# THE FINANCIAL COLLAPSE OF ENRON—Part 4

## HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

## COMMITTEE ON ENERGY AND COMMERCE
## HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MARCH 14, 2002

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# FINANCIAL COLLAPSE OF ENRON CORPORATION, WITH FOCUS ON ENRON'S INSIDE AND OUTSIDE COUNSEL

**THURSDAY, MARCH 14, 2002**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 2322, Rayburn House Office Building, James C. Greenwood (chairman) presiding.

Members present: Representatives Greenwood, Stearns, Burr, Whitfield, Bass, Tauzin (ex officio), Deutsch, Stupak, Strickland, DeGette, and Dingell (ex officio).

Also present: Representatives Markey, Green, and Waxman.

Staff present: Tom Dilenge, majority counsel; Mark Paoletta, majority counsel; Brendan Williams, legislative clerk; Mike Geffroy, majority counsel; Will Carty, legislative clerk; Peter Kielty, legislative clerk; Shannon Vildostegui, majority counsel; David Cavicke, majority counsel; Brian McCullough, majority professional staff; Edith Holleman, minority counsel; Consuela Washington, minority counsel; Chris Knauer, minority investigator; and Jonathan Cordone, minority counsel.

Mr. GREENWOOD. The hearing will come to order.

Witnesses may be seated at the table. Good morning and welcome to the Subcommittee on Oversight and Investigations' ongoing inquiry into the financial collapse of the Enron Corporation.

Today we are going to examine elements of Enron's structure of corporate governance. The words "corporate governance" describe the entire architecture of how a modern corporation is managed on behalf of its investors and stockholders, its customers, and its employees.

This encompasses executives at every level, corporate accounting teams, corporate counsel, senior managers, and the Board of Directors. It also includes the outside expert advice, often consultants, attorneys, and accountants, that senior management, the Board of Directors, or the Audit Committee of the Board retained to provide advice on a wide array of issues. These issues ranged from human resources to tax analyses to producing an audited financial statement.

Up to this point, our work has focused primarily on what went wrong at Enron. Through our work we have been able to cast a considerable amount of light on the people and transactions behind this company's unparalleled failure. As a result of this effort, we have been able to slowly parse the complex of self-dealing transactions that contributed to Enron's dramatic descent into bankruptcy.

We have also acquired a more complete understanding of how these highly irregular transactions were cloaked behind a curtain of nearly impenetrable financial arrangements. We know much more, too, about the individuals who devised and implemented these schemes.

And it becomes increasingly clear that the collapse of Enron, which was greeted with such surprise by investors, shareholders, customers, analysts, and employees alike, was more than mere happenstance. Instead, a complex infrastructure of ill-defined partnerships, hedges, collars, and various other off-the-books transactions were purposefully designed to mislead shareholders about Enron's precarious financial position.

Phantom assets and phantom earnings were created in order to create phantom wealth. Sadly, the investors and employees who risked their fortunes and their futures were very real, and they suffered very real losses.

Among the many mysteries yet surrounding this collapse, one in particular has emerged. What role, whether by omission, commission, did Enron's corporate governance team play in the slide into bankruptcy and the increasing reliance on riskier and riskier transactions to keep Enron afloat?

It is especially important to undertake this examination, since we now know that many of the seeds of this particular financial tragedy were sewn years ago. How is it, then, that the Board of Directors and senior management failed to red flag flagrant issues of conflict of interest and highly questionable transactions behind several key partnerships, such as the Chewco deal and the various LJM associated transactions?

What we have discovered to date amounts to a systemic failure on the part of Enron's legal and accounting personnel, as well as outside counsel and accountants, both to discover these problems and to warn of their dangers. Clearly, no actions were taken to prevent the ensuing disaster.

A few courageous individuals attempted to raise the alarm, but either their warnings came too late or too half-heartedly. Or perhaps the right people didn't hear the alarms.

This disserving situation brings us to the question at hand today. Where were the faithful stewards of Enron? In particular, where were the people whose fiduciary duty it was to guard against hidden dangers and to protect the interests of Enron and its shareholders? Where were the professionals whose job it was to ferret out wrongdoing and guard against malfeasance? What, if any, actions did they either take or recommend to put an end to those irresponsible actions which eventually led to Enron's demise?

This phase of our hearing involves the people who were paid to have known better, and who should have done more, much more, the accountants and lawyers. Next week we will have a chance to hear from the accountants. This morning we have before us the attorneys, Enron's inside and outside counsel.

I look forward to this opportunity to listen to their testimony about a wide array of issues, particularly their actions and advice surrounding the many dubious related party transactions. For example, I'd like to get a clearer understanding of the attorneys' assessments and advice on the thorny ethical problems surrounding the two LJM partnerships which did business with Enron, even though these partnerships created a clear conflict of interest with Enron's former CFO Andy Fastow, who succeeded in having a financial stake on both sides of the transactions.

I would like to know why legal counsel worked so hard to minimize what Mr. Fastow disclosed about his financial arrangements with the partnerships in proxy filings. Was his comfort level about disclosure more compelling than the interests of Enron and its shareholders in ensuring that he wasn't benefiting improperly at their expense?

I would like to learn about the attorney's role and advice in the formation and evidence of the LJM Enron transaction approval process. It was this document that was supposed to manage the inevitable conflicts arising out of such a curious arrangement and ensure the fairness of these transactions to Enron and its shareholders.

Why did it take so long for the lawyers to catch inherent weaknesses in the process? And why weren't these corrected in a timely manner?

I also want to know why no one seemed to be monitoring the actions of senior Enron employees working on behalf of outside interests, and why the LJM2 private placement memorandum, in which Mr. Fastow and other Enron employees were marketing their access to inside information, failed to raise any red flags to those responsible for looking out for Enron's interests?

We are not looking at 1 or 2 missteps here, but a pattern of behavior characterized by neglect and avoidance by Enron's legal advisors. We will also look at the series of decisions and actions following Sherron Watkins' letter to Kenneth Lay. Who made the decision that the investigation of her serious allegations by Enron's outside counsel, Vinson & Elkins, should be so limited, and on whose advice?

We have a lot of ground to cover, so let me thank the witnesses who have come today. You all have been responsive to our requests for interviews, and we appreciate that. We also appreciate that you have come here voluntarily to try to help us understand your role in these matters. We thank you again.

I will now recognize the ranking member, the gentleman from Florida, Mr. Deutsch.

[The prepared statement of Hon. James C. Greenwood follows:]

PREPARED STATEMENT OF HON. JAMES C. GREENWOOD, CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

Good morning, and welcome to the Subcommittee on Oversight and Investigations' ongoing inquiry into the financial collapse of the Enron Corporation. Today, we are going to examine elements of Enron's structure of "Corporate Governance". The words Corporate Governance describe the entire architecture of how a modern corporation is managed *on behalf of its investors and stockholders, its customers and its employees.*

This encompasses executives at every level, corporate accounting teams, corporate counsel, senior managers and the Board of Directors. It also includes the outside expert advice, often consultants, attorneys and accountants, that senior management, the Board of Directors or the Audit Committee of the Board, retain to provide advice on a wide array of issues.These issues range from human resources to tax analyses, to producing an audited financial statement.

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We have also acquired a more complete understanding of how these highly irregular transactions were cloaked behind a curtain of nearly impenetrable financial arrangements. We know much more too about the individuals who devised and implemented these schemes.

And it becomes increasingly clear that the collapse of Enron, which was greeted with such surprise by investors, shareholders, customers, analysts and employees alike, was more than mere happenstance. Instead a complex infrastructure of ill-defined partnerships, hedges, collars, and various other off-the-books transactions were purposefully designed to mislead shareholders about Enron's precarious financial position. Phantom assets and phantom earnings were created out of whole cloth in order to create phantom wealth. Sadly, the investors and employees who risked their fortunes and their futures were very real and they suffered real losses.

Among the many mysteries yet surrounding this collapse, one in particular has emerged. What role, whether by omission or commission, did Enron's corporate governance team play in the slide into bankruptcy and the increasing reliance on riskier and riskier transactions to keep Enron afloat?

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What we have discovered to date amounts to a *systemic* failure on the part of Enron's legal and accounting personnel, as well as outside counsel and accountants, both to discover these problems and to warn of their dangers. Clearly no actions were taken to prevent the ensuing disaster.

A few courageous individuals attempted to raise the alarm, but either their warnings came too late or too half-heartedly. Or perhaps the right people didn't hear the alarm. This disturbing situation brings us to the question at hand today:

Where were the faithful stewards of Enron? In particular, where were the people whose fiduciary duty it was to guard against hidden dangers and to protect the interests of Enron and its shareholders? Where were the professionals whose job it was to ferret out wrongdoing and guard against malfeasance? What, if any actions did they either take or recommend to put and end to those irresponsible actions which eventually led to Enron's crack-up?

This phase of our hearing involves the people who were paid to have known better, and who should have done more . . . much more—the accountants and the lawyers. Next week we'll have a chance to hear from the accountants. This morning, we have before us the attorneys—Enron's inside and outside counsel.

I look forward to this opportunity to listen to their testimony about a wide array of issues, particularly their actions and advice surrounding the many dubious "related party transactions".

For example, I would like to get a clearer understanding of the attorneys' assessment and advice on the thorny ethical problems surrounding the two LJM partnerships, which did business with Enron even though these partnerships created a clear conflict of interest with Enron's former CFO Andy Fastow . . . who succeeded in having a financial stake on both sides of the transactions.

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I also want to know why no one seemed to be monitoring the actions of senior Enron employees working on behalf of outside interests. And why the LJM2 private placement memorandum—in which Mr. Fastow and other Enron employees were marketing their access to insider information—failed to raise any red flags to those responsible for looking out for Enron's interests?

We are not looking at one or two missteps here, but a pattern of behavior characterized by neglect and avoidance by Enron's legal advisors.

We'll also look at the series of decisions and actions following Sherron Watkin's letter to Kenneth Lay. Who made the decision that the investigation of her serious allegations by Enron's outside counsel, Vinson & Elkins, should be so limited? And on whose advice?

We've got a lot of ground to cover. So let me thank the witnesses who have come today. You all have been responsive to our requests for interviews and we appreciate that. We also appreciate that you have come here voluntarily to try to help us understand your role in these matters. Thank you again.

