but so far that has had as much to do with the unfolding story as the fact that the Clintons lost money on their Whitewater investments.

Lay suggested [to O'Neill] the case of Long-Term Capital Management LP could be a model.... "Secretary O'Neill then contacted Undersecretary [Peter R.] Fisher, Undersecretary Fisher looked at that and concluded there would be no more impact on the overall economy." Fisher had been involved in the Long-Term Capital bailout as a Federal Reserve official.
Washington Post

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NO FISCAL STIMULUS BILL, BUT...

We don't expect a fiscal stimulus bill to pass Congress this year, but that doesn't mean there won't be a stimulative fiscal policy or that there will be no tax cuts or spending increases. We expect spending to be higher in some areas and a number of targeted tax cuts are possible. But we don't think that most of the elements of the widely debated stimulus bill will be enacted this year. Below we outline which proposals we think are unlikely, possible and unlikely.

Likely (Above 60% Chance)

- **Extension of unemployment benefits.** Congress normally extends unemployment benefits during recessions, especially during election years. This will probably take several months to get enacted as it will first get mired in a broader tax cut/stimulus debate, though. It should amount to \$10 to \$15 billion over the next two years.
- **Higher spending on homeland security and national defense.** President Bush will request \$20 billion more for the Pentagon (including \$7 billion more for procurement) as well as more funds for homeland security. Congress will probably exceed his request.
- **Minor tax cuts such as extending expired tax provisions.** While it won't amount to much from a fiscal stimulus standpoint (a few billion dollars in 2002 at most), some of the targeted tax credits to matter to specific companies and sectors. It could be many months before these expired provisions are extended, however.

Possible (40% to 60% Chance)

- **Targeted energy tax cuts.** An energy bill is a real possibility, and such a bill would almost certainly include a package of tax cuts designed to encourage energy production and conservation. A House-passed bill added up to only \$35 billion over ten years.
- **Higher domestic discretionary spending.** Higher domestic spending (education, health research, etc.) is a near certainty, but the increase may not be large enough to qualify as fiscally stimulative.

Unlikely (Below 40% Chance)

- **Republican tax cut wish list.** Republicans supported speeding up the Bush tax cut, "bonus" depreciation, and repeal of the corporate AMT. Some Republicans and Democrats also favored including a sales tax holiday or payroll tax holiday as part of a stimulus bill last year. None of these proposals — most of which would amount to tens of billions of dollars — are likely to pass this year.
- **Democratic spending wish list.** Democratic fiscal stimulus priorities are also unlikely to become law, such as "rebate" payments to low-income workers who don't pay income taxes, a big boost for infrastructure spending or new federal payments for health care insurance for the unemployed. These proposals amounted to more than \$10 billion each.

WAITING FOR THE CHAIRMAN

Chairman Greenspan will speak on the economy (according to Bloomberg, at 1:55 pm Eastern time). We'll gauge the impact of his comments on market expectations for the January meeting and the extent of Fed tightening for 2002.

We've been writing about the magnitude of tightening the eurodollar market is assuming for this year and wondering who is taking the other side of that bet. We've heard from a few of those investors recently, and a key part of the argument is that the post-September 11 rate cuts were crisis-driven, not fundamentally driven, and that crisis-based rate cuts have a shorter shelf life. For some time the amount of Fed tightening for 2002 was about the size of the post-September 11 rate cuts (175 bp). We have some sympathy for that point of view, but the more we thought about it, the more those rate cuts look more fundamentally based. The real funds rate is just above zero, about where it has been in most past recessions.

If the futures market is right, our first thought is that stocks are in for a shock. But Jason Trennert developed this table, which as a first cut suggests that Fed tightening in a recovery is not a disaster for stocks. Jason does note the high valuations for stocks now, and while stocks could handle some Fed tightening, the 140 bp now priced in may be much more than equity investors now expect.

Date of First Tightening	Change in S&P 500		
	% Change + 3 Mo.	% Change + 6 Mo.	% Change + 12 Mo.
1 December 1954	8.4%	11.7%	33.4%
2 August 1958	8.1%	16.7%	27.4%
3 August 1961	2.0%	2.8%	-14.7%
4 April 1971	-0.6%	-1.5%	6.8%
5 July 1975	-12.6%	-4.9%	9.2%
6 August 1980	5.2%	6.9%	8.0%
7 June 1983	1.0%	2.4%	-5.7%
8 February 1994	-6.0%	-3.9%	-1.9%
Average	0.7%	3.8%	7.8%

Bush has to decide on steel import limits in March. Should he take aggressive action against European steel producers, the EU has a huge weapon to wield against the US. The WTO has already approved \$4 billion in trade sanctions due to a US export tax subsidy, which the EU has not yet acted on.

George's Steelmaker Deal
Is Another Example of U.S. ...

Harvey, Reavie

From: Nancy Lazar [nlazar@isigrp.com]
Sent: Thursday, January 10, 2002 9:35 AM
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In today's POLITICAL REPORT:

- Interpreting The FOMC Speakers
- Fuel-Cell Makers Get Big Boost
- Enron Investigation Update

Please let us know if you have any questions.

All the best,

Nancy Lazar
212/446-5633

ISI INTERNATIONAL STRATEGY & INVESTMENT

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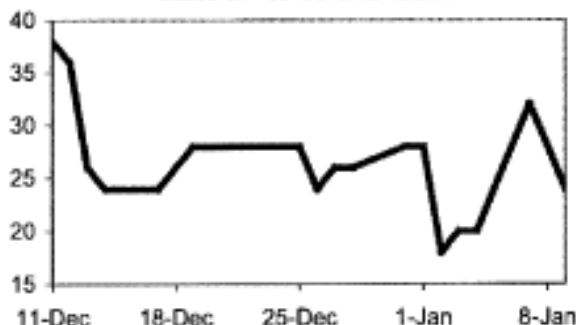
INTERPRETING THE FOMC SPEAKERS – MAYBE A JANUARY CUT, BUT DEFINITELY NOT THAT MUCH TIGHTENING IN 2002

This week Guynn, Santomero, McDonough, Broadus, McTeer, Ferguson, and Poole have all been on the tape with economic comments. Greenspan speaks both today (on economic literacy) and tomorrow (on the economy).

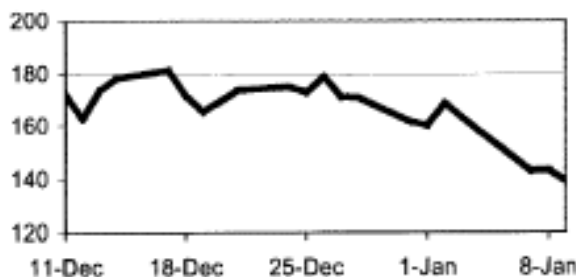
The message from the various FOMC speakers this week have had roughly consistent themes – they aren't confident of the timing or strength of the recovery, but they are confident of a recovery. **In normal times such comments would be taken as a sign of a probable interest rate cut at the next meeting, and they could be taken so now. But they are also consistent with the Fed leaving rates unchanged but keeping the easing bias in place.** Consequently, the odds of a quarter-point cut have gone up from 20% last Friday to about 25% yesterday.

