STATEMENT OF
JP MORGAN CHASE & CO.
SUBMITTED TO
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENT AFFAIRS
UNITED STATES SENATE
JULY 23, 2002

Mr. Chairman and Members of the Subcommittee, my name is Jeffrey Dellapina. I am a Managing Director in the Credit and Rates Group of JP Morgan Chase & Co. I am accompanied by my colleagues Don McCree, a Managing Director and Robert Traband, a Vice President. I was involved in the later Enron prepay transactions. Mr. Traband is based in Texas and worked on the Enron account beginning in 1999. Mr. McCree currently serves as senior credit officer for the JP Morgan Chase Bank. He was not involved in the transactions that are being discussed today. He is here because the Subcommittee requested a senior banker who could address broad policy issues.

Overview

JP Morgan Chase & Co. is a holding company. Through our subsidiaries and affiliated companies we offer global financial services, have operations in more than 50 countries and serve more than 30 million consumers and the world's most prominent corporate, institutional and government clients, including over 90 percent of the *Fortune 1000* companies. JP Morgan Chase & Co. and its subsidiaries and affiliated companies employ nearly 100,000 people throughout the United States and worldwide.

Our institution has an established reputation for integrity and we welcome the opportunity to appear today at the invitation of this Subcommittee. In accordance with the Subcommittee's request, this statement will focus on, and provide background information with respect to the prepaid natural gas and oil forward contracts involving JP Morgan Chase and Enron.

At the outset, we wish to emphasize two significant points. *First*, prepaid forward contracts have been used for many years and are widely recognized as an entirely proper tool to enable businesses to increase their liquidity and diversify their sources of funding. *Second*, we do not provide accounting services to our clients. In the U.S. financial system, those are responsibilities that are properly assigned to the client's management, advised by its auditors (both internal and external), guided by generally accepted accounting principles (GAAP).

The Enron Prepaid Forwards

Before we turn to the Enron prepaid forward transactions, we would like to talk generally about corporate finance and prepaid forward commodity contracts in order to place these specific transactions in their proper context.

Importance of Corporate Finance Transactions

Senior financial officers of major corporations are continuously working to ensure that their companies' ongoing access to capital will enable asset growth and business prosperity. This management process includes taking actions to maintain liquidity and diversify the corporations' sources of funds. In support of these important objectives, lawyers, accountants, commercial bankers and investment bankers all work with clients to structure financial transactions that have favorable characteristics, within the parameters of existing accounting, tax and legal requirements.

Financing can be obtained in a multitude of ways, including, for example, common equity, preferred stocks, loans, commercial paper and other debt securities and, in the case of financial trading firms, repurchase and forward agreements. There are other forms of transactions that are designed to meet particular financing needs, commonly referred to as "structured finance" transactions. The structured finance market is very large and is participated in by the world's major financial firms. Examples of structured finance transactions include collateralized debt obligations (such as mortgage-backed securities and credit card securitizations), debt-equity hybrid securities, leases of all varieties, convertible bonds and convertible preferred stock.

Prepaid forward commodity transactions are also a form of structured finance. In "forward" commodity transactions, which are common in many industries, the parties enter into a contract for future performance tied to a commodity. A "prepaid forward" provides for payment to be made at the inception of the contract.

The specifics of structured finance transactions may differ significantly from client to client as we and other financial firms participate in transactions to meet the specific needs of each client. What these transactions have in common is increased liquidity and the diversification of funding sources. Diversification of funding sources is a matter of prudence. Throughout recent history, there have been numerous events that have had an adverse impact on the ability to access one or more funding sources and on the cost of doing so. Diversifying sources of financing mitigates a corporation's exposure to such events and enables it to maintain and expand its core business.

Description of the Enron Transactions

In 1992, Enron approached The Chase Manhattan Bank ("Chase"), one of the four predecessor banks that have now all been merged into JP Morgan Chase, with a request that it enter into a prepaid forward transaction. At that time, there was some uncertainty as to whether Chase, as a national bank, was authorized to accept physical delivery of a commodity. Therefore, the 1992 transaction was accomplished by having a special purpose entity, or SPE, take delivery of the commodity. SPEs are companies that are established for a particular purpose. They are widely used in structured finance transactions.

From 1994 through 2001, Enron entered into a total of 10 more prepaid transactions involving Chase. Nine of these transactions were with Mahonia Limited and one was with Mahonia Natural Gas Limited, both Jersey Channel Islands SPEs (together, "Mahonia"). All but one of these transactions were "physically settled" transactions, meaning that they were settled with deliveries of gas or oil. The last transaction was "financially settled," meaning no commodity was delivered, although the cash payment was to be determined by the price of natural gas.

Prior to continuing with the chronology, we would like to address Mahonia. Mahonia is beneficially owned by a charitable trust. Neither Chase nor Enron has any ownership interest in Mahonia. No employee or officer of Chase or Enron served as an officer or director or held shares in Mahonia. The directors and officers of Mahonia make the ultimate determination as to whether or not to enter into a transaction. Those directors and officers are neither appointed, nor controlled, by Chase or Enron. The use of entities like Mahonia is standard activity in structured finance.

In the Enron prepaid forwards, the SPE entered into a prepaid forward contract with an Enron subsidiary using funds provided by Chase. The prepaid forward transaction created not only credit risks for Chase, but performance, delivery and commodity risks as well. As mitigants for these risks, the transactions included an Enron Corp. guarantee, a performance letter of credit or a surety bond, and either exchange-traded futures contracts or over-the-counter derivatives contracts with Enron Corp. Although the last prepaid transaction was financially settled, similar risks and mitigants were present in that transaction, the sole difference being that no physical delivery was required. Originally, the commodity purchased from Enron was sold into the broader market. After Chase was capable of taking physical delivery of gas or oil, Chase purchased the commodity from Mahonia, and in turn sold physical gas or oil into the market. Beginning in the late 1990s, Chase entered into contracts to sell its gas or oil positions to Enron, which was by far the largest market participant.

All of the transactions were undertaken at the initiative of Enron. Chase understood that the transactions originally had tax benefits for Enron. Later, Chase learned, Enron no longer received tax benefits from the transactions but chose to continue to engage in prepaid forward transactions for other corporate purposes. Enron management informed Chase that the prepaid forwards served to monetize the unrealized profit in its trading book. Enron also advised Chase that the rating agencies wished to see more cash generated from its growing trading activities.

There have been allegations in the media that the prepaid forward transactions were "disguised debt" or a "disguised loan." The prepaid forwards were undoubtedly financing, as all contracts are that involve prepayment features, but every financing is not a loan. These transactions had different features, benefits and risks than loans.

These prepaid transactions were accounted for on the books of JP Morgan Chase consistent with GAAP. It is our understanding that Enron recorded these transactions on its balance sheet; in other words, they were not "off balance sheet" transactions. As stated earlier, however, the manner in which Enron accounted for these transactions on *its* books of account and in *its* financial statements was a matter for Enron and *its* management and auditors.

Conclusion

As the Subcommittee is aware, JP Morgan Chase was one of several financial firms that provided financial services to Enron. We have been one of the parties substantially harmed by its failure, incurring hundreds of millions of dollars in losses. JP Morgan Chase welcomes this opportunity to answer the Subcommittee's questions today and will continue to cooperate with the Subcommittee's inquiry.