STATEMENT OF MERRILL LYNCH & CO., INC.

TO THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
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BACKGROUND

Merrill Lynch strongly believes that our limited dealings with Enron were appropriate and proper based on what we knew at the time. At no time did we engage in transactions that we thought were improper.
We welcome the opportunity to discuss them with you.

At the outset, all of us in this room recognize the enormous harm caused by the collapse of Enron. As Chairman Levin has stated:

- When Enron filed for bankruptcy on December 2, 2001, it was ranked the seventh largest corporation in America.
- In ten months, its stock had plummeted from $80 a share to practically nothing.
- Almost overnight, 20,000 employees lost their jobs and many of them lost their life's savings.

The facts that have now come to light about Enron, however, were not known at the time of the transactions discussed below. All of us now have the benefit of hindsight. Our decisions, however, had to be made based on the facts that we knew at the time.

At the time we conducted business with Enron, it was not the discredited, bankrupt company that it is today. It was, instead, the world's leading integrated electricity and natural gas company — a company of enormous stature and prestige.

In 1999, Enron reported revenues of $40 billion. It was ranked as the most innovative company in the country for ***five straight years*** by the Fortune 500 company CEOs, board members, and senior management who participate in the annual Fortune survey. In addition, it was ranked the top company for "Quality of Management" and the second best company for "Employee Talent." It was the highest rated global energy firm on the list of the "100 Best Companies to Work for in America." It was, literally, the textbook example of a modern American success story.

Moreover, at the time we dealt with Enron it was known to have extensive in-house and outside expertise. Enron's CFO, Andrew Fastow, had been awarded CFO Magazine's "Excellence Award for Capital Structure Management." Its CEO, Jeffrey Skilling, had been a partner at McKinsey & Co., the leading management consulting firm in the world. Enron had one of the most widely respected Boards in the country. Arthur Andersen, with its 85,000 employees and partners worldwide, was viewed throughout the world as a leader among independent auditing firms. Vinson & Elkins, Enron's principal outside counsel, was one of the leading law firms in Texas, where Enron was headquartered. It was well understood that Enron's financing activities were developed and vetted with these experts.

Importantly, Enron and its advisers were considered to be among the most knowledgeable in the world in structured finance transactions, particularly in the asset heavy energy business. All major corporations and their officers continuously work to ensure that they have diversified access to capital. An important component of this process is to maintain liquidity and seek a wide array of funding alternatives. Funding can be obtained through equity or debt financing, private equity investments, preferred equity, loans or structured finance transactions. The types of structured finance transactions will vary by type of client, industry or asset classes, but their common objective is increased liquidity and diversification of funding sources. All would agree that, used appropriately, structured finance transactions are perfectly acceptable.

Our firm dealt with Enron at arms-length, and made business decisions based on the information that was then available. We relied on Enron's accountant's opinions, its Board approvals, its lawyers' opinions, its audit committee oversight, and other governance processes, and felt justified at the time in believing Enron's financial representations. In addition, the transactions were subject to Merrill Lynch's internal approval process, and included review with business, legal, and other personnel who had no personal stake in the outcome. At no time did we engage in transactions that we thought were improper.

MERRILL LYNCH'S RELATIONSHIP WITH ENRON

In terms of fees, Enron was not a large client relationship for Merrill Lynch.

Merrill Lynch is one of the world's largest global diversified financial institutions. We participate in every aspect of investment banking for corporate, institutional, and government clients throughout the world. In 1999 – the time of the transactions at issue – we had net revenues of $22.3 billion and net earnings of $2.7 billion. Our investment banking revenues alone that year were $3.7 billion. Enron was not a significant contributor to Merrill Lynch's revenues or earnings.

Between 1997 and 2001, Enron retained advisors to assist it on 43 completed strategic transactions. These transactions often involved mergers and acquisitions and are among the most profitable transactions for investment banks. Merrill Lynch is one of the leading advisers in the world on such transactions. Yet Enron retained Merrill Lynch to act as an adviser on only one such transaction during the entire five-year period. The total fee on that assignment was $1 million. At least ten other firms performed more advisory assignments for Enron during this period, including two firms that, added together, performed a total of 23 such assignments.

Although Merrill Lynch participated in debt and equity offerings for Enron, the relationship was modest. During these five years, Merrill Lynch's average annual investment banking fees were $3.5 billion while its Enron-related investment banking fees were $8.2 million – only two-tenths of one percent of the total average annual fees.

