TESTIMONY OF CURT N. LAUNER
Senate Committee on Governmental Affairs
Enron Hearings
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Introduction

Good morning, Mr. Chairman. My name is Curt Launer and I am a Managing Director at Credit Suisse First Boston (CSFB)[1] in the Equity Research Group. I head the Global Utilities Research Group of CSFB that comprises 28 professionals, including 14 senior analysts around the world. My specific research coverage is the Natural Gas & Power sector. As a research analyst for the past 18 years, I have followed Enron and its predecessor companies.

My career on "Wall Street" began as a research analyst in 1984 with the firm of LF Rothschild. In 1987, I joined Donaldson Lufkin & Jenrette and was there until its October 2000 merger with CSFB. Prior to 1983, I was in the Energy business as an accountant with Gruss Petroleum and Mobil Oil for three years. I began my career in 1977 as an auditor with Arthur Young & Company following graduation from the State University of New York at Buffalo (B.S. Accounting).

Summary

In discussing the role of an analyst and the Enron situation, I would like to make four main points today.

First, the role of the analyst is to make informed judgments about companies based on publicly available information. We assume such information is complete and truthful. To that end, we depend on senior corporate officials and independent accountants – who are subject to regulatory and professional standards – to ensure the accuracy of public disclosures. We rely on the same public information about a company that is disclosed to individual investors. If that information is inaccurate or incomplete, then no analyst can make sound judgments about a company. Without accurate and complete financial reporting from a company, I simply do not have the proper tools to do my job.

Second, I want to answer an obvious question: whether inaccuracies and lack of information in Enron's financial reporting affected my conclusions and ratings on Enron. The answer is yes. Each day there are new allegations in the media concerning Enron about which I previously was unaware. Examples include the number of off balance sheet partnerships and the magnitude of their debt obligations, Enron's apparent misuse of fair value accounting, and Enron's "Raptor" transactions.

Third, I would like to address any questions regarding the independence of my work. The fact is that my research has no value unless investors believe in the quality of the information provided and the sound analytical framework upon which it is based. I performed my analysis independently and objectively, and I never felt pressure from Enron or any investment banker or other employee of my Firm to reach any conclusions other than my own. Not only have I done my work independently, but, in addition, my Firm has strict rules that prevent me from even having access to the kind of confidential nonpublic information that investment bankers often have. CSFB also has adopted rules banning stock ownership by analysts in the companies we cover. We are firmly committed to taking whatever steps are necessary to protect the integrity of our research.

In this regard I would like to note that my sons were each the beneficial owners of 100 shares of Enron held in trust accounts until these shares were sold in December 2001 to comply with new CSFB rules. My family's only current direct or indirect investments relating to Enron are an $18,000 investment in the NewPower Company, a public retail natural gas and electricity provider in which Enron has an interest, and an Enron bond held by my mother, which is now in default.

Finally, I would like to address certain public policy concerns raised by the Enron situation. While we need to guard against overreaction, I applaud any effort to craft thoughtful responses to improve the overall quality of public company disclosures and restore confidence in our markets.

My Role as an Analyst

CSFB's client base, the group of customers who use my research, is largely comprised of sophisticated, institutional investors. It is not individual retail customers. My clients have their own research staffs that make their own investment decisions. They look to me for quality information and projections. They challenge information and analysis I provide and form their own conclusions.

As a research analyst I am a user of information provided by publicly held companies. My job is to analyze that information, bringing to it my understanding of the industry and my experience in reviewing similar material. I develop an understanding of how a company generates earnings and its performance and potential as compared to others in the industry sector I cover. If the information a company provides is incomplete, incorrect or misleading, my analysis will be undermined.

I begin my job by gathering and reviewing in detail a company's public disclosures. These include annual and quarterly reports on Forms 10K and 10Q. Principal among the things I rely on are the company's audited financials. These are the foundation for my conclusions. I also review the company's press releases and public statements. These steps are only the beginning. I stay informed about industry developments, including market and regulatory issues. I gather information from many sources, including resources in the research area such as strategic analyses, customers of companies I follow, operating managers and suppliers, among others. I also review media coverage.

With this information, I work towards my ultimate goal of estimating a company's future earnings, cash flow, and balance sheet, comparing those estimates to other companies in the Natural Gas & Power sector. The critical step here, starting with the company's certified financial statements, is to build my own model of the company's future financial performance. I compare my projections both to the company's public guidance, and to information about other companies in the same industry. All of this work results in a report, which includes a "recommendation" relative to the current price of the stock.

Independence and Objectivity

To protect the integrity of our research, CSFB consistently and without exception follows "Chinese wall" procedures. These procedures separate me from other areas of CSFB's business, particularly its investment banking arm. To maintain our independence and ensure that our research is not influenced improperly, the research group is not permitted access to files of the investment banking department or other units of the Firm that handle confidential information. Nor can we discuss such information with other employees of the Firm. In addition, the offices and floor space of the research group are separated physically from other CSFB units, and research analysts are not permitted unescorted access to investment banking floors.

If an investment banking team wants my expertise on the industry or the markets, I am (to use the industry's jargon) "brought over the wall" under a set of strict conditions to maintain the independence of our research. In order to bring me over the wall, the banking team must contact the Control Room of the Firm, a unit within the Firm's Legal and Compliance Department that is responsible for compliance review of research, and requests that an analyst be "brought over the wall." Either a member of the banking team or the Control Room contacts a research supervisor and discusses the request to bring an analyst "over the wall." The research supervisor then decides whether it is appropriate for that to occur. When we are "over the wall" we are very carefully limited to the use of previously published research in our comments and other public information.

