TESTIMONY

JOINT STATEMENT OF
ROBERT TRABAND, ERIC PEIFFER AND ANDREW FELDSTEIN
ON BEHALF OF
J. P. MORGAN CHASE & CO.
SUBMITTED TO
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
DECEMBER 11, 2002

Mr. Chairman and Members of the Subcommittee, my name is Robert Traband. I am currently a Vice President of J.P. Morgan Chase & Co. (AJPMC@). Through its subsidiaries and affiliated companies, JPMC offers global financial services, has operations in more than 50 countries and employs nearly 100,000 people throughout the United States and worldwide. We serve more than 30 million consumers as well as the world=s most prominent corporate, institutional and governmental clients, including over 90 percent of the *Fortune 1000* companies.

I am based in Houston, Texas and have served in our corporate banking group since 1999. I participated, as a member of a larger JPMC team, in the two JPMC transactions with Enron that we have been advised the Subcommittee is examining today. My principal responsibilities involved evaluating the credit exposure to Enron on each of these transactions.

In accordance with the Subcommittee=s request, I am accompanied today by my colleague Eric Peiffer. Mr. Peiffer is also a Vice President and is based in New York. He joined our interest rate derivatives group in July 2002, after having served in our structured finance group since February 2000. During his tenure with the structured finance group, Mr. Peiffer participated, also as a member of a larger JPMC team, in one of the transactions that the Subcommittee is examining today; specifically, the so-called AFlagstaff@ transaction.

I am also accompanied by my colleague Andrew Feldstein. Mr. Feldstein is a Managing Director of JPMC and is co-head of our Structured Products and Derivatives Marketing Group.

Preliminary Statement

Let me make two important points at the outset, Mr. Chairman. First, while we believe that our participation in the AFishtail@ and AFlagstaff@ transactions was perfectly legal and followed established rules, had we known then what we know now about Enron=s allegedly fraudulent practices, we would not have engaged in these transactions with Enron. We would not have accepted at face value, as we did in 2000 and 2001, Enron=s statements that its requests to structure Fishtail or Flagstaff in particular ways were designed to properly achieve Enron=s desired financial statement treatment of the transactions in accordance with generally accepted accounting principles. In addition, we would have wanted to know more about the aspects of the transactions in which JPMC was not involved. But at the time, JPMCClike many other partiesCdealt with Enron in the belief that it was a respected and creditworthy company and that it was not JPMC=s role to second guess our counterparty=s accounting or other structuring determinations. In the case of Enron, JPMC suffered substantial injury, not only by the loss of hundreds of millions of dollars from its own transactions with Enron, but also to the injury to its reputation from the erroneous suggestions of some that JPMC was Ainvolved@ in Enron=s wrongdoing. For these and many other reasons, we regret that we ever dealt with Enron.

As one of the world=s leading financial institutions, we recognize that it is incumbent upon us to do more than simply express our regret. One of the hallmarks of our leadership is that we learn from prior experiences and thoughtfully adjust our

practices in light of those experiences. In this regard, you will shortly hear from my colleague, Michael Patterson, who will outline the procedures we now have in place to meet the challenges before JPMC now and in the future.

Second, we have cooperated fully and voluntarily with this Subcommittee, as well as the full Committee on Government Affairs, in the year-long investigation of the collapse of Enron. We have presented testimony at two prior public hearings, responded affirmatively to staff requests to conduct numerous interviews of our employees, and provided a broad array of documents.

This cooperation reflects our recognition that Congress has an important responsibility in its duties under Article I of the U.S. Constitution to determine whether, in the public interest, changes in laws or regulations are necessary or appropriate in light of the failure of Enron. Under our system, the judicial branch is properly the exclusive forum within which to determine whether liabilities should be imposed with respect to matters involving Enron, and to adjudicate the rights and responsibilities of private parties that have financial claims with respect to transactions involving Enron; but we recognize that this Subcommittee=s responsibilities in the public policy arena, although different from those of the judiciary, are important as well.

The Enron Transactions

Let me now turn to the specific transactions with respect to which the Subcommittee has requested information from JPMC. Because we have provided the Subcommittee staff with detailed descriptions of each of these transactions, together with supporting documentation, I will not unduly lengthen this statement by repeating those descriptions in their entirety. Nevertheless, we are, in accordance with the Subcommittee=s request, prepared to respond to questions concerning JPMC=s understanding of and participation in these transactions.

The AFishtail@ Transaction

The first of these transactions has been referred to by the Subcommittee and others as AFishtail@. This transaction was a $41.5 million loan commitment extended by JPMC in December 2000 to a special purpose entity named Annapurna LLC (AAnnapurna@) established by Enron. This commitment expired by its terms in June 2001 and was never funded.

