STATEMENT

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HEARING ON
THE ROLE OF THE FINANCIAL INSTITUTIONS IN ENRON'S COLLAPSE

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Enron was the first in the recent wave of corporate scandals and continues to instruct us on what has gone wrong and what needs to be reformed. Earlier this month the Permanent Subcommittee on Investigations released a Subcommittee report on the role of the Board of Directors in the collapse of Enron. It found that the Board had failed in its fiduciary duty to protect Enron shareholders and shares responsibility for Enron's deceptions and bankruptcy. Today we are looking at financial institutions and the role they played in Enron's collapse.

It has become common knowledge that Enron engaged in accounting deceptions to convince investors, lenders, analysts, and the public that the company was in better financial shape than it really was. In examining the role that financial institutions played in Enron's demise, we are focusing on one type of so-called "structured finance" transaction Enron referred to as "prepays" and used to obtain billions of dollars in financing for Enron without showing any additional debt on its books. I think most will conclude after we hear today's testimony that Enron's use of these prepays to disguise debt was an accounting sham, and to carry out the deceptions Enron had the help and knowing assistance of some of the biggest financial institutions in our country -- including JP Morgan Chase and Citigroup. By the way, Enron was not the only company using sham prepays in the way it did. Both Chase and Citicorp have shopped the prepay structures around, and other banks and other companies have engaged in similar transactions.

Prepays, in concept, are simple and legitimate. They are arrangements in which a company is paid in advance to deliver a service or product at a later date. But they didn't stay legitimate with Enron and banks like Chase and Citigroup which together began constructing complex, phony prepays that resulted in Enron obtaining billions of dollars that were in reality undisclosed loans to Enron. There was an appearance of a product to be delivered at a later date, but the reality was different. No product was intended to be delivered; the transaction was in reality a loan; and it was artfully disguised so no loan would appear on Enron's books.

Enron used these so-called prepays to obtain approximately $8 billion in financing over about 6 years. On its financial statements, Enron reported the prepays as energy trading activity instead of debt, giving the false impression that the money from the prepays was part of Enron's ordinary business activities, instead of the loans they really were.

The purpose of all the complexity was to hide a loan, so it wouldn't appear as debt on Enron's books.

This structural deception had a clear purpose. There's a big difference in the financial world between cash that comes from business activity versus cash that comes from a loan, and there is supposed to be a big difference in the accounting treatment. Increased business activity can boost a company's credit rating and stock value. In contrast, greater debt levels can lower a company's credit rating and stock value.

In a few minutes we will hear from the Chief Investigator of the PSI Staff, Robert Roach, who will describe the intricacies of how these phony prepays worked for Enron. We will then hear from two major credit agencies, Moody's and Standard and Poor's, who will testify that despite following Enron quite closely, they were unaware of the extent and nature of Enron's prepays which, had they known of them, would have significantly affected Enron's credit ratings. We will also hear from the former Chief Accountant at the SEC, Lynn Turner, about the shady accounting Enron used to hide the prepay debt and deceptively increase operational cash flow.

Then we will hear from JP Morgan Chase and Citigroup who were the biggest participants in Enron's phony prepay activities. We will hear how the banks arranged for Enron to carry out these so-called prepays by using offshore shell companies the banks controlled, like Mahonia and Delta Energy, which have no employees and no offices, and operate in secrecy jurisdictions that make it tough to uncover or understand their relationships to the banks behind them. We will also hear how the banks acted to limit public disclosure of Enron's prepay obligations.

Central to the issues today is evidence indicating that Chase and Citicorp knew what Enron was doing, assisted Enron in the deceptions, and profited from their actions. Take a look at this chart which contains excerpts taken from internal documents at Enron, its auditor, and Chase and Citibank. Each discusses Enron's so-called prepays.

First is an internal presentation from Enron's own accounting department. It states:

"Why Does Enron Enter into Prepays? Off balance sheet financing (i.e., generate cash without increasing debt load)."

Next is an internal email from Chase which has this to say about Enron's prepays: "Enron loves these deals as they are able to hide funded debt from their equity analysts because they (at the very least) book it as deferred rev[enue] or (better yet) bury it in their trading liabilities."

A Citigroup email makes a similar point: "E[nron] gets money that gives them c[ash]flow but does not show up on books as big D Debt."

Andersen of course knew what was going on. Its internal email states: "Enron is continuing to pursue various structures to get cash in the door without accounting for it as debt."

These are a few of the documents my Subcommittee uncovered that show that the Enron's prepay activity was well-known to its participants, but hidden from everyone else. Each knew that Enron's prepays were designed to manipulate its financial statements, not to achieve business objectives. Each also knew that Enron was booking prepay proceeds as trading activity instead of loans, even though no trade or sale was ever intended. Phony prepays produce misleading financial statements. That's what happened here.

When Enron collapsed and declared bankruptcy on December 2, 2001 , it had about $5 billion in outstanding so called prepays that were virtually unknown to the company's creditors, investors, and business associates. This disguised debt contributed significantly to the Enron meltdown and the huge loss to Enron's shareholder.

Deception piled on deception. There are many who are responsible for the massive loss to people relying on pension funds and stock investments. Today we'll shine the light in an area where complexity had been used to hide the truth. Hopefully we'll cut through the darkness and place appropriate level of responsibility on the banks who participated in these schemes.