I will now recognize the Ranking Member.

Mr. DEUTSCH. Thank you, Mr. Chairman. And the reason I asked staff to put up this chart is this is a chart that we showed at the hearing with the Enron executives of one of the 4,000 partnerships. And we have looked inside of the partnership at this point in time, and I guess I feel comfortable saying that at least this partnership was illegal, because if we look inside of the partnership it did not have a business purpose.

And we can get into the details at a later date, but my understanding is that at least the structure of the partnership was approved by Mr. Derrick and by Mr. Astin. And I guess in the questioning, I guess I am going to ask you direct questions about if we now know, or at least you can disagree with my assessment, that the partnership itself was a violation of security laws. The structure might not have been, but inside, why did, you know, as attorneys representing a client and representing your company, did we miss that?

And since my understanding is the structure of the partnerships were not that much different, and we know that some—at least several of the others that we have been able to understand and really delve into, also did not have business purposes. Why did that occur?

So I yield back the balance of my time and look forward to questions.

Mr. GREENWOOD. The Chair thanks the gentleman from Florida and recognizes the Chairman of the full committee, the gentleman from Louisiana, Mr. Tauzin.

Chairman TAUZIN. Thank you, Mr. Chairman. And let me commend you again for doing such a thorough job throughout this process, and for the great assistance the minority has provided and partnership in which this investigation has occurred.

This subcommittee's task has been to investigate the reasons behind the sad tale of Enron's collapse, so that the full committee can understand what went wrong, so that our committee and our committees of Congress might address, legislatively if necessary, some of these problems.

Only by accurately identifying the basic problems can we accurately identify an appropriate remedy. I believe we have gone a long way toward this goal, but we have more to learn. And we have been able to begin exploring remedies because of the subcommittee's good and instructive work, and I want to thank you for that.

This morning we turn, of course, to the attorneys in the equation, the people whose duty it was to protect the legal interest of Enron and its shareholders, and I look forward to hearing what they have to say for themselves.

Last month when we had Sherron Watkins before us I pointed out a legal doctrine known as the Doctrine of Last Clear Chance. It holds that basically, even if you are totally in the right on the highway, if you had the last clear chance to avoid a crash, you could be responsible for what happened if you didn't exercise the last clear chance to avoid that accident.

Indeed, Sherron Watkins offered Enron's leadership a last clear chance to avoid the crash, not to avoid a total loss, not to avoid damage, but to avoid potentially a total crash. And what strikes me today about her action as a loyal employee was that Sherron Watkins was not an attorney. She did the right thing, I think, but she did something that was technically not her job, something that might more directly be associated with the legal team, counsel's office. Vinson & Elkins' team was responsible, basically, for helping Enron make the right legal choices.

I think, in some respects, the folks who literally had that responsibility and who could have helped avoid the last clear chance, and, therefore, this accident, are with us today, and we intend to learn as much as we can about what went wrong. Why didn't this team and the counsel's office at Enron see these problems as clearly as a non-attorney, Sherron Watkins, did?

Well, it is clear from my investigations that others in the company, particularly the Board of Directors, either relied upon the supervision of the legal team and the accounting firm, as Mr. Skilling claims to have done, or they are hiding behind that assertion to hide the problems of their own failure to supervise the conduct of some of their employees.

I understand that arrangements of duties and functions among attorneys are complex. I am an attorney myself, and I understand those complexities. Responsibilities, in fact, at Enron were divided, and I know that Enron was a huge and a complicated operation, so I want to hear your sides of the story as carefully as we can, and to understand it as carefully as we can.

But we want to hear about the LJM transactions, the approval processes, which were meant to prevent the CFO from taking advantage of the company and its shareholders. All of these controls the Board told us about, you were asked to examine, when, in fact, Mr. Lay's attention was brought to these problems, and he asked for assistance from his counsel's office and eventually from the legal team who were hired to protect the company.

I want to know why the outside counsel, the duty to make sure these extremely complex transactions would not put Enron at risk, eventually signed off on it and ended up providing legal cover for what would turn out to be a very destructive transaction—set of transactions.

I want to know why when Mr. Lay was advised by Ms. Watkins that the company was about to implode, that individuals had breached their fiduciary duty and were investors, and had breached their ethical duty and were crossing the line by making money from these transactions, and she requested that an outside legal team look at what happened, and she requested that outside auditors look at what happened, why it was that the counsel's office ended up, instead, turning to the same legal team whose duty it had been in the first place to prevent those transactions from endangering the company, turning to them to ask them if it was a good idea to get an outside legal team and then receiving a reply, I suppose that you could sort of guess would be coming, that, no, everything is okay, we don't need a legal team to look over our shoulder and tell us we did a good job or a bad job.

Why, instead, wasn't an outside legal team called in to look at whether or not people had adequately protected the company? And why it was, at that point, that counsel's office said maybe it isn't a good idea to get some outside auditors in and check and see whether the auditors hired by the company had led us astray.

Why, instead, the same legal team is called in to give advice to the president of the company that, no, you don't need anybody else to look at this, everything is okay. It is a pretty serious problem.

Mr. Chairman, I look forward to this hearing and look forward to giving these important witnesses a chance to clarify these questions and to help us understand these complex relationships. I yield back my time.

[The prepared statement of Hon. W.J. "Billy" Tauzin follows:]

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank you Chairman Greenwood. And let me commend you for doing such a thorough job throughout this process. This Subcommittee's task has been to investigate the reasons behind this sad tale of Enron's collapse, so that the Full Committee can understand what went wrong.

Only by accurately identifying the basic problems can we accurately identify an appropriate remedy. And I believe we've gone a long way towards this goal. We have more to learn, but we've been able to begin exploring remedies because of the Subcommittee's good and instructive work, and I thank you for that.

This morning we turn to the attorneys—the people whose duty it was to protect the interests of Enron and its shareholders. I look forward to hearing what they have to say for themselves.

Last month, when we had Sherron Watkins before us, I pointed to a legal doctrine known as the last clear chance; this holds that, basically, even if you're totally in the right on the highway, if you had that last clear chance to avoid a crash, you could be responsible for what happened.

Sherron Watkins offered Enron's leadership that last clear chance to avoid the crash. And what strikes me today about her action as a loyal employee was that Sherron Watkins was not an attorney. She did the right thing, but she did something that was not in her job description, something not directly associated with her function at Enron.

What also strikes me is that some of the people who should have shown Enron leadership the proper course—who could have prevented the crash—are sitting before us today. They could have acted before matters got out of hand. They could have been more skeptical of the proposals and promises of the business teams. They could have looked to learn what was really happening, and warned Enron leadership about what they found. But they didn"t do this. They were not around to provide a last clear chance to save the company.

I think it says something when you have non-attorneys doing what attorneys are supposed to be doing. The attorneys are the people others rely upon to make sure matters are okay, are legal, are not going to put a company at undue risk.

They're the adult supervision. And it's clear from our investigation that others in the company, particularly on the Board of Directors, either relied on this supervision, or—as Mr. Skilling seems to have done—hid behind it to excuse their actions.

Now I understand the arrangements of duties and functions among the attorneys was complex. Responsibilities were divided. I know that Enron was a huge and complicated operation. And so I want to hear their side of the story.

I want to hear from them about the LJM transaction approval process, which was meant to prevent the CFO from taking advantage of the company and its shareholders. I look forward to learning about the attorney reactions to emerging warnings that the process was flawed, that questionable negotiations were taking place, that there were potentially serious problems to investigate.

I want to know why outside counsel, with the duty to make sure extremely complex transactions would not put Enron at risk, saw fit to sign off—providing the legal cover for what would turn out to be very destructive transactions indeed.

We do have a lot to cover this morning, Mr. Chairman. And I too would like to thank the witnesses for coming before us this morning. They've been responsive to our staff's requests and I thank them for their willingness to help us accurately identify the problems here.

I yield back.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes for 3 minutes for an opening statement the gentlelady from—I beg your pardon. The Chair recognizes the ranking member of the full committee, the gentleman from Michigan, Mr. Dingell.

Mr. DINGELL. Mr. Chairman, I thank you for your courtesy. I commend you for these hearings and for the inquiry by this subcommittee into the matters now under consideration.

I want to depart from my prepared statement just to commend my friend, the Chairman, also of the full committee for the courage and the energy which he has brought to the matters before us, and to express to him my respect and affection.

Mr. Chairman, one of the things that struck me as we get deeper and deeper into the Enron investigation is the ability of almost all of the people involved to disclaim knowledge of, or responsibility for, any of the events that caused Enron's collapse.

I remember a case when I was a young lawyer in the Detroit River area. Three ships had collided in a fog in the middle of the Detroit River, and in the case the judge observed that this event could not have occurred because of the testimony of all the witnesses indicated that none of the vessels was within three-quarters of a mile of the point of impact.

The most notable of those proclaiming lack of knowledge and responsibility are Messrs. Skilling, the former president and chief executive officer, and Lay, the chairman of the board. Now, although Mr. Skilling is widely understood to have been the architect of Enron as an asset-lite energy trading company with an increasing off-balance-sheet debt load, he presents himself as the unfortunate, unknowing "victim" of some as-yet-undefined forces of the marketplace.

Mr. Lay, who was CEO during all of Enron's history except the last 6 months when Mr. Skilling held the job, claims that he knew even less. Yet most of these top officers ran a company which numerous former and current employees have described as "crooked," a "pyramid scheme," the home of "house of cards accounting," a place where you "drank the Kool-aid" instead of questioning what was going on, and fed the earnings "monster" with more and more questionable deals.

Moreover, the Board of Directors, from one end to the other, was asleep. For example, they never even bothered to find out how much Andrew Fastow, the company's chief financial officer, was making on his side deals with the company. To this day, neither the Board nor anyone at the top levels of Enron knows exactly how much Mr. Fastow made on those deals. Nor did the Board bother to check if the controls it had ordered to keep these deals above-board were actually being carried out.