The clearer implication of the FOMC speakers is that they don't expect to raise rates as much as the futures market expects. The expected tightening in 2002 has fallen from 160 bp last Friday to 140 bp yesterday. In short, the Fed doesn't see growth creating inflationary pressures, so the markets shouldn't expect much tightening. **We think even the 140 bp is still substantially higher than the Fed is likely to do this year.**

Odds of January Easing Still Low...
Based on Feb fed funds futures



...But expected '02 rate hikes are dropping
Dec 02 minus Jan 02 LIBOR futures, adjusted for risk premium

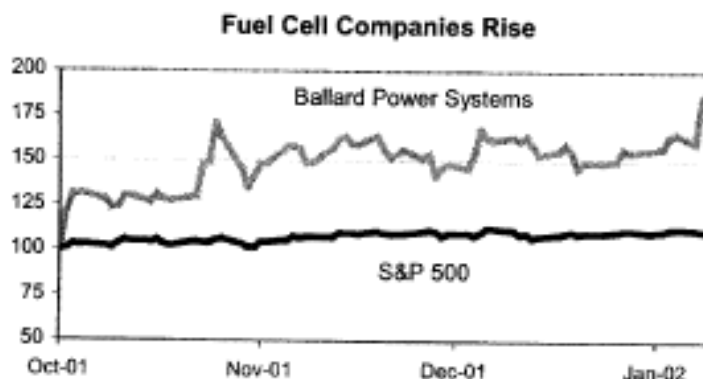


Ballard Power Systems Rises as Fuel Cell Technology Gains Favor

The Bush Administration is jettisoning a program once pushed by Al Gore to build a car that could get 80 miles per gallon in favor of more funding for fuel cell technology. As the accompanying graph shows, the news has helped Ballard Power the past few days, the leading fuel cell company.

The Administration is also hoping the announcement will help reduce support in Congress for raising corporate average fuel economy (CAFE) standards on sport utility vehicles. Higher fuel standards would hurt the automakers by raising the cost of their most profitable vehicles. We think that if an energy bill does pass Congress this year — which is highly uncertain — an increase in CAFE standards is likely to be included in it.

Energy legislation could be on the Senate floor sometime in February. The House has already passed two different energy bills, one that would raise CAFE standards and provide tax incentives and subsidies for increased energy production and conservation. The other bill would open ANWR to oil drilling.



ENRON INVESTIGATIONS TO HAVE BIGGER POLITICAL THAN POLICY IMPACT

The Justice Department announced that it has launched an investigation of Enron, joining just about every other outfit in Washington. We have no idea where a criminal probe will lead, but the congressional investigations are more about politics than policy. **While five congressional committees are investigating the company — and these hearings will get plenty of media attention — so far there is little evidence that major legislation (such as more regulation of energy markets) will result from this process.** Democrats intend to use the Enron debacle to try to embarrass the Bush Administration. For example, earlier this week Democrats demanded to know details of any Administration meetings with Enron officials. With that said, these hearings will help pressure regulators to tighten disclosure rules. In addition, there could be legislation limiting how much employer stock can be held in employee retirement plans.

Harvey, Reavie

From: LaKritz, Robb
Sent: Thursday, January 10, 2002 2:21 PM
To: Harvey, Reavie
Subject: FW: News Story

Thanks.

Robb LaKritz

-----Original Message-----

From: McCardell, Dan
Sent: Thursday, January 10, 2002 1:26 PM
To: LaKritz, Robb
Subject: News Story

Thursday January 10 12:57 PM ET

White House: Enron Official Phoned

By KAREN GULLO, Associated Press Writer

WASHINGTON (AP) - Enron Chairman Kenneth L. Lay reached out to two of President Bush's Cabinet officers when the energy company was collapsing, the White House disclosed Thursday as the Justice Department opened a criminal investigation of Enron's bankruptcy.

Bush, who received significant campaign contributions from Lay and other Enron executives, said he himself has never discussed Enron's financial problems with its embattled corporate chairman. The president said he last saw Lay in Texas at spring fund-raiser for former first lady Barbara Bush's literacy foundation.

Lay also was among a group of some 20 business leaders who came to the White House early in the Bush administration to discuss the state of the economy, Bush said.

Many Enron employees lost their life savings when the company filed for bankruptcy Dec. 2.

"What anybody's going to find out is that this administration will fully investigate issues such as the Enron bankruptcy, to make sure we can learn from the past and make sure workers are protected," Bush said.

But Lay did seek the ear of other top-level administration officials last fall.

According to White House press secretary Ari Fleischer Lay telephoned Treasury Secretary Paul O'Neill amid Enron's collapse "to advise him about his concern about the obligations of Enron and whether they would be able to meet those obligations."

Lay also told O'Neill that Enron "was heading to bankruptcy," Fleischer said.

O'Neill received calls from Lay on Oct. 28 and Nov. 8, said Treasury spokeswoman Michele Davis. It was on Oct. 16 that Enron made its stunning disclosure of a \$638 million third-quarter loss.

In a separate phone call to Commerce Secretary Don Evans, Lay similarly worried that the company might have to default on its obligations. He brought to the secretary's attention "that he was having problems with his bond rating and he was worried about its impact on the energy sector," Fleischer said.

After that conversation, Evans spoke to O'Neill "and they both agreed no action should be taken to intervene with their bond holders," Fleischer said.

The spokesman had said Wednesday he did not know of anyone in the White House who discussed Enron's

financial situation.

Fleischer also brushed aside talk of any conflict in the Justice Department investigation and said there was no reason to turn the probe over to a special counsel.

Lay gave \$25,000 to a leadership committee headed by then-senator and now Attorney General John Ashcroft according to the Center for Public Integrity.

An attorney for Enron welcomed Ashcroft's inquiry, the latest in a series of governmental probes into the company's demise, saying the investigation would "bring light to the facts."

"We want to get to the bottom of this too," said Robert Bennett, a Washington attorney representing the Houston-based company. "A lot of decent and honorable people work at Enron and we should wait until the facts are out."

Bush ordered a separate review Thursday of pension and corporate disclosure rules that could jeopardize workers' savings. "There has been a wave of bankruptcies that have caused many workers to lose their pensions and that is deeply troubling to me," Bush said.

The Justice Department is forming a national task force to look into the company's dealings. The group will be headed by lawyers at the department's criminal division and include prosecutors in Houston, San Francisco, New York and several other cities, said a Justice Department official, speaking on condition of anonymity.

The official declined to say when the investigation began. Enron faces civil investigations by the Labor Department and subpoenas from congressional committees.

