TESTIMONY

STATEMENT OF RALPH G. PELLECCHIA
SUBMITTED TO
THE COMMITTEE ON GOVERNMENTAL AFFAIRS
OF
THE UNITED STATES SENATE
MARCH 20, 2002

Mr. Chairman and Members of the Committee, my name is Ralph Pellecchia and I am a Senior Director in the Global Power Group of Fitch Ratings. I joined Fitch in July 1989 as an analyst in the natural gas and power sector. I have been the lead analyst following Enron at Fitch since May, 1997. At Fitch, I am the primary analyst for 14 companies in the Global Power sector and one of 15 Fitch analysts covering the North American Global Power sector.

Fitch is in the business of publishing independent ratings and credit analysis of companies around the world. I am responsible for coordinating this activity for the companies assigned to me. My work includes regularly visiting the companies I cover, maintaining contacts with the members of the finance staff and other important personnel at those companies and staying current on events affecting the companies and industry that I follow. I also conduct much of the quantitative and qualitative analysis that Fitch uses to assess the credit of the companies we rate in my area.

Finally, my role as the primary analyst is to synthesize the quantitative and qualitative factors and to propose a rating, with the final rating outcome to be determined by a credit committee. The credit committee is comprised of a minimum of five voting members typically specialists from the industry/sector, but frequently includes members from other groups within Fitch.

In my role as a primary analyst, I am guided by procedures and practices followed at Fitch. The ratings process related to Enron was, in all respects, consistent with those procedures and practices.

The assessment process is itself a blend of quantitative and qualitative factors. Quantitative factors that are parts of the rating process include an evaluation of published financial information, supplemental financial information and peer financial performance. Qualitative factors include business fundamentals, competitive position, growth opportunities, the regulatory environment and our view as to the abilities of management.

Our analysis of Enron followed the rating process described above. Over the past several years, because of a significant shift in its business mix and rapid revenue growth, Enron’s reported financial profile (in size alone), as presented in its income statement and balance sheet, changed significantly. Yet, although the market capitalization of Enron increased dramatically over the past several years, the various credit ratios and other factors used by Fitch supported a constant BBB+ rating during the period from 1993 until the fourth quarter of 2001. It should also be noted that of the more than 300 entities rated by our Global Power Group, the senior debt rating of more than 60% of the companies in the sector is above BBB+. BBB+ is in the lowest investment grade category.

In mid-October 2001, Enron released third quarter results that reflected a $618 million third quarter loss, and a $1.2 billion reduction in shareholder equity. Shortly thereafter, adverse press reports appeared, an informal SEC investigation was announced and the CFO was replaced. Following these events, on October 25, 2001 Fitch placed Enron on Rating Watch Negative warning that, "the loss of investor and counterparty confidence, if it continues, would impair Enron's financial flexibility and access to capital markets, therefore, impacting its ability to conduct its business." Eleven days later, on November 5, 2001, Enron's senior debt rating was downgraded to BBB-, the lowest possible investment grade rating, and left on Rating Watch Negative (an indication of the possibility of future downgrades).

On November 8, 2001, Enron restated its earnings for a five-year period, and on November 9, 2001, Enron announced its merger agreement with Dynegy. This announcement caused Fitch to revise the rating watch status to "Evolving." It was Fitch's opinion that Dynegy was a financially viable and knowledgeable purchaser with a sound financial and business profile on a standalone basis supplemented by a strong financial backer and investor through its affiliation with Chevron-Texaco. The merger agreement with Dynegy provided Enron with $1.5 billion in additional cash, which supplied needed liquidity. We also held the opinion that Dynegy, as a direct competitor, was quite familiar with Enron's operations. The Evolving status, however, reflected a high level of execution risk compared with other acquisitions by entities rated higher than the target company. In those cases, Fitch would typically place the target's ratings on Rating Watch Positive. Fitch warned in its commentary accompanying the ratings action of November 9, 2001 that, "If the merger were to terminate, Fitch believes Enron's ability to manage its business would be severely impaired and would expect to downgrade its securities to highly speculative grade. Termination provisions to the merger agreement add an element of uncertainty to completing the merger."

In the three-week period following the merger agreement, Enron disclosed additional liabilities and incurred substantial cash outflows that compromised its financial condition. Fitch commented on these developments on November 21, 2001, stating that in the absence of a merger transaction with Dynegy, Enron's financial condition was "untenable." At the time we published that comment, based on discussions with Enron and Dynegy management, it was our understanding that the parties were committed to the merger, but at revised terms that reduced the value received by Enron shareholders. Based on the inability to execute a revised merger agreement, as well as obtain additional secured bank financing, Enron's ratings were lowered to 'CC' on November 28, 2001, indicating probable default.

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