From time to time, Merrill Lynch also participated in credit lines for Enron. Here too, however, we had a minimal role. We did not participate in most of the credit lines and our commitments represented less than 3% of the few credit lines in which we participated. We were never the lead lender in any loan syndicate. We did not participate in any of the billions of dollars of pre-pay transactions that the Subcommittee has examined.

We discuss below the transactions that the Subcommittee has asked us to address.

BARGE TRANSACTION

At his May 7 testimony, Chairman Levin stated:

> One type of deception Enron used was to report on the company's financial statement the sale of an asset, despite an understanding that Enron would buy it back after the financial statement was filed or despite a hidden guarantee that the entity buying the asset would receive a certain rate of return.

In this regard, questions have been raised whether it was appropriate for Enron to record a December 1999 transaction with Merrill Lynch as a sale. In that transaction, a Merrill Lynch entity – Ebarge, LLC – bought shares of a company that entitled Ebarge to part of the cash flows from the sale of energy to be produced by generators on three barges. Merrill Lynch's investment exposure in the transaction was
$7 million. Merrill Lynch agreed to the transaction largely to build our relationship with Enron, and believed that it was likely, though not certain, that a third party unaffiliated with Enron would soon purchase Merrill Lynch's shares in the company.

Merrill Lynch does not know — even today — whether Enron's accounting treatment for this transaction was correct. We

were not advising Enron on the appropriate accounting treatment for this transaction. In general, when we act as a purchaser or seller, we are not asked for and do not provide advice on the other party's accounting treatment; rather, we expect them and their experts to determine the appropriate accounting treatment. This is market practice and fully in accord with legal standards. Furthermore,

1. There was no understanding by Merrill Lynch that Enron or any entity related to Enron would buy back Merrill Lynch's shares. In fact, Merrill Lynch had a contrary understanding – that an independent third party was likely to buy Merrill Lynch's interest.

2. There was no guarantee, hidden or otherwise, that Merrill Lynch would receive a certain rate of return. The purpose of not including a reference to any guarantee in the written agreement was not to hide it; it was because there was no guarantee and Merrill Lynch was at risk. The written purchase and sale agreement expressly provided that it was the entire agreement of the parties, and that it superseded any other understanding related to the purchase and sale. Had Enron not succeeded in finding a buyer for our interest, our only recourse would have been to try to find a buyer ourselves.

3. We did anticipate that an independent third party (an Asian trading company, which we understood was close to agreeing to the principal terms of a purchase of the shares) would buy Merrill Lynch's interest, but Merrill Lynch knew that it was at risk and knew that it had no remedy if the company failed to go forward and Enron and Merrill Lynch failed to find another purchaser.

4. The transaction was, in fact, a purchase of an equity interest rather than a loan. Merrill Lynch owned the shares, was at risk until it was able to re-sell those shares, and, though it hoped and expected to be able to re-sell those shares at a profit, had no guarantee that would happen.

5. Merrill Lynch played no role whatsoever in determining Enron's accounting for the transaction.

6. Nevertheless, we considered a number of issues presented by the transaction. Consistent with Merrill Lynch's internal procedures, the transaction was considered by a committee of individuals that included credit, legal and other personnel. Merrill Lynch uses these types of committees as a significant internal control. They include people from different areas of the firm who have no personal stake in the proposed transaction and who are expected to consider a wide range of issues potentially raised by a transaction. Before deciding to proceed with this transaction, the committee did what it was supposed to do: it considered the issues (including whether the transaction could be used to manipulate Enron's income statements) and concluded that Merrill Lynch's participation in the transaction was appropriate.

Among the factors considered:

i. Merrill Lynch was, in fact, at risk in the transaction,

ii. Enron's accounting for the transaction had been vetted with and approved by Enron's outside auditors,

iii. Enron and its experts were among the most sophisticated in the world on structured finance, and

iv. The transaction was so small relative to Enron ($40 billion in revenues reported in 1999) that it seemed inconceivable that the transaction could be used to manipulate Enron's income statements.

The Subcommittee may ask why the Asian trading company never purchased Merrill Lynch's interest and why LJM2 eventually did purchase Merrill Lynch's interest at the price it paid. We do not know the answer. Enron told Merrill Lynch in December 1999 that 1) it expected the Asian trading company to buy Merrill Lynch's shares within a relatively

short time, 2) Enron was close to an agreement with that company on the terms of the purchase, 3) Enron could not guarantee this result (obviously, with good reason, since the Asian trading company ultimately decided not to buy the shares), and 4) if the company elected not to purchase Merrill Lynch's interest then Enron would use its resources to try to find another purchaser.
The only people who can explain why the Asian trading company elected not to go forward and why LJM2 ultimately purchased those shares at the price it paid are the people at those entities who made the decisions.