All are looking into the energy trading company's collapse, the largest bankruptcy filing in U.S. history.

The failure hit employees and investors hard. Workers were prohibited from selling company stock from their Enron-heavy 401(k) retirement accounts as the company's stock plummeted. Many lost their life's savings.

Enron executives cashed out more than \$1 billion in stock when it was near its peak.

Former Enron chief executive Jeffrey Skilling, who left the helm nearly two months before the company's swift descent, welcomes the investigation, said spokeswoman Judy Leon. Skilling has said he had no idea, despite Enron's falling stock values, that the company was on the brink of failure.

Formed in 1985, Enron had 20,000 employees and was once the world's top buyer and seller of natural gas and the largest electricity marketer in the United States. It also marketed coal, pulp, paper, plastics, metals and fiber-optic bandwidth.

One likely focus of the Justice Department investigation is possible fraud based on Enron's heavy reliance on off-balance-sheet partnerships which took on Enron debt. The partnerships masked Enron's financial problems and left its credit ratings healthy so it could obtain the cash and credit crucial to running its trading business.

The Houston-based company went bankrupt after its credit collapsed and its main rival, Dynegy Inc., backed out of an \$8.4 billion buyout plan late last year.

Just a year ago, stock of Enron, the nation's largest buyer and seller of natural gas, traded at \$85 per share. Today it is less than \$1.

Lay has close ties to Bush and his father, the former president. Lay was a top contributor to the younger Bush's 2000 presidential campaign.

The company played a key role earlier this year when a White House task force met with business executives and other interests to fashion a national energy policy. The task force was headed by Vice President Dick Cheney.

Harvey, Reavie

From: Nancy Lazar [nlazar@isigrp.com]
Sent: Thursday, December 06, 2001 9:06 AM
To: ISI Reader
Subject: ISI Morning Political Report with Audio
Importance: High



12-06mjr.pdf

In today's POLITICAL REPORT:

- * Trade Vote Trending Toward Passage
- * Enron Fallout Continues
- * Administration Opposes Senate Farm Bill
- * Terrorism Insurance Bill Still a Close Call
- * Stimulus Package Update
- * Political Trivia - Age and Politics

Please let us know if you have any questions.

All the best,

Nancy Lazar
212/446-5633

THE WHITE HOUSE COALITION INFORMATION CENTER

1/5-6/2002

A Daily Summary of News, Message and Facts About the War on Terrorism

Weekend Schedule (EST)

Saturday

Prime Minister Blair delivers remarks in Bangalore, India.

President Bush travels to the west coast where he holds a town hall meeting in Ontario, California; tours the Northeast Portland (OR) One-Stop Career Center and Youth Opportunity Center; and delivers remarks to families, workers and business leaders in Portland, OR.

Sunday

9:00a EST Larry Lindsey to appear on *Fox News Sunday*

10:30a EST Secretary O'Neill to appear on *Meet the Press*.

10:30a EST Larry Lindsey to appear on *Face the Nation*.

11:30a EST Secretary Evans to appear on *This Week*.

12:00p EST Secretary Evans to appear on *Late Edition*.

Recent Key Quotes & Developments

- The Wall Street Journal (12/31/01) reported that anti-Taliban forces in Afghanistan confiscated a computer containing, among other things, the elements of a "plan to developed a 'home-brew nerve gas,'" and the text of a letter saying that "hitting the Americans and Jews is a target of great value and has its rewards in this life and, God willing, the afterlife."
- "The first magazine for women in nearly 10 years has hit the shelves of the war-ravaged country. *Seerat* (Attitude) does not look like a standard glossy magazine. [It is] crudely churned out on an old-fashioned printing machine. Three women [journalists] are funding the weekly magazine out of their own pockets. 500 copies of *Seerat*, which costs 2,000 Afghanis (10 cents), are being distributed by its authors to colleges, bookshops and other institutions. All they have asked is that the ministry, which reads it for censorship, does not change any of the articles. 'We are a long way behind the technology that other newspapers have used for a long time. Please send us magazines. Any help and all ideas are welcome,' [say the journalists.]" (AFP, 12/26/01)

Message

Osama bin Laden is a coward who murders innocents, including women and children and Muslims.

We are a long way from finished in Afghanistan. Much difficult and dangerous work is yet to come. Many terrorists are still hiding in heavily fortified bunkers in rugged territory. They are said to be prepared for a long stay underground. But they are in for a sudden change of plans – because one by one, we are going to find them. Piece by piece, we will destroy their network of terror.

The U.S. is leading a global coalition that has made great progress in the war on terrorism:

- **Began to destroy al-Qaeda's grip on Afghanistan by driving the Taliban from power.**
- **Disrupted al-Qaeda's global operations and terrorist financing networks.**
- **Helped the innocent people of Afghanistan recover from the Taliban's reign of terror.**
- **Helped Afghans put aside long-standing differences to form a new interim government that represents all Afghans – including women.**

In Case You Missed It...

- "We've disrupted any number of training camps, and it does take training to become a polished, successful murderer or mass murderer. You just don't walk out of grade school with that kind of knowledge; you need to practice and be taught by experts." (Defense Secretary Donald Rumsfeld, 1/3/02)

Facts of the Day

- The U.S. government has already spent more than \$32 million in fiscal year 2002 to help assist Afghani refugees return to their homes in Afghanistan.
- President Bush's call for American kids to send \$1 to America's Fund for Afghan Children has helped raise nearly \$2 million, which has been spent on hats, socks, coats, tents, school supplies and other important humanitarian items that have been shipped to Afghanistan.

President Bush Pushes Economic Security Agenda to Create Jobs and Opportunity for America's Workers

Today's Presidential Action:

- As his first order of business upon returning to Washington, President Bush today met with his top economic advisors and Federal Reserve Board Chairman Alan Greenspan to discuss the economy and ways to ensure the recovery happens sooner rather than later. The President also announced that he will include his economic security package in the 2003 budget.

Economic Growth Is Needed Now To Help Workers:

- ***The Senate Should Pass An Economic Security Plan Immediately:*** Given the uncertain economic outlook, we need an economic security package to boost growth now and get people back to work. President Bush called on Congress to pass an economic security bill months ago. The House acted quickly but the Senate failed to act, despite support for a bipartisan compromise that a majority of Senators supported. In the meantime, more than 900,000 Americans have lost their jobs. And, without action by the Senate, more than 300,000 workers will not find work this year.
- ***Economic Growth and Job Creation Boost Surpluses -- Not Tax Increases:*** The federal government is not responsible for budget surpluses. America's workers are the engines of economic growth that create surpluses. A strong economy and more jobs – not tax increases – are the keys to improving the daily lives of working families and creating budget surpluses for years to come.