Today we are going to hear more disclaimers of responsibility. Today we are going to hear from lawyers who will disclaim with great diligence. Some asked questions, but never followed up, and we will hear from other lawyers who knew of problems but never asked questions. For example, both the in-house and outside lawyers who represented Enron in the related-party transactions involving Mr. Fastow and Mr. Michael Kopper, who worked with Mr. Fastow, will tell us that.

It wasn't their responsibility to make sure that Enron or its accountants knew about the side guarantee with Barclay's Bank that brought down the Jedi-Chewco deal.

It wasn't their responsibility to make sure that Mr. Kopper's interest in Chewco was approved by the Office of the Chairman and known by the Board of Directors, even though these lawyers knew it was a conflict of interest violation.

It wasn't their responsibility to make sure the many deals made between Mr. Fastow's LJM entities and Enron were actually at arm's length and represented a fair deal for Enron in both the short and the long term.

We will hear that most of these lawyers didn't even know what controls were required by the Board of Directors to try and keep related-party deals above-board. They were told that the Board had approved the relationship with Mr. Fastow, and that was enough. Sometimes they even relied on Mr. Fastow himself as justification.

We will hear from lawyers who tried to find out how much Mr. Fastow made so it could be included in Enron's proxy, but when Mr. Fastow refused to tell them, their response was, "Next year we will do it." We will hear that lawyers were not responsible for asking about accounting decisions. We will hear from lawyers who ignored, rationalized, or even discounted problems brought to the company's attention by Sherron Watkins and others.

Maybe the lawyers involved in the Enron mess were simply doing their job. I find this a most troublesome prospect. And I would note that it appears that the legal profession may have changed in the 50 years since I was sworn in to the bar. At that time, we thought that it was the responsibility of the lawyer to serve with the highest integrity and responsibility, to protect the interests of the clients, and to see to it that justice is done.

Until this fiasco, then, I had always thought of lawyers as more than highly paid technicians. In this case, I was apparently wrong. It is very sad, Mr. Chairman.

Thank you.

[The prepared statement of Hon. John D. Dingell follows:]

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Thank you, Mr. Chairman. One of the things that has struck me as we get deeper and deeper into the Enron investigation is the ability of almost all of the people involved to disclaim knowledge of, or responsibility for, any of the events that caused Enron's collapse. The most notable of these are, of course, Jeffrey Skilling, the former president and chief executive officer, and Kenneth Lay, the chairman of the board.

Although Mr. Skilling is widely understood to have been the architect of Enron as an asset-light, energy trading company with an increasing off-balance-sheet debt load, he presents himself as a unknowing "victim" of some as-yet-undefined forces of the marketplace. Mr. Lay, who was CEO for all of Enron's history except the six months when Mr. Skilling held the job, claims to know even less. Yet both of these top officers ran a company which numerous former and current employees have described as "crooked," a "pyramid scheme," the home of "house of cards accounting," a place where you "drank the Kool-aid" instead of questioning what was going on, and fed the earnings "monster" with more and more questionable deals. Moreover, the Board of Directors was asleep. For example, it never even bothered to find out how much Andrew Fastow, the company's chief financial officer, was making on his side deals with the company. To this day, neither

the board nor anyone at the top levels of Enron knows exactly how much Mr. Fastow made on those deals. Nor did the board bother to check if the controls it had ordered to keep these deals above-board were actually being carried out.

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—It wasn't their responsibility to make sure that Enron or its accountants knew about the side guarantee with Barclay's bank that brought down the JEDI-Chewco deal.

—It wasn't their responsibility to make sure that Mr. Kopper's interest in Chewco was approved by the Office of the Chairman and known by the Board of Directors, even though these lawyers knew it was a conflict of interest violation.

—It wasn't their responsibility to make sure the many deals made between Mr. Fastow's LJM entities and Enron were actually at arm's length and represented a fair deal for Enron in both the short and the long term.

We will hear that most of these lawyers didn't even know what controls were required by the Board of Directors to try to keep the related-party deals above-board. They were told that the board had approved the relationship with Mr. Fastow, and that was enough. Sometimes they relied on Mr. Fastow himself as justification.

We will hear from lawyers who tried to find out how much Mr. Fastow made so it could be included in Enron's proxy, but when Mr. Fastow refused to tell them, their response was—"next year we'll do it." We will hear that lawyers were not responsible for asking about accounting decisions. And we will hear from lawyers who ignored, rationalized, or discounted problems brought to the company's attention by Sherron Watkins and others.

Maybe all the lawyers involved in the Enron mess were simply doing their job—a most troublesome prospect. Until this fiasco, I had always thought of lawyers as more than just highly paid technicians. In this case, I apparently was wrong.

Mr. GREENWOOD. The Chair thanks the gentleman from Michigan and recognizes the gentleman from Florida, Mr. Stearns, for 3 minutes.

Mr. STEARNS. Good morning, and thank you, Mr. Chairman, for holding this hearing. And let me again commend the staff for the very significant and competent job they are doing in preparing us and getting the witnesses here.

Mr. Chairman, over the course of the hearings we have had on this, we have learned of Enron's collapse, that it was basically a complete failure and a meltdown of fundamental responsibilities and oversight. We have heard from a number of Enron and Andersen officials and have developed what we think is a very good record of all of these transactions.

LJM, the Raptor, the Chewco, were developed and managed and hidden from scrutiny—this despite the numerous officials pleading the Fifth Amendment here in front of our committee in response to the subcommittee's questioning. So this hearing is very pertinent.

Mr. Chairman, I went on the internet to look up the American Bar Association's website to get and understand its model rules for professional conduct. And it is interesting, the first rule for lawyers under the rules for professional conduct is competence. And, my colleagues, let me just read what it says. "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for preparation."

So, Mr. Chairman, let us look at our hearing in perspective. In fact, let us get to the nitty-gritty. Our witnesses before us today are all attorneys. Their job was to be the legal watchdog for Enron's transaction. From the information we have discovered we are faced with this question: was the failure of oversight and responsibility due to a lack of competence or to a measure of culpability?

Mr. Chairman, Jan Avery was a woman who was an accountant at Enron in 1993. She put herself through college going at night. She didn't have polo shirts on and khakis when she came to work. She came in a suit. In 1993, she was given a thin manilla folder containing three sheets of paper. On one there was a number, $142 million.

This was the routine loss. It was a staggering amount for this company and for this young accountant to understand. So she said, "Where are the books for Enron Oil? How am I supposed to justify $142 million loss for State tax purposes?"

Mr. Chairman, no one could answer her in Enron Company. So I go back. We have lawyers here whose responsibility was to be the watchdog and protect Enron. If this woman accountant at Enron knew in 1993 that there was a problem, surely the people at this front desk should have provided advice that was more competent than this young woman who put herself through night school as an accountant.

So we are here today to find out what happened. And so, Mr. Chairman, I commend you and your staff.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes for 3 minutes for the purpose of an opening statement the gentlelady from Colorado, Ms. DeGette.

Ms. DEGETTE. Thank you, Mr. Chairman. Mr. Chairman, this investigation has really seemed to me like piecing together a big jigsaw puzzle. And we have looked at a number of the pieces of the puzzle so far. We have heard from senior management from Enron of all different flavors. We have heard from the Board of Directors. We have heard from the auditors. We have heard from outside experts. And until today there has been a big piece of that puzzle right in the middle missing, and that is the attorneys who were advising Enron throughout the events that we all know so well at this point.

I am looking forward to hearing what the attorneys have to say today. And, in particular, I am interested in Vinson & Elkins' representation of their client, and, in particular there, I am interested in this preliminary investigation of allegations that Vinson & Elkins did from Sherron Watkins' memo. The reason I am interested in this is I think it is almost a parable for what happened throughout Enron and for what happened from all of the experts that were advising Enron, because Ms. Watkins said in her memo to Mr. Lay, "I am incredibly nervous that we will implode in a wave of accounting scandals. My 8 years of Enron work history will be worth nothing on my resume. The business world will consider the past successes as nothing but an elaborate accounting hoax."

So what does Vinson & Elkins do when Enron asked them to do a so-called independent investigation of these allegations? Vinson & Elkins says, "It was decided that our initial approach would not involve the second-guessing of the accounting advice and treatment provided by Arthur Andersen. There would be no detailed analysis of each and every transaction, and there would be no full-scale discovery-style inquiry."

If the allegation is that there are accounting problems, how on earth can you have any kind of analysis when you don't look at the accounting in coming up with your assessment?

These and many other questions I am sure will be made clear today, Mr. Chairman, and I am looking forward to hearing the testimony.

Thank you, and I yield back the balance of my time.

Mr. GREENWOOD. The Chair thanks the gentlelady and recognizes the gentleman from North Carolina, Mr. Burr, for 3 minutes for an opening statement.

Mr. BURR. Thank you, Mr. Chairman. Let me take this opportunity to thank our witnesses today for their willingness to come in as we continue to peel the layers of the onion back and try to figure out exactly what happened.

Mr. Chairman, let me commend you. The way that you have structured these hearings, the patience that you have shown, rather than to run out and grab headlines, we have tried to put people together that could provide facts. And I want to just turn to some testimony that we are going to hear today from one of the partners at Vinson & Elkins.

And that testimony says the Enron bankruptcy filings—Enron listed more than 400 law firms as having represented them. Clearly, this was not a situation where Enron fell in trouble because they didn't seek or have provided for them enough legal help. Enron's legal affairs were directed by a highly sophisticated inhouse legal department consisting of approximately 250 in-house lawyers. Clearly, they had at their fingertips expertise that most companies don't have.

Enron recruited and employed experienced, highly capable and well qualified attorneys, many of whom had previously practiced in large law firms. There is experience within this company that certainly dispels any belief that maybe they were ill advised.

And it goes on in the testimony to say about the report, specifically, the report that Vinson & Elkins was asked to prepare and to hand over to the company, it says, "The report did conclude that no further investigation was necessary because the appropriate senior-level officers of Enron were fully aware of the primary concerns of Ms. Watkins, that Ms. Watkins wanted Mr. Lay to address, and had, in fact, already addressed them."

Ladies and gentlemen that are here today, let me assure you that we have had some Enron officials who have sat before us and said they didn't know, they can't remember. Today I hope you will help us fill in those blanks of who knew, who should remember, and who was told.

I thank you, Mr. Chairman.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes the gentleman, Mr. Stupak, for 3 minutes for an opening statement.