More specifically, with the assistance of JPMC, Enron was engaged in an effort to find an equity investor to participate in a joint venture (commonly known as AEnron Networks@) to conduct Enron=s pulp and paper trading business. By December 2000, Enron had engaged in discussions with a number of potential investors, but had not reached agreement with any. Enron informed JPMC that, in anticipation of its ultimate contribution of the existing pulp and paper business to such a joint venture, Enron wanted to deconsolidate its pulp and paper business from the rest of its businesses and that, in consultation with its accounting advisors, had devised a structure to achieve this objective. Enron would contribute its economic interests in the present and future contracts of the pulp and paper business to a newly formed entity (AFishtail@), which would be jointly owned by Enron and Annapurna.

As I have said, JPMC=s participation in this transaction was limited to a six-month commitment to make a bank loan to Annapurna. JPMC had no other involvement in the transaction. The loan to Annapurna could be drawn only to fund Annapurna=s capital contribution to Fishtail. And Annapurna could be called upon to make its capital contribution only if Fishtail sustained losses in excess of $208 million during the six-month commitment period. JPMC was willing to make this commitment because it concluded, as a matter of its credit judgment, that it was remote that Fishtail would sustain losses during the six-month commitment period in an amount large enough to trigger the capital call to Annapurna and hence a drawing of the JPMC loan. This was a reasonable credit decision and it is not at all unusual as banks often make loan commitments with the expectation that they will not be funded. For example,

banks frequently issue standby letters of credit supporting debt issuances by clients. In such cases, it is anticipated that the bank only will be called upon to fund the letter of credit if the client has defaulted on the underlying obligation because of adverse changes in its financial condition (or other factors).

JPMC did not initiate the Fishtail transaction and it did not develop the basic structure. It was merely asked to extend a loan commitment, which it did. It never extended any funds and its commitment terminated after six months. JPMC acted as a lender in this transaction and, consistent with industry practice, it did not make any determination whether completion of the transaction would achieve Enron=s accounting objective, a deconsolidation of Enron=s pulp and paper business. Such determinations were properly for Enron to make, with the advice and assistance of its internal accountants and its external auditors. In December 2000, when the Fishtail transaction was agreed to, JPMC had no reason to believe that any such determinations were not being made by Enron and Arthur Andersen in accordance with generally accepted accounting principles.

There are two final points I would like to make about the Fishtail transaction. First, it appears that Fishtail included a broader set of transactions by Enron to effectuate, not just the deconsolidation of Enron=s pulp and paper trading business, but to recognize income in connection with the sale of those assets. JPMC was not involved in these other transactions and, indeed, was told very little about them by Enron, or anyone else for that matter. Second, while JPMC provided a loan commitment to Annapurna, the equity in that entity was provided by the LJM2 limited partnership. As JPMC has previously disclosed, certain of its affiliated companies B along with many others B had invested at the end of 1999 as limited partners in LJM2, so that JPMC had a small stake in LJM2. JPMC, however, was a passive investor in the LJM2 partnership and played no role in LJM2=s decision to invest in Annapurna.

In view of your decision, Mr. Chairman, to examine transactions used by Enron to achieve accounting objectives for the purpose of enabling the Subcommittee to evaluate the need for changes in laws and regulations, we believe it is appropriate to call to your attention that it is widely acknowledged that our current financial accounting standards consists of a large body of specific Arules@ and that, as a result, the accounting treatment of a particular transaction frequently is a consequence of the form of transaction selected by the parties themselves. Earlier this year, this Subcommittee received testimony from others suggesting that, as a matter of broad public policy, it may be desirable to move to a Aprinciples@ based system of accounting standards. Significantly, in section 108(d) of the Sarbanes-Oxley Act, as enacted in July 2002, Congress directed the Securities and Exchange Commission to conduct a study of such an approach and to provide a report on the results of that study within one year. As the Subcommittee may be aware, a companion private sector initiative was announced by the Financial Accounting Standards Board on October 21, 2002. JPMC believes that these studies represent a constructive public policy response to the Enron collapse.

The AFlagstaff@ Transaction

The Subcommittee has also asked for information concerning JPMC=s understanding of and participation in the ASlapshot@ project, particularly with regard to the AFlagstaff@ transaction. As I will explain in greater detail, ASlapshot@ was the name given by JPMC to a generic form of transaction intended to permit a loan by a U.S. lender to a Canadian borrower to be structured in a manner that would provide advantageous tax treatment to the Canadian borrower under Canadian law. AFlagstaff@ was the name under which a specific transaction with Enron was undertaken in June 2001 to provide long-term refinancing for the acquisition of a Canadian pulp and paper mill (AStadacona@) acquired by a joint venture in which Enron was an equity participant. In short, AFlagstaff== was an actual transaction, but ASlapshot@ was not.

Representatives of JPMC=s Global Structured Finance Group participated, as members of a larger JPMC team, in connection with the Flagstaff transaction, and much of JPMC=s prior internal analysis of the generic Slapshot transaction was performed within that group. As the Subcommittee is aware, the term Astructured finance@ encompasses a wide variety of transactions and instruments designed to help clients achieve their risk management, financing, liquidity and other financial objectives within the framework of applicable legal, regulatory, tax and accounting rules and principles. These transactions and instruments are widely used by governments, corporations, consumers and investors, and virtually every major financial institution has a structured finance group.