President Bush - Providing Critical Leadership On The Economy:

- ***The President's Tax Relief Plan Will Help End the Recession Quicker:*** The President's tax cut was exactly the right medicine at the right time. It became law in May and workers began receiving checks in late August – pumping \$40 billion back into the economy and supporting consumer spending at a critical time. Had it not been for the September 11th attack, many economists believe our economy would have already recovered.
- ***While Some Blame Tax Cuts for Recession, the Facts Tell a Different Story:*** The recession began in March, two months before the tax cut even became law, and at least seven months before workers started receiving rebate checks. Despite Senator Daschle's claims, it is impossible that tax cuts made the recession worse.
- ***Democrats and Republicans Came Together Because the Tax Cut Was Needed:*** Twelve Senate Democrats and 41 House Democrats voted for the tax cut bill. They knew that cutting taxes was the right thing to do for America's future economic prosperity.

The War and Recession Drained the Budget Surplus:

- While some in Washington have attempted to blame the tax cut for the declining budget surplus, the facts tell a different story:
 - ***The Recession Erased Two-Thirds of the Surplus:*** The recession and declining tax revenues drained roughly two-thirds of the budget surplus between April 2000 and today.
 - ***Homeland Security and War Spending Used 19% of the Surplus:*** Immediately following the terrorist attacks, President Bush and Congress rightly passed significant spending increases for the war against terrorism, homeland security, airline security, and emergency response. This necessary spending accounted for approximately 19% of the surplus.
 - ***The Tax Cut Only Used 15% of the Surplus:*** Despite the claims of some in Washington, the tax cut used less than 15% of the surplus.
- ***The events of September 11 weakened an already slowing economy:***
 - Unemployment rose by almost 1% after September 11.
 - The airport and airline industry was entirely shut down, costing thousands of jobs.
 - The tourism industry was especially hard-hit, costing even more jobs.
 - Wall Street closed for a week, investment dried up, and the markets dropped.
 - Anthrax attacks shut down large portions of commercial mail and shipping industries.
- ***Despite the terrorist attacks and the slowing economy, the budget remains effectively in balance:*** The miniscule shortfall in the budget represents less than 1% of GDP, meaning that the budget is effectively in balance.
- ***While some in Washington use partisan politics as an excuse for inaction, President Bush will continue to work toward a real, effective economic security package for America's workers.***

For more information on the President's initiatives, please visit www.whitehouse.gov

DIVISION ON TAX INCREASES

"Daschle hasn't a leg to stand on, and his election-year opening salvo should be seen for just what it is: partisan politics at its worst."

--Manchester Union Leader Editorial, 1/8/02

Twelve Senate Democrats and 41 House Democrats voted for tax cuts. They knew that cutting taxes was the right thing to do for America's future economic prosperity.

IN THEIR OWN WORDS

Just a few examples of Democrats who disagree with Senator Tom Daschle's economic theory on tax cuts:

Senator John Breaux (D-LA): "I think that the worst thing you can do is increase taxes during a recessionary period. And to go back on that program would, in effect, be a tax increase." (CNN, Novak, Hunt and Shields, 1/6/02)

Senator Dianne Feinstein (D-CA): "Twenty percent of the Democratic Senate caucus voted for the tax cut. Over \$1 trillion dollars of that tax cut has yet not gone into effect. My view is that we ought to stay the course...I think it's good policy to let people keep more of their money." (CNN Late Edition, 1/6/02)

Senator Zell Miller (D-GA), who co-sponsored the tax cut, said Mr. Daschle's comments made neither political nor economic sense. (Washington Times, 1/8/02)

Senator Zell Miller (D-GA): "Maybe it's at a level my brain can't reach. How do you have as one of your highest priorities to re-elect the moderate Democrats from South Dakota, Montana and Missouri on one hand, then on the other hand blame them for voting for a tax cut that he maintains has created this recession? Hello?" (Washington Times, 1/8/02)

A spokesman for Senator Mary L. Landrieu of Louisiana said he "can't imagine that she would advocate delaying or repealing" the tax cut. (Washington Times, 1/8/02)

A spokeswoman for Senator Max Cleland said the Georgia Democrat "is not interested in revisiting the tax cut." (Washington Times, 1/8/02)

Senator Tim Johnson (D-SD), through a spokesperson, said "that he sees no reason to regret his vote for the tax cut."

A spokesman for House Minority Leader Richard A. Gephardt of Missouri, who usually stands shoulder-to-shoulder with Mr. Daschle against the White House on budget questions, said Mr. Gephardt wanted to stay out of the "Washington blame game." (Washington Times, 1/8/02)

Los Angeles Times editorial: "Daschle's charge is at least half-wrong. He also offers no way to fix the situation.

Harvey, Reavie

From: Jude Wanniski [jwanniski@polyconomics.com]
Sent: Wednesday, December 19, 2001 2:21 PM
To: reavie.harvey@do.treas.gov
Subject: client letter

I hope you know that unless there is devaluation, there will be lots and lots of Enrons next year. My guys think Phelps Dodge can't survive unless copper comes back and John Deere is at risk unless demand for industrial equipment comes back. The GAP and K-Mart will not be able to service their debt unless personal incomes rise in nominal terms, as the population is close to running out of credit. The companies are being held up by a Wall Street that believes in a rebound. Argentina is really sad. I see today people are breaking into supermarkets to get food. This is my client letter yesterday... more hopeful than many of our clients who are really grim.... but that's because we think you guys will do a dollar fix.

PS: Did you see there are people on hunger strikes in Turkey, protesting against IMF policies???

December 18, 2001

IS THIS HOLIDAY RALLY FOR REAL?

Probably not. We are most likely seeing just another in a long series of nice little rallies on Wall Street this year, each one pulled apart by the ongoing deflation process. But there are a few encouraging signs, enough to suggest a policy breakthrough perhaps early in 2002 that will give us back a genuine Bull Market. By far the most important was the trip to Japan last week of Deputy Treasury Secretary Ken Dam. He understands the gold issue as well as anyone in the Bush administration, and told the Japanese that if they wish to see the yen weaken against the dollar to deal with their deflation, the U.S. Treasury would not complain on behalf of our manufacturing industries. Presumably the National Association of Manufacturers understands the problems of our automakers and steelmakers have nothing to do with the forex market and will sit still for a slightly weaker yen. The yen immediately softened against the dollar even as the dollar weakened against gold. There are positive signs for equities in both countries, although not yet enough to bank on. We are trying to be of good cheer.

On the dark side, gold at \$280 could mean increased risk of a war with Iraq. While we think it will not come to that, the drumbeat from the GOP's War Party is enough to be discounted a bit in the gold market. Remember gold briefly surged above \$300 after September 11; in 1990, gold shot up to \$425 from \$350 when Iraq invaded Kuwait. But with oil behaving itself at the moment, gold's upward drift also could mean a policy drift toward a higher gold price. Gold, after all, has not moved up as much in other currencies, beyond the 2.5% in dollars and the 3.7% in yen. Our thinking is that if Fed Chairman Alan Greenspan today said his Christmas wish were to have gold at \$325, it would head there lickety-split. He's not going to do that. But if Ken Dam is encouraging Japan to end its yen deflation, can Treasury encouragement to the Fed be far behind? We do know that our deflation story is being taken very seriously in the administration where it had been considered only an oddity earlier in the year.