Mr. STUPAK. Thank you, Mr. Chairman. Over the brief President's Day district work period, I held three town hall meetings in my northern Michigan district, just as I am sure many of my colleagues did. The No. 1 issue I heard about from my constituents was not the current budget proposals, not a desire for tax cuts, not even the war against terrorism, although they are very concerned about it.

The No. 1 issue raised by people in my town hall meetings was the Enron collapse and their passionate desire to see that justice is served.

My district is about as far away as you can get from Houston, Texas, without leaving the continental United States. But constituents seem to feel a bond with the Enron employees and their shareholders.

Mr. Chairman, my constituents, like many of us, are saddened. They are angry, and they are frustrated. They are saddened to see the lives of so many Enron employees shattered. They are angry about the shredding of public trust by all the parties involved in the Enron debacle, and they are frustrated with the fact that many of those who have come before our committee, with maybe the exception of Ms. Watkins, have played dumb and had a memory that has faded away faster than Enron stock has dropped.

Now, I hope that today's panelists will be different. I hope they will answer our questions completely and honestly. I hope they will not have selective memory, and I hope they will provide us with answers.

Mr. Chairman, I yield back the balance of my time.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes the gentleman from New Hampshire, Mr. Bass, for 3 minutes for his opening statement.

Mr. BASS. Thank you, Mr. Chairman. I really do appreciate your holding this hearing. I believe this is either the fourth or fifth hearing we have had on this. My friend from North Carolina said, "I believe it has been thoughtful and pragmatic and informational, helpful for us in understanding what is clearly one of the most complex financial catastrophes in recent U.S. history."

And I also appreciate the opportunity to hear from counsel of various capacities willingly, which is somewhat of a change, and I look forward to your testimony. And of particular interest to me, quite obviously, to other members of the subcommittee, as you have heard, are the views on the expectations of how you define fiduciary duty and conflict of interest.

And I am certain at the end of the day we will have a greater understanding of Enron's related party transactions and other agreements with those who were supposed to be protecting the company's shareholders' interests. But I hope we also have some sense of what these various counselors had in mind when they made decisions to engage in certain behavior and otherwise ignore what may appear to be rather clear rules of ethics and accepted behavior.

Mr. Chairman, I yield back my time, so that we may proceed with the testimony and inquiry.

[Additional statement submitted for the record follows:]

PREPARED STATEMENT OF HON. PAUL E. GILLMOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you Mr. Chairman for your continued efforts in sorting outEnron's financial breakdown. In particular, I welcome this opportunity to seek the viewpoints of the company's in-house and outside counsel. I am hopeful the witnesses today will shed even more light on how an irresponsible corporation misrepresented its financial condition and manipulated all who had an interest in them.

I should also point out that in an effort to further increase corporate accountability and protect shareholders' rights, I recently introduced H.R. 3745, the Corporate Charitable Disclosure Act of 2002. This legislation would require companies to make publicly available each year the total value of contributions made to nonprofit organizations during the previous fiscal year.

Once again I thank the Chairman for my time and look forward to the witnesses' testimony.

Mr. GREENWOOD. The Chair thanks the gentleman for that, and welcomes our witnesses today.

Let me introduce them. They are Scott M. Sefton, Esquire, former General Counsel with Enron Global Finance. Good morning, sir.

Rex Rogers, Esquire, Vice President and Associate General Counsel from Enron Corporation. Good morning, Mr. Rogers.

James V. Derrick, Jr., Esquire, former General Counsel, Enron Corporation. Good morning, Mr. Derrick.

Joseph C. Dilg, Esquire, Managing Partner, Vinson & Elkins. Good morning, sir.

Ronald T. Astin, Esquire, Partner of Vinson & Elkins. Good morning to you.

And Carol L. St. Clair, Esquire, former Assistant General Counsel, ECT Resources Group of Enron Corporation. Good morning, Ms. St. Clair.

You are aware, all of you, that the committee is holding an investigative hearing. And in doing so, we have the practice of taking testimony under oath. Do any of you have objections to giving your testimony under oath? Seeing no such objection, I would also advise you that under the rules of the House and the rules of this committee, you are entitled to be advised by counsel.

Do any of you—during your testimony, do any of you seek to be advised by counsel during your testimony? Seeing that none of you do, in that case, if you would please rise and raise your right hands, I will swear you in.

[Witnesses sworn.]

Mr. GREENWOOD. Okay. You may please be seated. You are now under oath.

And let me begin with Mr. Sefton, and ask you, sir, do you have an opening statement?

**TESTIMONY OF SCOTT M. SEFTON, FORMER GENERAL COUNSEL, ENRON GLOBAL FINANCE, ENRON CORPORATION; REX R. ROGERS, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, ENRON CORPORATION; JAMES V. DERRICK, JR., FORMER GENERAL COUNSEL, ENRON CORPORATION; JOSEPH C. DILG, MANAGING PARTNER, VINSON & ELKINS, L.L.P.; RONALD T. ASTIN, PARTNER, VINSON & ELKINS, L.L.P.; AND CAROL L. ST. CLAIR, FORMER ASSISTANT GENERAL COUNSEL, ECT RESOURCES GROUP, ENRON CORPORATION**

Mr. SEFTON. Yes, I do. Chairman Greenwood——

Mr. GREENWOOD. Would you pull the microphone over to you? It is rather directional. It is the silver one that amplifies your voice, and the closer the better.

Mr. SEFTON. Chairman Greenwood——

Mr. GREENWOOD. You have 5 minutes to give your opening statement.

Mr. SEFTON. [continuing] and members of the subcommittee, good morning. I joined Enron Global Finance in the fall of 1999. I left Enron Global Finance about a year later in early October 2000.

I understand that this subcommittee——

Mr. GREENWOOD. I am sorry to interrupt you, Mr. Sefton. You probably want to pull that microphone—raise it up a little bit. There you go. And get that as close to you as possible. Thank you, sir.

Mr. SEFTON. I understand that this subcommittee would like to discuss with me today certain matters relating to my time in Enron Global Finance. Please note that it has been over a year since I worked at Enron. That as a former employee I do not have access to my own Enron documents, and have not had access since I left the company, and that I have had a limited amount of time to prepare for this hearing.

That said, I look forward to answering your questions today to the best of my ability.

Mr. GREENWOOD. Thank you, Mr. Sefton. We will be mindful of those concerns.

Mr. Rogers, do you have an opening statement, sir?

**TESTIMONY OF REX R. ROGERS**

Mr. ROGERS. I just have a short comment. Good morning, Mr. Chairman.

Mr. GREENWOOD. Good morning, sir.

Mr. ROGERS. I do not have a long prepared statement but want to thank the committee for inviting me here today. For the past 16½ years, I have been employed as an attorney for Enron Corp, currently managing several corporate attorneys in the fields of employment law, environmental law, information and technology, intellectual property, securities, mergers and acquisitions, and general corporate matters. I have neither a background nor expertise in accounting matters.

Over the past several months I have cooperated fully with the Wilmer, Cutler & Pickering attorneys in preparation of the Powers Report, with the FBI who interviewed me on several issues, and with your staff members only a week ago. Now I hope to be able to assist the members in your inquiry of Enron Corp and am prepared to answer any and all of your questions.

Thank you.

[The prepared statement of Rex R. Rogers follows:]

PREPARED STATEMENT OF REX R. ROGERS, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, ENRON CORPORATION

Mr. Chairman: I do not have a prepared statement, but want to thank the Committee for inviting me here today.

For the past sixteen and one-half years I have been employed as an attorney for Enron, now managing several corporate attorneys in the fields of employment law, environmental law, information and technology, intellectual property, securities, mergers and acquisitions, and general corporate matters. I neither have a background nor expertise in accounting matters.

Over the past several months I have cooperated fully with the Wilmer, Cutler & Pickering attorneys in preparation of the Powers Report; with the FBI who interviewed me on several issues; and with your staff members only a week ago. Now I hope to be able to assist the Members in your inquiry of Enron Corp. and am prepared to respond to any questions.

Thank you.

Mr. GREENWOOD. Thank you, Mr. Rogers. We do appreciate your cooperation.

Mr. Derrick, do you have an opening statement, sir?

**TESTIMONY OF JAMES V. DERRICK, JR.**

Mr. DERRICK. Yes, I do, Mr. Chairman.

Mr. GREENWOOD. We can hear you, and, please, you have 5 minutes to make your opening statement, if you choose to.

Mr. DERRICK. Good morning to each of you. I am Jim Derrick, and I, too, am pleased to be here with you today to answer any questions you may have for me.

From the summer of 1991 until March 1 of this year, I had the great privilege of serving as the General Counsel for Enron Corp, and as a member of a legal team of more than 200 women and men for whom I had, and still have, the utmost respect and admiration. I graduated from the University of Texas School of Law in 1970, had the honor of serving as judicial clerk to the Honorable Homer Thornberry of the United States Court of Appeals for the Fifth Judicial Circuit, and then I practiced law at Vinson & Elkins for 20 years until I was requested by Enron Corp, more than a decade ago, to become its General Counsel.

First, I commend you in your efforts to examine the tragedy that has befallen Enron, so that the lessons learned here may help others avoid similar misfortune.

Second, I wish to express my sincerest heartfelt sympathy to those members of the Enron family who have lost their jobs and suffered financially and otherwise, and to their loved ones who have also been affected. I also want to acknowledge with great gratitude the ongoing efforts of the more than 20,000 women and men who are still working at Enron and its affiliated companies.

Finally, while, of course, I can't anticipate all of the questions that you will want to ask me today, I do want to address very briefly the question that some of you have alluded to in previous hearings as to why we did not immediately institute a complete forensic investigation, as contrasted with a preliminary investigation, into the concerns expressed in the letter received by Mr. Kenneth L.

Lay last August, utilizing firms that had no involvement in the transactions in question.

When Mr. Lay received the August letter, we took the concerns expressed in it very seriously. We wanted to ascertain, as promptly as practical, whether the facts contained in the letter warranted a full-scale, forensic-type investigation. Because of the seriousness of the allegations, we believed it best to engage an outside firm to make this determination, rather than to rely on an internal inquiry.