Let me emphasize, Mr. Chairman, that JPMC takes very seriously the principle that structured finance transactions must be developed *within* the framework of applicable legal, regulatory, tax and accounting rules and principles. This was true in the case of Slapshot. As the Subcommittee is aware, there are substantial differences in the tax codes of other countries that taxpayers, including both individuals and businesses, may lawfully and properly take advantage of. Such a situation existed under Canadian tax law, but before proposing the transaction to any client, the JPMC structured finance group solicited and received a written opinion of an independent and highly regarded Canadian law firm setting forth the likely tax consequences of that structure under Canadian law. Ultimately, JPMC obtained written opinions from two leading Canadian law firms that the structure, and the Canadian tax benefits it provided, were legal and valid.

As I have indicated, the AFlagstaff@ transaction had its genesis in the planned purchase of the Stadacona Canadian paper mill by CPS, a Canadian corporation owned by a joint venture (ASundance@) between Enron and another party. JPMC did not participate in the formation of the Sundance joint venture. Documents shown to JPMC by the Subcommittee staff during interviews in preparation for this hearing reveal that there were many aspects of the structure and funding of the joint venture that were completely unknown to JPMC. Indeed, at the time of the Flagstaff transaction, JPMC did not even know the identity of Enron=s partner in the joint venture.

JPMC learned of the Stadacona mill acquisition before it was consummated. In January 2001, representatives of JPMC met with Enron to present a proposal under which a group of banks led by JPMC would make loans to finance the acquisition of the mill. During that meeting, JPMC advised Enron that it had concluded, based on the opinion of counsel, that the loan transaction could be structured in a manner that would provide advantageous tax treatment to a Canadian borrower under Canadian law. Enron informed JPMC that it was aware of and had itself already devoted substantial attention to analyzing the same (or a substantially similar) Canadian tax structure.

Enron ultimately selected JPMC to lead the bank group, but opted to have CPS complete the acquisition of the Stadacona mill in March 2001, with a bridge loan of approximately $375 million provided by Enron. At that time, the Stadacona mill, which is located in Quebec City, Canada, was the 11th largest newsprint producer in North America. The Flagstaff transaction was thereafter completed in June 2001 in order to repay the bridge loan and provide the long term debt financing.

At closing, the $375 million loan was funded by JPMC and three other banks in the form of loans to Flagstaff, a wholly-owned subsidiary of JPMC, which then reloaned the funds to the CPS group.

The Flagstaff loan transaction was structured in a manner intended to permit the realization of the Canadian tax benefits by the Canadian borrowers. To the best of JPMC=s knowledge, this structure did not provide otherwise unavailable U.S. tax benefits to any party. We understand that Enron obtained, and relied upon, its own written opinion from Canadian tax counsel that the anticipated Canadian tax benefits could, and should, be realized under the structure.

As the Subcommittee is aware, the Flagstaff structure is highly complex, and among the several transactions that comprised the structure was an intraday loan of approximately $1 billion provided by JPMC to Flagstaff. It also involved two special purpose entities created by Enron or its affiliates. The complexity of the Flagstaff financing and the legal documentation required to implement it were necessitated by Canadian tax considerations and were undertaken in reliance on the opinions of Canadian tax counsel to facilitate realization of the Canadian tax benefits.

As the Subcommittee also is aware, the credit support for the loan was provided by Enron principally through a total return swap (and certain supporting transactions) rather than, as originally contemplated, a guarantee by Enron. This change was specifically requested by Enron. One or more members of the JPMC team understood at the time that a principal reason for Enron=s position in this respect was that Enron had concluded that a guarantee might require consolidation of the entire joint venture, the assets of which included CPS and the Stadacona mill.

JPMC understood that the use of a total return swap to facilitate the continued deconsolidation of the joint venture had been vetted by Enron with its external auditors, Arthur Andersen, and had been approved by them. JPMC did not attempt to Asecond guess@ this accounting judgment. As I have noted earlier, under applicable law and practice, each party is properly responsible to ensure that it correctly accounts for the transactions to which it is a party. At that time, JPMC had no reason to believe that any such determinations were not being made by Enron and its external auditors in accordance with generally accepted accounting principles. Consequently, from JPMC=s standpoint, the issue presented by Enron=s decision not to provide a guarantee was whether the total return swap provided sufficient credit support for the Flagstaff loans that the new arrangement could prudently be accepted by the banks in lieu of a direct Enron guarantee. Ultimately, JPMC and the other members of the bank group each concluded that the total return swap provided adequate credit support.

Conclusion

JPMC was just one of many firms that provided financial services to Enron. JPMC also has been one of the parties most harmed by Enron=s failure. We are prepared to respond to your questions today and will continue to cooperate with the Subcommittee in its consideration of the public policy aspect of Enron=s collapse.

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