In my two trips to Washington early this year, as I warned the deflation would slowly overcome interest-rate cuts and tax cuts, my purpose was to put my reputation on the line. I learned long ago that a political establishment is not persuaded by logic or reason, but by accurate predictions of what will happen if they do X or do not do Y. It was greatly encouraging that one of the people I warned in March, syndicated columnist Tony Blankley, on NBC's McLaughlin Group Sunday disputed Larry Kudlow's optimism about a first-quarter recovery by noting Jude Wanniski's correct deflation-related forecasts. Blankley, who had been Newt Gingrich's press secretary, is not associated with me, so his comment may have had the

effect of breaking the ice. Somewhere along the line there must be an open discussion of monetary policy. At the moment there is probably not a single member of Congress who is not asking: The Fed has cut interest rates 11 times this year; what more can it do? That is, it can shift its target from the overnight rate to an explicit dollar devaluation against gold/commodities, or even a policy aimed at keeping the yen from moving much above 130 or 135.

The housing market continues to do well, cutting against the deflation not necessarily because mortgage rates are low. Even after the Fed's 11 cuts in the funds rate, the mortgage rate at 7% is higher than it was at the start of the year. More likely is the fact that a house is much more than a "consumer good," for many people a preferable way of using cash that is otherwise paying almost no interest in a money-market account. You do pay tax on what little interest you earn. And you now not only can deduct your interest and tax charges from gross incomes for tax purposes, but also have been exempted from the first half-million dollars of capital gains, if there are any. It's hard to track down numbers on wage costs of home construction in so many parts of the country, but we would be surprised if they have not fallen in nominal terms in non-union areas.

The statistics that hold back serious consideration of dealing with the deflation -- such as the 0.4% rise in the "core" Consumer Price Index for November -- are not being taken seriously by the top administration economists, which is all to the good. Car prices are part of the jump when everyone knows the sticker price is meaningless with discounts that incorporate zero financing. The book chains are complaining about the high sticker prices of both hardcovers and paperbacks, as publishers try to hold up revenues while sales decline. My wife says she paid \$20 at Costco for the new John Adams biography, which theoretically retails for \$40. We went to see the Harry Potter movie last Monday evening, at \$8.50 a ticket. The theater could seat 300 but there were only four of us there. I recalled that in China last year, where the yuan is pegged to the dollar, movie theaters were empty until the chains decided to cut ticket prices by more than half, at which point they filled to the brim. The Laffer Curve works in a deflationary direction too. If all but five major league baseball teams lost money last year, what happens in 2002?

The problem for all our competitors who are predicting a bigger and better Bull Market next year is this absence of pricing power. If you can't raise prices with volume in decline, you can't pay your debts or your wages and certainly cannot handle your pension liabilities. With investment houses and mutual funds desperately trying to coax cash out of hoards, we see daily forecasts of the Dow Jones Industrials reaching 12,000 or 13,000 a year from now. Those numbers are possible, of course, but only with gold close to \$350. Even at \$300 there would be a deflation drag. For bedtime reading last night, I dipped into the 1934 classic *Prices*, by Warren & Pearson, the fellows who devised the first price indices. In the deflation chapter I found:

"In order to function, an economic society that is based on the private ownership of property must have a reliable medium of exchange. When the medium of exchange rises in value, the chaos that results leads persons to challenge this economic order. The thing that has broken down is not "capitalism," which is another name for private enterprise, but merely the medium of exchange. Capitalism is no more to blame for this than it is to blame for the failure of a bridge to carry a certain load. One of the necessary tools of society has failed. The remedy is to supply a tool that will work. The only tool that will work is a measure of value that will keep the average price of commodities stable."

Not understanding the fiscal causes of the Crash of 1929 and the Great Depression, Warren & Pearson thought gold was the culprit, which is why they decided to construct "scientific" price indices to guide policymakers. They were correct about the absolute need for a capitalist system to have a reliable money, but we have today a system that interprets their price indices as being inflationary when they should be looking at gold. Unless we make more progress in doing so in 2002 than we have in 2001, this holiday rally will be another in a long line of disappointments.

Harvey, Reavie

From: Jude Wanniski [jwanniski@polyconomics.com]
Sent: Saturday, December 01, 2001 9:50 AM
To: Tim.Adams@do.treas.gov
Cc: reavie.harvey@do.treas.gov
Subject: O'NEILL IN CLIENT LETTER

Tim.... I sent this to clients yesterday.

November 30, 2001

ENRON, O'NEILL, IRAQ, and the YIELD CURVE

By Jude Wanniski and Michael T. Darda

ENRON: In case you have not thought about it, Enron is a victim MAINLY of the monetary deflation we have experienced for the last five years. Yes, it has had management problems, but those problems were magnified every step of the way by the convulsions in the global energy markets. If the dollar had been linked to gold at the end of 1996, before it began its decline from the \$380 plateau, oil and natural gas prices would have remained relatively stable, with little temptation for an Enron to play the energy market instead of meeting customer demand.

O'NEILL: The Wall Street Journal takes a cheap shot at Treasury Secretary Paul O'Neill in its lead editorial today, comparing him to former President Bush's budget director Dick Darman. The new editorial-page editor, Paul Gigot, probably wrote the editorial, which complains that O'Neill has not been pushing cuts in marginal income-tax rates hard enough and has been spending too much time talking about "tax relief" for low- and moderate-income workers and accelerated depreciation for business. In 1993, we argued the Clinton income-tax increases on the top rates would not have a terrible effect on the economy because the lower brackets were left alone and so was the capgains tax. Similarly, a lowering of those top rates by a few points would have almost no effect on growth, especially against the drag of the monetary deflation which the Journal editors ignore out of their affection for Alan Greenspan. O'Neill's prescriptions are at least as positive and are politically sound, in that low- and middle-income workers are being crushed by the Greenspan deflation and need relief in paying debts.

IRAQ: The big push by the Republican armchair warriors to take on Baghdad as soon as Osama bin Laden is found and disposed of is going nowhere, thanks to Russian President Vladimir Putin, who we also thank for talking President Bush into hanging on to the ABM treaty. The United Nations did approve extension of the sanctions on Baghdad for another six months, but have eased them somewhat at Putin's urging. More interesting is Bush's willingness to discuss with Putin the possibility of lifting the embargo on Iraq if Saddam Hussein allows inspectors back in to look around for weapons of mass destruction. Iraq has always been willing to do this deal, but if it can be made to look as if he is knuckling under to pressure from George and Vlad, so much the better. On the ABM delay, Putin is not only representing the interests of Russia, I believe, but also the interests of Beijing, which is not a party to the treaty but whose interests are protected by it. Here too, the GOP warriors are being outgunned intellectually by Secretary of State Colin Powell, who is driving them nuts.