To have turned to firms with no knowledge of these complex transactions would necessarily have required them, we believed, to expend a very significant amount of time getting up to speed before they could provide us with recommendations. We turned, therefore, to Vinson & Elkins, a firm that possessed the institutional knowledge to commence the preliminary investigation quickly, and a firm that is widely regarded as one of the world's very best legal institutions.

Andersen, Enron's independent accounting firm at that time, was widely regarded as one of the world's foremost accounting institutions. That firm, we believed, had knowledge of the transactions and of the company, had repeatedly certified Enron's financial statements, and had represented to the company's Audit and Compliance Committee that it was comfortable with, and had signed off on, the company's financial disclosures.

To have immediately engaged another accounting firm to examine the allegations contained in the August letter, without first doing a preliminary investigation of the substance of the allegations, including Andersen's position on them, would have been seen, we believed, in the context of the matters as they existed back in August, as an extraordinary act.

As we have seen from our experience, when we did turn in October to an accounting firm and a law firm that had had no involvement in the transactions, it required them, despite their good faith Herculean efforts, several months to produce a report, and even now there seem to be a number of issues in respect of which the correct accounting and legal answers to these extraordinarily complex issues remain a matter of judgment.

Of course, had I been blessed with the gift of clairvoyance, had I been permitted to gaze into the future and foresee the events that would unfold in respect of Andersen, I would have advocated the choosing of another path back in August. But that was a gift that I was not given.

The decisions in which I participated had to be, and were, made in the context of the matters as they then existed. They were made in absolute good faith, with the sincere intent of ascertaining by means of a prompt preliminary investigation conducted by a truly world-class law firm, whether a broader investigation, including the engagement of another accounting firm, was warranted.

Members of the committee, I very much appreciate your according me the time to make these remarks, and I look forward to answering the questions you have for me today to the best of my ability and recollection.

Thank you very much.

[The prepared statement of James V. Derrick, Jr. follows:]

PREPARED STATEMENT OF JAMES V. DERRICK, JR., FORMER GENERAL COUNSEL, ENRON CORPORATION

Good morning, Congressmen. I'm Jim Derrick, and I'm pleased to be here to answer the questions you may have for me.

From the summer of 1991 until March 1 of this year, I had the great privilege of serving as the General Counsel of Enron Corp. and as a member of a legal team of more than 200 women and men for whom I had, and still have, the utmost respect and admiration. I graduated from the University of Texas School of Law in 1970, served as judicial clerk to the Honorable Homer Thornberry of the United States Court of Appeals for the Fifth Judicial Circuit, and then practiced law at Vinson & Elkins for 20 years until I was asked by Enron Corp., more than a decade ago, to become its General Counsel.

First, I commend you in your efforts to examine the tragedy that has befallen Enron so that the lessons learned here may help others avoid similar misfortune.

Second, I wish to express my sincerest heartfelt sympathy to those members of the Enron family who have lost their jobs and suffered financially and otherwise, and to their loved ones who have also been affected. I also want to acknowledge with gratitude the ongoing efforts of the more than 20,000 women and men who are still working at Enron and its affiliated companies.

Finally, while I can't anticipate all the questions you will ask today, I do want to address briefly the question that some of you have alluded to in previous hearings as to why we did not immediately institute a complete forensic investigation—as contrasted with a preliminary investigation—into the concerns expressed in the letter received by Mr. Kenneth L. Lay last August, utilizing firms that had no involvement in the transactions in question.

When Mr. Lay received the August letter, we took the concerns expressed in it very seriously. We wanted to ascertain, as promptly as practical, whether the facts contained in the letter warranted a full-scale, forensic-type investigation. Because of the seriousness of the allegations, we believed it best to engage an outside firm to make this determination, rather than to rely on an internal inquiry. To have turned to outside firms with no knowledge of these complex transactions would necessarily have required them, we believed, to expend a very significant amount of time getting up to speed before they could provide us with recommendations. Therefore, we turned to Vinson & Elkins, a firm that possessed the institutional knowledge to commence the preliminary investigation quickly and that is widely regarded as one of the world's very best legal institutions.

Andersen, Enron's independent accounting firm at the time, was widely regarded as one of the world's foremost accounting institutions. The firm, we believed, had knowledge of the transactions and of the company, had repeatedly certified Enron's financial statements, and had represented to the Company's Audit and Compliance Committee that it was comfortable with the Company's financial disclosures. To have immediately engaged another accounting firm to examine the allegations contained in the August letter without first doing a preliminary investigation of the substance of the allegations, including ascertaining Andersen's position on them, I believe would have been seen, in the context of matters as they existed back in August, as an extraordinary act.

As we have seen from our experience, when we did turn in October to an accounting firm and a law firm that had had no involvement in the transactions in question, it required them, despite their good faith Herculean efforts, several months to produce a report, and even now there seem to be a number of issues in respect of which the correct accounting and legal answers to these extraordinarily complex issues remain a matter of judgment.

Of course, had I been blessed with the gift of clairvoyance, had I been permitted to gaze into the future and foresee the events that would unfold in respect of Andersen, I would have advocated the choosing of another path last August. But that was a gift I was not given. The decisions in which I participated had to be, and were, made in the context as matters then existed. They were made in absolute good faith, with the sincere intent of ascertaining by means of a prompt preliminary investigation conducted by a world class law firm whether a broader investigation, including the engagement of another accounting firm, was warranted.

I very much appreciate your according me the time to make these remarks, Congressmen. I am ready to answer your questions to the best of my ability and recollection. Thank you.

Mr. GREENWOOD. Thank you.

Mr. Dilg, do you have an opening statement?

**TESTIMONY OF JOSEPH C. DILG**

Mr. DILG. Yes, sir.

Mr. GREENWOOD. You are recognized for 5 minutes.

Mr. DILG. Good morning, Mr. Chairman, and members of the committee. My name is Joe Dilg. I am the Managing Partner of Vinson & Elkins. My partner, Ron Astin, is here to assist me—to assist the committee in responding to its questions. We decided, to economize on time, that I would give the opening statement on behalf of both of us.

Vinson & Elkins, which was founded in 1917, is now an international law firm. We have offices worldwide with approximately 850 attorneys. Although Mr. Astin and I have each personally worked on many Enron matters, we were directly involved in only part of the firm's work for Enron. We are testifying today only to our own personal knowledge.

Since Enron's bankruptcy, there have been reports and statements that have inaccurately described the role Vinson & Elkins played in the advice we gave to Enron. We look forward to responding to your questions, because we are confident a full exploration of the facts will show that our firm has met all of its professional responsibilities.

First, let me say that the lawyers of Vinson & Elkins are greatly saddened by the financial collapse of Enron. Many outstanding and decent people who worked at Enron and their families have been greatly harmed. Likewise, many Enron investors have unfortunately lost a great deal of money. Many cities like Houston will be harmed by the loss of the very significant business and civic achievements of Enron.

Our work for Enron consisted of a large number of specific projects for which we were selected by the Enron legal department. Enron listed in its bankruptcy filing hundreds of law firms as having represented Enron. Enron was a significant client for many major law firms.

Enron's legal affairs were directed by a highly sophisticated inhouse legal department of approximately 250 lawyers. Enron recruited and employed experienced, highly capable, well qualified attorneys, many of whom had previously practiced in large law firms. Pursuant to Enron corporate policy, Vinson & Elkins, as well as all other outside counsel employed by Enron, were employed by and directed to interface with Enron's legal department, not Enron's executives.

Despite our sadness over the collapse of Enron, we remain proud to have served as Enron's counsel in many matters. Our representation of Enron provided interesting and challenging legal work on highly visible transactions and other matters. It is a pleasure to work with their highly qualified in-house counsel.

In representing Enron, our lawyers worked closely with the world's leading investment banking firms, commercial banks, and other major law firms. We provided Enron with quality legal services, and we did so professionally and ethically.

Much of the committee's attention and the media's coverage of the relationship between Enron and Vinson & Elkins has focused on the preliminary review conducted by Vinson & Elkins into allegations made by an Enron Vice President, Ms. Sherron Watkins. We are pleased to have the opportunity to discuss that matter.

Ms. Watkins indeed raised serious issues. Contrary to some public reports and the implication of previous statements made in hearings conducted by this committee, Vinson & Elkins did not advise Enron that there were no problems. Our written and oral reports pointed out significant issues, including the credit problem in the Raptor vehicles, the aggressiveness of the accounting, conflicts of interest, litigation risks, and the risk of credibility-harming media attention.

The report did conclude that no further investigation was necessary because the appropriate senior-level officers of Enron were, at that time, fully aware of the primary concerns expressed by Ms. Watkins, and, in fact, were taking actions to address them.

Mr. Fastow had already resigned from his position with the LJM partnerships, eliminating the conflict of interest issues raised by Ms. Watkins in her letter, and earlier by Mr. McMahon to Mr. Skilling. Prior to the delivery of our final written report, the company had terminated the Raptor entities, which were the primary focus of Ms. Watkins' concerns. The company reported in its earnings release for the third quarter of 2001 a loss of more than $500 million associated with such termination.

The bankruptcy of Enron in December of 2001, approximately 6 weeks after we delivered our written report, appears to have been due to the convergence in the fall of 2001 of a number of factors, many of which related to investment decisions made years before in current events outside of Enron's control.

No one can deny that the adverse publicity associated with the related party transactions and the accounting errors related to the November restatement announcements contributed to the loss of confidence Enron experienced in the energy trading and financial markets. This confidence was critical to the continued success of Enron's trading operations which accounted for a significant portion of their business.

With regard to the related party transactions, it is important to consider the role of legal counsel. If a transaction is not illegal and has been approved by the appropriate levels of corporation's management, lawyers, whether inside corporate counsel or with an outside firm, may appropriately provide the requisite legal advice and opinions about legal issues relating to the transactions.

In doing so, the lawyers are not approving of the business decisions that were made by their clients. Likewise, lawyers are not passing on the accounting treatment of the transactions.

In conclusion, I want to make it very clear that we are confident that Vinson & Elkins fully met its ethical and professional responsibilities in connection with our representation of Enron. We are pleased to assist in the committee's deliberations and are happy to answer your questions within the constraints of our professional responsibility to our clients.