LJM2

The Subcommittee has asked Merrill Lynch to discuss its role in LJM2.

LJM2 was organized by Mr. Fastow with the approval of Enron and its Board of Directors. Its express purpose was to make privately negotiated investments in energy and communications related businesses or assets – principally those owned or identified by Enron. It followed the structure of LJM1, which was developed by Enron and its experts, not Merrill Lynch.

Merrill Lynch acted as private placement agent for LJM2 between September 1999 and April 2000 and, in that capacity, helped introduce sophisticated investors to LJM2. These investors contributed approximately $265 million of the $390 million that was raised for LJM2. For these efforts, Merrill Lynch received just over $3 million in fees. Merrill Lynch itself invested $5 million in and committed to lend up to $10 million — out of a total commitment by all lenders of $120 million — to LJM2. It is not unusual for placement agents to invest in private partnerships for which they are acting and in this partnership other major investment banking houses made similar or larger investments. Ninety-six Merrill Lynch employees invested approximately $16.6 million in LJM2 through an investment fund. All such transactions were conducted only after appropriate review in accordance with Merrill Lynch's applicable policies and procedures. To date, the investors in LJM2 (including Merrill Lynch and its employees) have not received and may not ever receive the full amount of their investment, much less a significant return on their investment.

Following Enron's collapse questions have arisen about the role played by Mr. Fastow as the managing member of LJM2's general partner. Of course, Merrill Lynch did not choose that role for Mr. Fastow. We did, however, receive assurances that Enron's Board and senior management had considered Mr. Fastow's role and had implemented a number of significant internal controls designed to protect Enron's interests (for example, requiring Enron's Chief Accounting Officer to review each transaction). We also knew that Enron's Board had vetted the issue internally with its own lawyers. The conflicts were disclosed not only to LJM2 investors but to Enron investors as well.

RESEARCH COVERAGE

The Subcommittee has asked about an Enron complaint in April 1998 concerning Merrill Lynch's research coverage of Enron and whether, as a result, Merrill Lynch's research rating was compromised.

The facts are:

- In April 1998, an internal memorandum to Merrill Lynch's then-president, Herb Allison, indicated that Enron was not going to invite Merrill Lynch to participate in an underwriting of Enron's common stock because Enron was disappointed with our research coverage. The memorandum asked Mr. Allison to place a call to Enron executives for the purpose of reconsidering their decision, citing our longstanding relationship with the company and leadership position in the natural gas industry.
- We understand that such a call was made and ultimately Merrill Lynch participated as a co-manager in the transaction, which occurred in May 1998.
- At no time was Merrill Lynch's research compromised. In fact, our analyst retained his intermediate Neutral rating

throughout the time in question. His Neutral rating extended from at least July 1997 through August 1998, when he left the Firm.

- In October 1998, after he joined his new firm, our former analyst initiated his Enron coverage with a rating of Accumulate.
- In November 1998, the Merrill Lynch analyst who assumed coverage of Enron, along with continuing his coverage of a related sector, also initiated coverage with a rating of Accumulate.
- In 2001, our analyst was one of the first to downgrade Enron.

PARTICIPATION IN LOAN FACILITY FOR ZEPHYRUS

Finally, the Subcommittee has also asked about Merrill Lynch's participation in a loan syndication for Zephyrus, an Enron-related entity. The facts with regard to Zephyrus are:

- On November 28, 2000, J.P. Morgan Chase, Bank of America, N.A., BNP Paribas and Fleet National Bank provided Zephyrus with a $482 million five-year senior secured loan.
- In April 2001, Merrill Lynch agreed to commit up to $40 million of the $482 million facility; we are currently owed $22.5 million.
- This commitment was approved in the ordinary course pursuant to the firm's applicable policies and procedures for such commitments.

CONCLUSION

We thank the members of the Subcommittee for this opportunity to come before you today and present information that may be helpful in your investigation into Enron's collapse. We fully support your efforts and want to assist in restoring investor confidence in our capital markets. Merrill Lynch intends to be an industry leader in helping to ensure that America's capital markets are governed by the highest ethical standards.

Had we known at the time what we know today, we would not have conducted business with Enron. Without the benefit of hindsight, however, and based on the information available to us at the time, we strongly believe that our actions were appropriate and proper.