IRAN NUKE? All the talk of Russia supplying Iran with materials that could translate into an Iranian nuke fails to note that Iran is signatory to the Non-Proliferation Treaty, which means it must permit inspections in every nook and cranny of its territory if the Vienna-based International Atomic Energy Agency says it has reason to suspect something funny is going on. This new protocol was added after Iraq was forced to admit in 1991 that it had a clandestine nuke program from the time Israel blew up its nuke power plant in 1981. Twice in the last year, the IAEA has asked Iran to let it look at suspicious activities spotted from the sky and both times found

nothing to worry about. It is extremely difficult to actually hide a nuke weapons facility, I'm told, because of the infrastructure involved -- especially the power lines necessary to feed it the huge amounts of electricity needed to run the centrifuges. Thus far, Iran looks innocent. Iraq let the IAEA inspectors into a site in January, where it found nothing untoward. It is now stonewalling the IAEA, which wants to inspect again; The reasoning is not clear, but the protocols do require something more than a fishing license. (JW)

DEFLATION AND THE TREASURY YIELD CURVE: The following is a response to a client inquiry about why the yield curve is so "steep" even though we are ensconced in a monetary deflation with strong dollar demand and falling dollar velocity. We thought it would be instructive to post the reply here, as it bears directly upon recent bond-market activity:

In a monetary deflation, there is a "deflation premium" attached to non-interest bearing debt (liquidity) because it appreciates against real goods. In other words, money demand outstrips money supply causing the purchasing power of the monetary unit to rise in value. Thus, the deflation "premium" and declining velocity. By contrast, the "interest-rate premium" that investors demand to hold 30-year treasuries vs. 2-year treasuries is reflected in the spread between these two instruments. The reason for the wide spread is that the market expects the Fed funds rate to fall to 1.75% in the next month and then begin rising next year -- by more than 175bps according to the eurodollar futures market. We expect this interest-rate risk to be wrung out as expectations of a strong recovery are dashed, which should allow yields to fall further along the entire treasury curve. Just this week, comments from Fed Governor Lawrence Meyer about the need for aggressive rate cutting have pushed expectations for a rate cut on December 11 to more than 90% from below 40% prior to the speech. Of course, there is always devaluation risk at the longer end of the curve. The last two episodes of deflation (1982 and 1985) were ended with the dollar eventually pitching into inflationary territory, a perennial risk in a fiat monetary system. In Japan, where the economy has labored under a decade of monetary deflation, the 2-year JGB note yields 0.15% and the 30-year JGB yields 2.44%, also a wide "positive" spread in an overtly deflationary environment. (MD)

Harvey, Reavie

From: Cetina, Jill
Sent: Wednesday, October 31, 2001 1:02 PM
To: DL_Market Group; Andrew Sacher; ClayLowery; Eric Otto; Griffiths; Hoffman; MegLundsager; Paul Reid; PMalmgren; Wayne
Subject: Oct 31 Noon Report-- A morning of surprises.. betterthan-expected data but the curve flattens

A morning of surprises-- preliminary Q3 GDP and Chicago PMI betterthan-expected; Treasury eliminates the long bond; buybacks as needed going forward
U.S. Markets

Treasuries: Today's advance Q3 GDP data came in somewhat betterthan-expected, contracting 0.4% q/q. At 10 a.m. Treasury announced it would eliminate issuance of 30 year nominal and inflation adjusted bonds and that while buybacks would continue for this year future buybacks would be announced quarterly. The decision caught participants off guard. The bond rallied with the yield falling 29 bps to 4.92% in heavy trading. TIPS also rallied.

However, dealer contacts complained news of the bond's elimination had been leaked citing early morning rumors, tightness of the bond in the repo market yesterday, buying of cash and futures ahead of the official release as well as an early posting of the news on Treasury's website. A few dealers noted rumors had also circulated that Treasury would resume monthly 5-year auctions which was not announced today. Some dealers questioned whether the Administration was trying to flatten the Treasury curve to pass on lower rates to corporates and homeowners to stimulate the economy. Shortdated Treasuries underperformed, as accounts reallocated and bought bonds and on strength in U.S. equities. Anecdotally, some participants noted today's data coupled with lower rates at the bank and increased the likelihood the FOMC would cut by 25 bps next Tuesday, not 50 bps. The 2-10 year and 2-30-year curves are 11 and 23 bps flatter relative to this morning. Canadian long bonds benefitted, with the yield falling 16 bp (JCetina 2-2017)

U.S. equities were mostly higher in active trading, in reaction to today's data. News Treasury was halting sales of long bonds also boosted stocks. Enron rose 14.2% to \$12.75 on talk of a takeover by GE Capital, Berkshire Hathaway or Royal Dutch Petroleum. (JSharer 2-2042)

Global Markets

Fx: The dollar gained following the data, and was also bolstered by strength in equities and Treasury's news about the bond and is currently about 0.5% firmer against most major currencies. This morning's move has pushed the euro and yen to near technically significant levels at \$0.90 and Y122.50, if these levels are broken, further dollar buying could be triggered. (JCetina 2-2017)

Europe: European bourses closed flat to 2.1% higher, with the CAG40 outperforming as a number of firms announced costcutting moves and U.S. equities gained. German bund yields were up 2 to down 9 bps, with 30year bunds outperforming. U.K. gilt yields fell 1 to 6 bps on slumping consumer confidence and expectations for another BOE rate cut. (JSharer 2-2042)

Latin America: Dealers noted this morning continued interest by a large Spanish bank to buy Argentine bonds earlier this morning, triggering further buying by others to cover short

01/14/2002

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positions. However, later in the morning contacts noted rumors Argentina has moved its reserves to the BIS (interpreted as a move to protect Argentine assets from creditors in the event of a default) which has weighed somewhat on Argentine debt. The Argentine 08' bond is currently down 2 points. (JCetina 22017)

Today's Events: Period	Actual Consensus Expectation	Previous
US Q3 GDP, advance q/q	-0.4% q/q -1.0 q/q	0.3%
US Q3 GDP deflator 2.1%	2.1% 1.6%	
Treasury Quarterly Refunding	10 a.m.	
Chicago PMI 46.6	46.2 44.0	

In addition to the PDF version of the report, please find text from today's Quarterly Refunding.

Dam, Ken

From: Congressional Quarterly [midday-owner@cq.com]
Sent: Thursday, April 12, 2001 2:04 PM
To: middayupdate@lists.cq.com
Subject: CQ DAILY MONITOR MIDDAY UPDATE 4-12-01

CQ DAILY MONITOR MIDDAY UPDATE
from Congressional Quarterly - <http://www.CQ.com>
Thursday - April 12, 2001 - 2:00 p.m.