Thank you very much, Mr. Chairman.

[The prepared statement of Joseph C. Dilg follows:]

PREPARED STATEMENT OF JOSEPH C. DILG, MANAGING PARTNER, VINSON & ELKINS

Good morning Mr. Chairman and members of the Committee. My name is Joe Dilg. I am the Managing Partner of Vinson & Elkins L.L.P. Vinson & Elkins, founded in 1917, is now an international law firm of approximately 850 lawyers. My partner Ron Astin is with me to assist in answering the Committee's questions.

From 1991 until December 2001, I served as the Vinson & Elkins partner primarily responsible for coordinating the firm's relationship with Enron. In this role, I coordinated much of the legal work performed by Vinson & Elkins for Enron through all of our offices. Although Mr. Astin and I each personally worked on many Enron matters, we were directly involved in only part of Vinson & Elkins' work for Enron.

This statement, as well as the testimony that Mr. Astin and I will provide, is based solely upon our individual personal knowledge and best recollection of the events. We cannot purport to know and thus be able to speak to all of the knowledge and information possessed by all lawyers at our firm.

Since Enron's bankruptcy, there have been reports and statements that inaccurately describe the role Vinson & Elkins played and the advice we gave. We look forward to responding to questions as fully as possible because we are confident a full exploration of the facts will show that our firm fully met its professional obligations.

First, let me say that the lawyers of Vinson & Elkins are greatly saddened by the financial collapse of Enron. Many outstanding and decent people who worked at Enron and their families have been greatly harmed. Likewise, many Enron investors have unfortunately lost a great deal of money. Many cities like Houston will be harmed by the loss of the very significant business and civic contributions of Enron and its employees.

Our work for Enron consisted of a large number of specific projects for which we were selected by Enron's legal department. In the Enron bankruptcy filings, Enron listed more than 400 law firms as having represented Enron. Enron was a significant client for a number of major law firms.

Enron's legal affairs were directed by a highly sophisticated in-house legal department consisting of approximately 250 attorneys. Enron recruited and employed experienced, highly capable, and well qualified attorneys, many of whom had previously practiced in large law firms.

Pursuant to Enron corporate policy, Vinson & Elkins and other outside attorneys were employed by and directed to interface with Enron's legal department, not Enron's executives.

Despite our sadness over the collapse of Enron, we remain proud to have served as Enron's counsel in many matters. Our representation of Enron provided interesting and challenging legal work on highly visible matters, and it was a pleasure to work with their very able in-house counsel. In representing Enron, our lawyers worked closely with many of the world's leading investment banking firms, commercial banks, and law firms. We provided Enron with quality legal services, and we fully met our professional and ethical obligations in rendering those services.

Much of the Committee's attention and the media's coverage of the relationship between Enron and Vinson & Elkins has focused on a preliminary review conducted by Vinson & Elkins into allegations made by an Enron Vice President, Ms. Sherron Watkins, in a letter and supplemental materials delivered to Mr. Kenneth Lay in August of 2001. We are pleased to have an opportunity to discuss that matter.

Ms. Watkins raised serious issues. Contrary to some public reports and the implication of some previous statements made in hearings conducted by this Committee, Vinson & Elkins did not advise Enron that there were no problems. Our written report pointed out significant issues, including the credit problem in the Raptor vehicles, the aggressiveness of the accounting, conflicts of interest, litigation risks, and the risk of credibility-harming media attention.

The report did conclude that no further investigation was necessary because the appropriate senior level officers of Enron were fully aware of the primary concerns Ms. Watkins wanted Mr. Lay to address—and had in fact already addressed them. Mr. Fastow had resigned from his position with the LJM partnerships, eliminating the conflict of interest problems raised by Ms. Watkins and earlier by Mr. McMahon. Prior to the delivery of our final written report, the Company terminated the Raptor entities which were the primary focus of Ms. Watkins' concerns. The Company reported in its earnings release for the third quarter of 2001 a loss of more than $500 million attributable to the termination.

The bankruptcy of Enron in December of 2001, approximately six weeks after we delivered our written report, has been the subject of numerous published analyses which have made clear that Enron faced very significant business challenges. Enron had made major and highly publicized investments in the broadband, water, international infrastructure, and retail electric businesses, all of which had resulted in significant illiquid capital investments and large losses for the company. The price of Enron's common stock had already declined approximately 60 percent from August 2000 to August 2001, when Mr. Skilling's resignation created even more uncertainty about the company. At the same time, Enron's online trading through Enron Online and the related dependency on trade credit from its counter-parties was experiencing explosive growth.

In hindsight, there appears to be a consensus that these events, coupled with impending maturities of a significant amount of debt and the turmoil in the financial markets created by the tragic events of September 11, 2001, placed Enron in an extremely vulnerable position in the fall of 2001. No one can deny, however, that the adverse publicity associated with the related party transactions and the accounting errors related to the November restatement announcements contributed to the loss of confidence Enron experienced in energy trading and financial markets. This confidence was critical to the continued success of Enron's trading operations, which accounted for a significant portion of Enron's business.

With regard to the related party transactions, it is important to consider the role of legal counsel. If a transaction is not illegal and it has been approved by the appropriate levels of a corporation's management, lawyers, whether corporate counsel or with an outside firm, may appropriately provide the requisite legal advice and opinions about legal issues relevant to the transactions. In doing so, lawyers are not approving the business judgment of their clients. Likewise, lawyers are not responsible for the accounting treatment of the transactions.

In conclusion, I want to make it very clear that we are confident that Vinson & Elkins fully met its professional responsibilities in connection with our representation of Enron. We are pleased to assist in the Committee's deliberations and are happy to answer your questions, within the constraints of our professional responsibilities to our clients.

Mr. GREENWOOD. Thank you, Mr. Dilg.

Mr. Astin, I understand that Mr. Dilg's opening statement spoke for you as well?

Mr. ASTIN. That is correct, Chairman.

Mr. GREENWOOD. Very well.

Ms. St. Clair, do you have an opening statement?

**TESTIMONY OF CAROL L. ST. CLAIR**

Ms. ST. CLAIR. Yes, I do.

Mr. GREENWOOD. Okay. You are recognized for 5 minutes.

Ms. ST. CLAIR. Good morning. Mr. Chairman, and members of the subcommittee, my name is Carol St. Clair. I start——

Mr. GREENWOOD. I am going to ask you to move that white notebook and then pull the microphone front and center there and get it nice and close. Thanks.

Ms. ST. CLAIR. I started at Enron in 1994 working for the Liquids Group in the Legal Department of Enron North America Corporation. In 1995, after the Liquids Group was sold, I transferred to Enron North America's Finance Group. I worked in Enron North America's Finance Group until March 1999, when I transferred to the Financial Trading Group of Enron North America, where I remained until June of 2000.

In January 2001, after a 6-month maternity leave, I joined Enron North America's Power Trading Group, which along with the Gas Trading Group was sold in February in Enron's bankruptcy proceeding.

As you know, Mr. Chairman, I am appearing this morning voluntarily. To date, I have fully and freely cooperated with the subcommittee's investigation, and intend to continue to do so. Mr. Chairman, I will, to the best of my ability, be glad to answer questions you or any of the members of the subcommittee may have this morning. Thank you.

[The prepared statement of Carol St. Clair follows:]

PREPARED STATEMENT OF CAROL ST. CLAIR, FORMER ASSISTANT GENERAL COUNSEL, ETC RESOURCES GROUP, ENRON CORPORATION

Good morning. Mr. Chairman and Members of the subcommittee, my name is Carol St. Clair. Last month, I accepted a new position as a trading attorney in the Legal Department of UBS Warburg Energy, LLC after working at Enron Corporation for more than seven years. I started at Enron in 1994, working for the Liquids Group in the legal department of Enron North America Corporation. In 1995, after the Liquids Group was sold, I transferred to Enron North America's Finance Group. I worked in the Finance Group until March 1999 when I transferred to Enron North America's Financial Trading Group where I served until June 2000. In January 2001, after a six month maternity leave, I joined Enron North America's Power Trading Group.

As you know, Mr. Chairman, I am appearing this morning voluntarily. To date, I have fully and freely cooperated with the subcommittee's investigation and intend to continue to do so. Mr. Chairman, I will, to the best of my ability, be glad to answer questions you or any other members of the subcommittee may have.

Thank you.

Mr. GREENWOOD. We thank you, Ms. St. Clair, and appreciate your cooperation.

The Chair recognizes himself for 10 minutes for purposes of inquiry. And let me address my first question to Mr. Dilg. Mr. Dilg, you are the Vinson & Elkins engagement partner for the Enron account, and you have worked on the account since 1990, when Jim Derrick handed over the account to you when he left V&E to become Enron's General Counsel.

Reportedly, Enron is V&E's single largest client. V&E billed Enron over $36 million in 2001 and over $150 million during the past 5 years. By comparison, Arthur Andersen billed $54 million to Enron in 2001. V&E's partners earned a reported average annual income of $655,000. Your first year associates, straight out of law school, salary starts at $122,000 per year.

In August of 2001, Jim Derrick called and asked you to look into allegations regarding accounting improprieties and conflicts of interest at Enron. Sherron Watkins asked that Enron investigate her concerns and specifically recommended that V&E not be used, because V&E had done much of the legal work on the problematic transactions.

Nevertheless, you and Mr. Derrick concluded that V&E could conduct a review of Ms. Watkins' allegations. In brief, V&E took on the task of investigating its own work. The question is: was there not an inherent and obvious conflict of interest for V&E in taking on the investigation?

Mr. DILG. No, sir, there was not a conflict of interest in Vinson & Elkins undertaking the investigation. Ms. Watkins raised a number of issues in her letter. Her primary concern was Mr. Lay being aware of the business issue that faced Enron that there were large losses in the Raptor partnerships that are large obligations under the derivatives written with the Raptor partnerships that would be backed up by Enron stock, and the issue of how to deal with that with the Enron shareholders going forward as far as the dilution that would occur.

She raised issues of the conflict of interest created by Mr. Fastow's participation in LJM and a number of other issues. She mentioned in her letter that Vinson & Elkins had written true sale opinions on some of the transactions, and, therefore, would have a conflict, but her allegations did not address the legal work provided by Vinson & Elkins. We were not being asked to review our own work.