As I have previously noted, CSFB now bans stock ownership by me and my family in companies I cover. CSFB not only complies with the Securities Industry Association's Best Practices for Security Analysts but also has worked with the SEC, the NYSE, and the NASDR to create new rules for analysts and investment banks, which after months of work were recently announced. These new requirements will mandate disclosure of existing investment banking relationships and ownership in a company by the firm or by analysts if their firms allow analysts to own stock (which CSFB does not).

CSFB takes the rules regarding analyst independence and objectivity seriously and again, I have never been pressured in any manner to alter my research or recommendations by any part of the firm.

Coverage of Enron

In general, I believe that Enron as a company was unique in terms of its complex business model, rapid growth, aggressive accounting and contract valuation, and "dot-com" characteristics. Enron utilized outside financings, outside partnerships, fair-value accounting and other techniques and vehicles. Some companies may use one of these techniques; Enron used all of them in an array of interwoven transactions that were apparently not fully disclosed and that we are just beginning to understand.

It now appears that some critical information on which I relied for my analysis of Enron was inaccurate or incomplete. One example was a disturbing press report after Enron filed for bankruptcy protection. In January 1998, I attended an analyst meeting at Enron along with over 100 analysts. During this meeting we toured a trading floor of Enron Energy Services. In viewing the activity in the trading room, I was impressed at the progress Enron had made in developing this business. It has been alleged that Enron may have "staged" the activity on that trading floor and if these allegations were true, the progress they were making was illusory.

In addition, as has been reported, during the August 15, 2001 analyst conference call following Jeff Skilling's resignation, I specifically asked him whether his departure suggested that there were likely to be future disclosures with respect to Enron's finances. Mr. Skilling responded that there was "nothing to disclose" and that the company was in "great shape."

Another example of the lack of completeness in Enron's disclosures involves the question of how approximately $1.5 billion in cash from ChevronTexaco/Dynegy provided to Enron was used. It does not appear to have gone to its intended purpose of satisfying Enron's pending debt obligations.

Furthermore, Enron never publicly disclosed the alleged use of the Raptor investment vehicles. It now appears that these entities may have engaged in trades with Enron simply to establish artificially higher asset values. If this is true, those trades would have artificially inflated Enron's financial statements.

Had I known of any or all of these items, this information would have significantly affected my analyses and recommendations.

However, in my opinion, much of the public debate surrounding Enron's demise misses crucial points related to the firm's finances, accounting and structure. In general, we should not regard complex financings or off balance sheet financings as problematic in and of themselves – some very sound firms use such mechanisms. Even earnings restatements may not be fatal where the underlying business of the company is sound. Here again, Enron was a different matter: even its restatements appear to have been incomplete and inaccurate, and thus they too exacerbated Enron's downward spiral.

If Enron had taken the appropriate steps, I believe that the company could have survived. A substantial capital infusion, combined with complete disclosure of off balance sheet liabilities and debt levels plus a decision to slow growth could in my opinion have resulted in Enron's survival. These actions may not have restored the share price to historic highs, but the interests of employees, shareholders and communities would have been improved.

Essentially these are the elements that could have been provided by the Dynegy merger.[2] Indeed, it appears that ChevronTexaco and Dynegy had much the same view of Enron as I did. ChevronTexaco was willing to commit $2.5 billion in cash to its view of Enron and Dynegy was willing to issue $8.5 billion worth of additional shares to acquire Enron.

In sum, hindsight allows a view that I, as an analyst, never had. I based my views and ratings on the information that was available at every step of the way.

Policy Implications of Enron Collapse

As an analyst for 18 years, I have watched with interest the policy debates that have taken place over the last two years about disclosure and the role of analysts. It is time to recognize that the corporate disclosure system can be improved.

The goals of "full disclosure" to investors and analysts (immediate, complete and clearly understandable disclosure from all publicly registered companies) and "equal access to information" (providing that information to everyone) are both extremely important. There can, however, be a tension between the two, and, with Enron, the balance has tipped decidedly against "full disclosure."

The Securities and Exchange Commission (SEC) adopted regulation FD in 2000 in order to promote "equal access" by preventing the selective disclosure of information to some individuals, but not the public at large. As laudable as that goal is, the regulation can be used as an excuse by company officials, as it was by Enron, to duck tough questions from analysts and thus, thwart "full disclosure." The point, of course, is that those tough questions should be answered and the answers made available not just to the questioners but also to the public. That is not what always happens. And that is certainly not what happened in the case of Enron.

I am aware that there are many initiatives being currently considered to improve corporate disclosure. The focus of any such changes should be more complete, more timely, and more understandable disclosure. To accomplish these goals, we should consider full disclosure of off-balance sheet financing and related party transactions, more accelerated disclosure of insider transactions and corporate reports, and enhanced disclosure of stock option programs. It should also require greater scrutiny of accountants and other professionals, and additional resources for regulatory agencies like the SEC.

Thank you again for the opportunity to appear today and I will be happy to answer any questions.

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[1] Credit Suisse First Boston (CSFB) is a leading global investment bank serving institutional, corporate, government and individual clients. CSFB's businesses include securities underwriting, sales and trading, investment banking, private equity, financial advisory services, investment research, venture capital, correspondent brokerage services and retail online brokerage services. It operates in over 87 locations across more than 39 countries on 6 continents, and has some 28,000 staff worldwide. The Firm is a business unit of the Zurich based Credit Suisse Group, a leading global financial services company.

[2] CSFB was not involved in the proposed Dynegy merger.