TODAY IN WASHINGTON:

- LEAD STORY: President Bush today ordered into effect the medical privacy rules developed by the Clinton administration, while asking HHS Secretary Tommy G. Thompson to recommend modifications.
- The HOUSE is in recess until 2 p.m., Tuesday, April 24.
- The SENATE is in recess until noon on Monday, April 23.
- President BUSH will make brief remarks at 3:15 p.m. welcoming home the U.S. crew of the spy plane forced to land in China earlier this month.
- In WASHINGTON, the National Committee for Quality Health Care holds its annual meeting.
- The QUOTE OF THE DAY: "We have spent \$125 billion of Title I money over 25 years - money spent on low-income students. And if the truth be told, we have little to show for it. This is not just wasted money, more importantly, it is wasted potential and wasted hope." - President BUSH
- Today's TRIVIA: Rep. Steve Horn, R-Calif., traces his support for federal arts funding to childhood memories of hearing a symphony orchestra play in the high school gym of his small California town, an event financed by the federal Works Progress Administration. (Source: Congressional Quarterly's "Politics in America.")

Edited by Martha Angle and Jack Deutsch

BUSH ORDERS MEDICAL PRIVACY RULES INTO EFFECT:

President Bush surprised health industry lobbyists today by announcing immediate implementation of medical privacy rules giving patients broad control over their records. Hospitals, insurance companies and pharmacists had sought a rewrite of the regulations, which were issued in the last days of the Clinton administration. Critics said rules requiring patient consent forms to release records could slow provider payments and emergency health care. Health and Human Services Secretary Tommy G. Thompson shared their concerns and froze the rules during a 60-day review. He said as recently as Monday that there would be a further "short delay," to assess 24,000 written public comments. HHS will recommend revisions, according to the White House, but the rules will take effect without changes. Anyone selling confidential medical information could face penalties of up to \$250,000 and 10 years in prison. "Patients will have full access to their medical records and more control over how their personal information will be used and disclosed," Bush said.

BUDGET CONFEREES LIKELY TO SPLIT THE DIFFERENCE ON TAX CUTS, KEY AIDE PREDICTS:

Senate and House negotiators will likely split the difference and agree on a budget resolution that will provide \$1.45 trillion for tax cuts over 10 years, the staff director for the Senate Budget Committee predicted today. The House passed a budget resolution (H Con Res 83) earlier this month that gave President Bush his requested \$1.62 trillion tax cut. Last week, the Senate passed its version of the resolution, calling for a \$1.18 trillion tax cut over 10 years and an \$85 billion stimulus package for this year. "I think God invented conference committees to split the difference.

From my perspective that is a very simple \$1.45 trillion," said William Hoagland, staff director for Senate Budget Chairman Pete V. Domenici, R-N.M. "The difference between a \$1.3 trillion, a \$1.6 trillion or \$1.5 trillion [tax break] in a \$300 trillion economy over the next 10 years is so insignificant, it has to be, quite frankly, silly," Hoagland said. He made his comments at a forum at the Brookings Institution.

INDEPENDENT TASK FORCE URGES NEW SUV FUEL-ECONOMY STANDARDS:

An independent energy task force that included a prominent friend of President Bush recommended in a report today that new fuel-economy standards be set for sport utility vehicles and other vehicles to improve energy efficiency. The task force, cosponsored by Rice University's Baker Institute and the Council on Foreign Relations, said "there are many good reasons" to mandate tougher standards as part of a national energy strategy, pointing to the 925,000 barrels of oil per day that would be saved if minimum fuel-mileage standards for SUVs are brought into line with those of automobiles. The task force included a range of Democrats and Republicans, including Enron Corp. Chairman Kenneth Lay, a key fundraiser for Bush. Other task force members said they have discussed their findings with staffers for Vice President Dick Cheney, who is developing an administration energy policy blueprint to be issued later this month or in May.

IOWA REDISTRICTING PLAN WOULD PUT REPS. LEACH AND NUSSLE IN SAME DISTRICT:

Republican Reps. Jim Leach and Jim Nussle would be thrown into the same Iowa congressional district under a redistricting proposal introduced today by the state Legislature's nonpartisan Legislative Service Bureau. The new map puts Leach and Nussle in a reconfigured 1st District, a Democratic-leaning area in eastern Iowa that includes much of Leach's current district. Most of Nussle's 2nd District would become part of a new 3rd District, which scoops up the hometown of Republican Rep. Tom Latham. No incumbent currently lives in the redrawn 5th District, a vast and heavily Republican area in western Iowa that takes in much of Latham's current district. House members are not required to live in their districts. The politically competitive districts of Republican Rep. Greg Ganske, who is running for Senate, and Democratic Rep. Leonard Boswell would become more Democratic under the plan. After three public hearings, the Republican-controlled Legislature will give the plan an up-or-down vote expected at the end of April.

POLLS SHOW MOST IN MISSISSIPPI FAVOR KEEPING CURRENT FLAG:

In a racially divisive referendum being billed as "Dixie's Last Stand," voters in Mississippi seem likely on Tuesday to reject a proposed new flag and keep their current banner, which prominently displays an emblem of the Confederacy. A poll this week commissioned by several Mississippi newspapers and The Associated Press found 66 percent of voters, including 30 percent of blacks, wanted to keep the current flag. Only 22 percent, including just over 50 percent of blacks, favored the new flag. Mississippi's population is about 61 percent white and 36 percent black. Several Southern states have struggled with the Confederate flag issue in recent years. But Mississippi's referendum represents the first time citizens have had a chance to vote on it. Mississippi is the last state that conspicuously displays the Confederate cross on its flag. Many state and business leaders, including Democratic Gov. Ronnie Musgrove, are supporting the new design. The Republican Party is staying neutral.

POLITICAL CLIPPINGS:

The Bergen RECORD reported that former investors in Internet Channel Inc. want to know how Sen. Robert G. Torricelli, D-N.J., was able to sell his shares in the company for at least \$1,001 when they couldn't sell their shares at any price. Dale Leibach, Torricelli's spokesman, has said only that Torricelli lost all but a fraction of his money on the deal.

The Harrisburg PATRIOT NEWS reported that conservatives have begun airing ads in central Pennsylvania and other predominantly Republican parts of the state attacking moderate Republicans opposed to President Bush's

proposed tax cut. The ads, financed by the Club for Growth, accuse tax-cut opponents of "the ultimate act of betrayal."

The Kansas City STAR reported that former EPA Administrator Carol Browner spoke out yesterday for the first time against Bush administration policies. "The breadth and speed of some of their anti-environmental actions has been stunning," said Browner, who led the agency for eight years under President Bill Clinton.

AND FINALLY...