Mr. Derrick was aware that we had previously represented Enron on some of the transactions that she was talking about, but the appropriate standard, I believe, is whether or not our own interest would materially interfere with our work. We did not feel that we had a conflict of interest based on what we were being asked to do.

Mr. GREENWOOD. Well, yes, but you certainly had an interest in keeping the client. And wouldn't it seem to be the case that had V&E reviewed its own work and/or had V&E sought outside counsel to review its own work, that outside counsel recommended to V&E that—or advised Enron, I should say, that V&E had given it less than adequate counsel, that it certainly might have threatened your interest in keeping your largest client, would it not?

Mr. DILG. Again, we were not being asked to review our own work. We were being asked to conduct a preliminary review to see whether a further, more extensive forensic review was necessary. Ms. Watkins was raising matters that were well known to a number of executives in the company and transactions that had been approved by the Board of Directors of the company.

We were not being asked to review the quality of the legal work on any of the transactions, and I am not sure that there has been any—in any of the materials that I have seen any allegations that the legal work in putting the transactions together had any infirmities.

Mr. GREENWOOD. Well, here is what the Powers Report notes. "The result of the V&E review was largely predetermined by the scope and the nature of the investigation and the process employed. The Powers Committee identified the most serious problems in the Raptor transactions only after a detailed examination of the relevant transaction, and, most importantly, discussions with our accounting advisors, both steps that Enron determined and V&E accepted would not be part of V&E's investigation."

"With the exception of Watkins, V&E spoke only with very senior people at Enron and Andersen. Those people, with few exceptions, have substantial professionalism and personal stakes in the matters under review. The scope and process of the investigation appear to have been structured with less skepticism than was needed to see through these particularly complex transactions."

That is what Powers said, which is quite different from what you have just said. How would you respond to the Powers Report's assertions?

Mr. DILG. I think it is important to understand the difference in the scope and purpose of the special committee formed by the Board of Directors shortly after our report was delivered. It was in response to an SEC inquiry as well as derivative suits being filed against the company and had a much broader scope as far as looking at overall related party transactions.

We were making a preliminary review of the matters raised by Ms. Watkins, which both in her letter and when we subsequently interviewed her, primarily related to the Raptor transactions. I think that is consistent with what the Powers Report says that she told Mr. Lay. And to make sure that Mr. Lay, in coming back in as CEO, understood the serious business issues they had with the Raptor transactions.

She raised questions as to the accounting. The company's Audit Committee had chosen Arthur Andersen as their accountants. We wanted to make sure in our review that Arthur Andersen had the proper facts, that they had all of the facts that they needed to make the review, and that they were comfortable with their accounting decisions. But we were not in a position to second-guess Arthur Andersen's ultimate professional judgment on the accounting issues involved.

Mr. GREENWOOD. Well, you may not have been in a position to second-guess the details of the accounting firm, but you certainly had a responsibility to protect the company from liability, did you not? The company has faced 77 lawsuits as a result of these partnerships and the demise of the company, and I can't quite understand why it is that V&E would take the position that it didn't have some responsibility to its client to examine the potential risk that these transactions imposed in terms of civil liability.

Mr. DILG. I think we, both in our oral conversations with Mr. Derrick and Mr. Lay, and in our written report, pointed out the risk that these transactions posed in connection with shareholder litigation, as far as the ability of a potential plaintiff's lawyer, etcetera, to paint these transactions in a very bad light. I think we picked up references that we had had in some of our interviews to bad cosmetics, if you will.

Again, the focus of the review was to determine whether there were additional facts that were not known at that time that warranted further investigation. We did not find that any of the individuals that Ms. Watkins said to check with to see if she was all wet had any additional facts, or felt that there were any additional facts that weren't known at that time to make sure Mr. Lay knew how to address the transactions.

Mr. GREENWOOD. Well, let us talk about bad cosmetics. During the course of your inquiry, you interviewed Jeffrey McMahon. In the summary of Mr. McMahon's first interview on August 30, 2001, with you, you note that he indicated that some bankers thought there might be linkage between investing in LJM and future business with Enron.

In his second interview with you conducted on October 18, 2001, a few days after you submitted your report, Mr. McMahon told you of specific instances where investment bankers complained to him of being pressured to invest in LJM transactions, or were promised Enron business if they invested in LJM.

Mr. McMahon identified specific institutions—First Union, Merrill Lynch, Deutsche Bank, Chase Bank—and specific bankers, including Paul Riddle, and provided the names of Enron employees who could provide additional information on this subject—Ben Glisan, Tim Despain, Ray Bowen, and Kelly Booth. This subcommittee has learned of other individual bankers who have complained.

In your October 15, 2001, letter to Mr. Derrick, you wrote, "The second potential conflict of interest identified by several individuals was that investors in LJM may have perceived that their investment was required to establish or maintain other business relations with Enron. Although no investors in LJM were interviewed, both Mr. Fastow and Mr. McMahon stated unequivocally that they had told potential investors that there was no tie-in between LJM investment and Enron business."

Your description of what you had learned appears to be highly misleading. Mr. McMahon clearly indicated in his first report that some banks—that there was a linkage, and that someone at Enron had made these promises. Presumably, given his position, it was Mr. Fastow. But you make it appear as if they are both shooting down this allegation when, in fact, it was Mr. McMahon who raised the allegation. And he clearly had names of individuals and banks as set forth in the summary of the second interview.

Based on the facts you knew at the time you submitted the report, why isn't your description misleading?

Mr. DILG. I don't believe our description is misleading, Mr. Greenwood. We did want to alert the company to the concerns raised, I think both by Ms. Watkins and Mr. McMahon, that they had heard that there was linkage. Mr. McMahon told us that he had told any banker that asked him that there was no linkage. Mr. Fastow also adamantly denied any linkage.

The concerns we heard raised were some people within investment banking and commercial banking institutions grumbling because they didn't get deals that they thought they were supposed to get because they invested in LJM, which indicated——

Mr. GREENWOOD. Did you ask those bankers if, in fact, they had been made promises or had threats made against them?

Mr. DILG. We did not.

Mr. GREENWOOD. Why is that?

Mr. DILG. We did not interview anyone outside the company at this point in time.

Mr. GREENWOOD. They just took the words of the—Sherron Watkins has these allegations about Fastow and other people wearing two hats, conflicts of interest. You go to them and basically say, "Do you have conflicts of interest? There are allegations that bankers felt that you were squeezing them on these deals. Did you do that?" They say no. You go to the bankers and say, "We heard you had complaints. What was your experience with Fastow that caused you to complain?" You didn't do that?

Mr. DILG. We didn't interview anyone outside of the company in connection with our preliminary review. Mr. McMahon had indicated to us in the initial interview that he was not aware of any situation where a banking arrangement looked unusual. Again, both Mr. McMahon and Mr. Fastow denied there was any linkage, or at least Mr. Fastow denied there was any linkage. Mr. McMahon said he told the banks there was no linkage.

His information that he gave to us after we had submitted our report was more detailed. Within I think a week—I am not positive on the date—but within a very short period of time after that interview, Mr. McMahon was the chief financial officer of the company in charge of all of the banking relationships.

Mr. GREENWOOD. My time has expired. But did you ask Mr. McMahon for the names of these individuals that he complained about to begin with, in the first interview?

Mr. DILG. I can't recall that we did.

Mr. GREENWOOD. Didn't that raise any red flags with you that would cause you—I mean, I am trying to understand why the first thing you wouldn't have done, the next thing you would have done was say, "Oh, my God," pick up the phone, call these bankers, and say, "I am supposed to protect this company from liability, and there is a lot of liability that could result from these allegations if these allegations are true."

I don't understand why you didn't feel a responsibility to Enron and stockholders to make those calls right away and find out what was really happening, not just taking Andy Fastow's word for it.

Mr. DILG. You have to understand, Mr. Chairman, that in the context that the preliminary review was conducted, Mr. Skilling had just resigned from the company. There was a great deal of speculation in the market and with Enron's counter parties as to the reasons for Mr. Skilling's resignation. We were trying to develop the facts that we could by talking with people inside the company so as not to create lots of speculation and rumors until we knew what we could report to Mr. Derrick.

Again, the people that we interviewed indicated that they had seen no business arrangements that were contrary to Enron's best interest coming out of this, or any indication that banks were getting more favorable deals than they should have gotten due to a linkage with LJM. And the person in charge of the banking relationships at that point in time denied there was any linkage.

Mr. GREENWOOD. Well, it sounds like what you are saying is that the preliminary review also had, as part of its purpose, not just a preliminary review but you didn't—this was to be a hushed review because of the concern that Skilling's departure created a lack of confidence in the company. And if you took the review outside the walls of Enron, that to really get to the bottom of it, that it would have some negative short-term consequences for Enron when, in fact, what you might have done is prevented some very, very serious long-term consequences.

My time has expired. The Chair recognizes the gentleman from Florida, Mr. Deutsch, for 10 minutes.

Mr. DEUTSCH. Thank you, Mr. Chairman. I am going to read just a couple of sentences from Ms. Watkins' letter. "Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transaction with us at the same prices without substantial premiums from Enron. In other words, the $500 million in revenue in 2000 would have been much lower."

Which is really the contention that I have said in terms of the fact that these transactions did not serve a business purpose. And if we accept her premise, that is the issue.

And, you know, as I mentioned in the introduction, Mr. Derrick, if you can comment, you know, on the Rhythms transaction, just the structure of it, as a general partnership set up to sell back to Enron the stock—I mean, the outside—if they had done that with an investment bank there would be no question that they can do it. But setting this up as an off balance sheet, were you personally involved with approving this or involved with understanding it?

Mr. DERRICK. No, Congressman. I had no personal involvement in the structure. That would have been—in terms of the legal work with respect to that, that would have been done by the lawyers who I think at that time were in Enron North America. And, of course, the business aspects of that would have been handled by the business individuals who were part of structuring the transaction, but I had no personal involvement in that.

Mr. DEUTSCH. So you—again, we are trying—today's hearing was—the purpose of sort of trying to, you know, have the top dogs, you know, in front of us. So it would not have come to your attention. I mean, specifically, is there anyone here—you know, again, Mr. Astin, would you be aware of who would have approved this?