Before Roger Clinton and Billy Carter, there was Randolph Jefferson. A commission of scholars today blamed him, the younger brother of Thomas Jefferson, for fathering children with slave Sally Hemings. The findings resulted from a yearlong study commissioned by a group of Jefferson admirers convinced that the third president's reputation is being besmirched. The report comes more than two years after DNA tests showed that Hemings' youngest son, Eston Hemings, was fathered by a Jefferson male. "The circumstantial case that Eston Hemings was fathered by the president's younger brother is many times stronger than the case against the president himself," according to the commission's 450-page report. The Associated Press reported that a sole dissenter on the 13-member commission contended that Thomas Jefferson most likely fathered children by his slave.

--30--

Managing Editor: Jackie Frank

Senior Editors: Martha Angle, Joyce Barrett, John Bicknell, Jack Deutsch, Val Ellicott, Kathleen Silvassy and Randy Wynn. Reporters: The staff of the CQ Daily Monitor and CQ Weekly. Political Clippings compiled from BNN Frontrunner.

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Langford , William

From: Williams, Suzanne [SuWilliams@FDIC.gov]
Sent: Thursday, January 31, 2002 8:41 AM
To: 'William.Langford@do.treas.gov'
Subject: Delaware corporations

01/31/2002 03:17:01

Enron, Others Found Delaware Inviting for Establishment of Subsidiaries
By Joseph N. DiStefano, The Philadelphia Inquirer Knight Ridder/Tribune
Business News

Jan. 31--To manage its far-flung financial interests, avoid local taxes, and shroud high-stakes deals from investor scrutiny, Enron Corp. organized a sprawling network of 2,000 corporate subsidiaries in 62 countries and 23 U.S. states.

Hundreds of Enron units were set up in offshore tax havens such as the Cayman Islands; others, under the laws of Brazil, England, and other places where Enron did business, according to the bankrupt energy-trading company's annual report.

But the largest number of Enron subsidiaries -- 685, not counting duplicate names -- were set up in Delaware, where the creation and care of corporate entities is big business.

The speed, secrecy, and state tax exemptions offered by Delaware, along with its business-friendly courts, have long enticed everyone from blue-chip corporations to international gangsters. State officials say more than half the Fortune 500 and the companies on the New York Stock Exchange are chartered there, and the General Accounting Office has cited Delaware as a haven for foreign money launderers.

You can start a Delaware company without ever going there. First, pick a Delaware-registered corporation agent. (They advertise in magazines and on the Web.) For just \$85 in fees, you're in business. You don't need to open a bank account; disclose your profits, sales or purpose; or even give your name. Yearly fees of \$50 to Delaware and another \$100 or so to your agent keep you there.

The government agencies investigating Enron, and the outraged investors and ex-employees who are suing the company's former management, have not alleged wrongdoing by the Delawareans who helped Enron set up hundreds of subsidiaries. But Delaware-chartered Enron subsidiaries feature prominently in the massive losses the company reported last fall before filing for bankruptcy Dec. 2.

Those losses included more than \$400 million suffered over the last four years by Enron's Joint Energy Development Investments L.P., a Delaware-chartered business that invested in foreign power plants.

Enron also acknowledged \$1 billion in what it called "equity adjustments" due to prior "accounting errors" that had concealed losses from Raptor L.P., another Enron Delaware partnership, whose investments included New Power Co., an aggressive Enron electricity-sales company that tried to compete with regional power providers such as Philadelphia's Peco Energy.

Delaware is no stranger to notorious companies. A 2000 report on money laundering by the GAO said that Delaware's permissive incorporation rules invited abuse.

"We routinely and legitimately criticize foreign countries that allow the creation of corporations with secret ownership for the purpose of hiding money. Yet, in states in our own country, we are basically doing the same thing," U.S. Sen. Carl I. Levin (D., Mich.) said at that time, citing Delaware's example.

But Delawareans call that attention unfair. "We're victims of our own renown," Richard Geisenberger, head of the state Division of Corporations, said. "There is no state in the country that requires [a company] to disclose" its owners or finances, he added. "Nonpublic companies have very good reasons why they don't want to disclose who the owners of their business are. It's one of the things that makes our economy run well."

Lawrence A. Hamermesh, a professor at the Widener School of Law and a member of Delaware's influential Corporation Law Council, added: "It is only at the

federal level that enforcement and administration [of corporation law] makes any sense."

In all, 525,000 corporations, companies and partnerships are chartered in Delaware, mostly in Wilmington, where businesses outnumber people. Since the early 20th century, giant companies such as General Motors Corp. and Coca-Cola Co. have operated under Delaware charters, although they are based in distant states. The government in Dover relies on corporate fees for 27 percent of its \$2.3 billion in yearly revenue.

Even companies incorporated in other states often set up their subsidiaries in Delaware.

Enron, though based in Texas, is incorporated in Oregon, home of one of its more substantial subsidiaries, Portland General Electric.

The most valuable U.S. company, General Electric Co., is a New York corporation -- but 12 of its 24 major subsidiaries are set up under Delaware law. Comcast Corp., a Pennsylvania corporation with a famously complex legal structure, incorporated two-thirds of its nearly 400 subsidiaries in Delaware.

What's the attraction? "Delaware does not impose its corporate tax on passive income" such as royalties or license fees, enabling corporations to legally avoid paying state income taxes on some of their operations in other states, Hamermesh, the Widener law professor, said.

To qualify for this tax shelter, companies are typically required to open a Delaware office and to hire at least a part-time bookkeeper and receptionist to ensure that the company actually has Delaware operations. Such services can be rented from dozens of companies, from big banks such as Wachovia Corp. and Wilmington Trust Corp., and even from freelance accountants and moonlighting state legislators.

Several Enron subsidiaries share office space in a modern brown-brick two-story building on the edge of Wilmington, nestled between such Delaware landmarks as the Capano family's construction company, a credit-card marketing center, and the ruins of a du Pont family farm.

The building is home to Entity Services Group, which markets itself as a manager of Delaware investment holding companies as a route to "minimization of state and local income taxes" for its corporate clients.

At least four Enron holding companies are based at Entity, on the second floor, past a reception area decorated with Brandywine School prints and dark-stained paneling.

Entity employees, including Entity president Andrew T. Panaccione, a former auditor for Enron's ex-accountant, Arthur Andersen & Co., and Suzanne M. Hay, who manages the Enron subsidiaries' books, set up at least two Enron units last year, according to state corporation records.

How did Entity get Enron's business? Don't ask Hay: Queried about her firm's Enron connection last week, she tried to wrest away a reporter's notebook, then grabbed the front doors and tried to block him from leaving. Other Entity officials did not respond to requests for comment. Nor did Enron officials in Houston.

Langford , William

From: Langford , William
Sent: Wednesday, February 06, 2002 10:29 AM
To: 'Williams, Suzanne'
Subject: RE: Delaware corporations

Thanks for the article. Very interesting.

- W

-----Original Message-----

From: Williams, Suzanne [mailto:SuWilliams@FDIC.gov]
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