And, Mr. Derrick, I mean, who specifically—so our staff at least can follow up. I mean, who specifically would have approved the structure of this transaction?

Mr. DERRICK. Well, from the Enron side, Congressman, I can't say with certainty. I would think that it would have been Ms. Mordaunt or someone in the legal group in which she was involved who was working with Ms. Mordaunt.

And let me make it clear that I was at the Executive Committee—well, I am sorry. I was at the—I would have been at a Board meeting in which that was presented, so I don't mean to say that I have not heard of this matter. But in terms of having any detailed knowledge about it, or having been personally involved in the structure of it, I was not.

Mr. DEUTSCH. Mr. Sefton, as a former General Counsel as well, I mean, are you aware of the—who approved this transaction, or any—or the structure of it?

Mr. SEFTON. This transaction was completed before I started my position in Global Finance.

Mr. DEUTSCH. And Mr. Astin?

Mr. ASTIN. Congressman, I had a very limited role in providing some initial securities disclosure-related advice to Ms. Kristina Mordaunt, with regard to this transaction. I did not work on the structuring of it. I did review the first draft or so of a partnership agreement, just to——

Mr. DEUTSCH. So who at Vinson & Elkins would have approved this transaction?

Mr. ASTIN. No one. We didn't work on the transaction except as I have described.

Mr. DEUTSCH. And would that be typical, that in-house counsel would have basically—so now we are looking for Mrs. Mordaunt, and our staff at least can question her. I mean, is she, on her own, the person who basically said—you know, gave it the, you know, legal Good Housekeeping Seal of Approval that it is okay. Mr. Derrick?

Mr. DERRICK. Well, again, I don't—specifically, with respect to this transaction, I don't know, Congressman. Let me say under our corporate governance rules, every transaction that would have constituted a binding obligation on the part of Enron would have required the signoff, and should have the initials of, the attorney who approved that transaction.

Now, in many of our transactions, not literally every one, but in many of our transactions there would have been an outside firm also working with the in-house group. As Mr. Dilg just pointed out, Enron used a great many law firms. I don't know whether another law firm was specifically involved in this transaction or not.

Mr. DEUTSCH. All right. And, again, this is one of 4,000 partnerships. It is one of the largest. It is not the largest. As you well know, you booked—or Enron booked a $390 million gain on the Rhythms stock. So it is not a small, you know, transaction. I mean, it—so I guess I—if you are not aware, you are not aware. You are not aware of any specific outside counsel that would have been involved in this transaction.

Mr. DERRICK. No, I am not. But that is not to say that that information is not available. It certainly should be.

Mr. DEUTSCH. Do you understand this transaction and how it was set up?

Mr. DERRICK. No, Congressman, I can't explain the transaction, because, again, I had no personal involvement in it.

Mr. DEUTSCH. I don't know if I want to ask you to give a legal opinion, because maybe I can, you know, explain it a little bit. Let me go more specifically as part of this—Mr. Fastow, who obviously remained as the chief financial officer, was also the general partner. My understanding is that at the Board meeting it was the understanding of the Board that he was not to receive any compensation for his work as the general partner. Is that your understanding as well?

Mr. DERRICK. Well, I would have to look at the minutes of that Board meeting specifically to truthfully answer that question.

Mr. DEUTSCH. Was there any objection to him receiving compensation as general partner to these types of transactions?

Mr. DERRICK. The only Board meeting at which I was in attendance related to the LJM1 transaction, which I believe was the hedge of the Rhythms transaction. And I do believe that there was a discussion by Mr. Fastow of the proposed compensation structure and that attached to the minutes of that meeting would be a slide which does explain whatever was explained at the meeting with respect to his proposed compensation.

Mr. DEUTSCH. Were you aware of the conflict of interest role that Mr. Fastow had regarding his role in LJM partnerships?

Mr. DERRICK. Yes. And the very purpose of presenting that—well, let me say, as you undoubtedly know by now, under the Enron code of conduct, our code of ethics, conflicts of interest are not prohibited. It is provided—there is a procedure provided in the code of conduct that requires that a conflict of interest be presented to the chairman and chief executive officer. It actually is not required to be presented to the Board, although in this case it was.

And the very purpose of having that discussion, as I recall——

Mr. DEUTSCH. All right. So, really, you were trying to put in a meaningful system to put in place to guard against potential conflicts of interest with Mr. Fastow.

Mr. DERRICK. Exactly. That is right.

Mr. DEUTSCH. And it was a serious conflict that you expected and a suitable system was supposed to be in place?

Mr. DERRICK. Well, with respect to LJM1, I was not present at the Board meetings where the LJM2 structures were discussed. As I recall, LJM1, Congressman, was actually looked at as a—at the time as basically one transaction to put in place a hedge to protect the value of the company.

Mr. DEUTSCH. How was the conflict system supposed to operate?

Mr. DERRICK. Under our code, any employee who has a conflict of interest is required to present that to the chairman and chief executive officer. It is then up to that individual to make whatever decision he or she believes is appropriate. There is no formal requirement for it to be sent through——

Mr. DEUTSCH. I am asking questions because—again, I have 10 minutes, so I really do need——

Mr. DERRICK. I am sorry.

Mr. DEUTSCH. [continuing] to go relatively quickly. Let me just ask you, in the LJM deals, there was a structure where there is a multi-name signature block. Why was that set into place? And, again, the specific information we have now is that it was not followed through on a continuous basis. That Mr. Skilling specifically did not sign, you know, continuously those approval sheets, and yet the transactions were approved.

Mr. DERRICK. I will have to defer, in large part, I think to the lawyers in the Enron Global Finance Group who were charged with that. I don't recall having any specific involvement in setting up those approval sheets. And I don't recall at the time that the Rhythms transaction was being discussed, Congressman, that there was such an approval sheet.

Mr. DEUTSCH. Did you understand the system that it was supposed to include these approval sheets?

Mr. DERRICK. At the time of the Rhythms transaction, there was no approval sheet.

Mr. DEUTSCH. What about LJM2?

Mr. DERRICK. As LJM2 was developed, my understanding is that the Enron Global Finance Group, in conjunction with——

Mr. DEUTSCH. The bottom line is, did you know that these approval sheets were part of the system that you had supposedly implemented to avoid conflict?

Mr. DERRICK. Yes, at some point.

Mr. DEUTSCH. Okay. And did you know that Mr. Skilling did not sign them on a continuous basis?

Mr. DERRICK. My first awareness of that came in my conversations with Mr. Mintz, who raised the issue that there was not contemporaneous——

Mr. DEUTSCH. So who was guarding the store? Who was the cop watching what was going on? I mean, not internally, not externally. I mean, you set up a system which apparently no one followed.

Mr. DERRICK. Well, I think that—I am not sure that that is correct, Congressman. There was a system that was set up, I think, designed in good faith to deal with these issues. The question that everyone was looking at is: was the system appropriately adhered to? But that responsibility was allocated by the Board to Enron Global Finance Legal, as well as to our chief accounting officer and our chief risk officer.

Mr. DEUTSCH. Let me go back to the—do you have the chart again? Let me just go back to it. Just because, again, we are not—sometimes I just have found it easy to focus on the specific transaction. I am going to do my best to try to explain this, that on the Rhythms transaction, as I said, the stock value went up about $390 million is my understanding. Enron made a corporate decision to basically lock in the price, they wanted to buy it put to do that.

Mr. Fastow set up the partnership to sell that put back to Enron. It was capitalized by Enron stock right here. As soon as he set up the general partnership, he took out a several million dollar general partnership fee. That was actually the first thing that he did.

He then sold the put back—actually, the general partnership set up a swap as a subsidiary, which was actually done improperly, because by taking out the general partnership fee it had less equity than was needed for a 3-percent set-aside. But they sold it back.

The problem with the transaction is two things. One is the general partnership never could have made good on the put. I mean, basically, Enron bought a put from itself in this transaction. And, effectively, that is what occurred. And that is the point of what I am saying that we—that at least in my opinion this transaction is illegal. It is illegal because a business purpose is not there.

The business purpose—the purpose, as far as I can see, is, No. 1, to enrich Mr. Fastow as the general partner to take the fee, No. 1. No. 2, to basically manipulate the stock price, because what you have done is you have booked the gain, the $390 million gain. The liability that that stock might go down is not listed as a liability anywhere.

So this is the point, you know, of why it is legal and where the problem comes in—is that an outside auditor, or someone—the public, an analyst—looking at the books, unless they can get inside of this transaction, does not understand what occurred. And I can't, you know, for the life of me—and no one—and I have used this chart with other people to try to come up with, why is this a legitimate transaction?

What is legitimate about this, except maybe, you know, if this was, you know, Goldman Sachs, then it would be legitimate, because they would be selling a put. But Mr. Fastow didn't go to Goldman Sachs to buy the put. He bought the put from himself. And, in fact, what continues in this transaction is that it was capitalized, as I said, by Enron stock, literally given by Enron stock, when both the Rhythms net and Enron stock went down without consideration.

Enron then gave, at Mr. Fastow's request, an additional—I believe it is $150 million of additional stock to this general partnership without consideration. Without consideration. Without showing that as a liability on the balance sheets. And, again, what is significant about this, as we have delved into these partnerships, is basically this is one of many. I mean, this is one of the largest. It is not the largest. And this is the structure.

Again, we talked about how Enron did all of these complicated things. This is not so complicated. It really isn't that complicated. And this is the structure, apparently, that was continuously used by Mr. Fastow in the LJM partnerships. Very similar. There were different products. You know, it could have been a pipeline that had a value, and they locked in the pipeline.

But essentially, I mean, our understanding is this was a game. And, I mean, from your perspective as general counsel, I don't see how you weren't aware that this was the game. And if it was the game, then try to explain to me why it was a legal game and why this whole thing was not a scam from day one, why it wasn't, you know, basically thieves in blue suits and red ties. And, really, that is what this whole thing is about.

And I think that is the question which is going on, because the issue that I think we go back to is Enron's demise is not business as usual in America. There have been several companies since Enron's bankruptcy in America that have gone bankrupt. K-Mart has gone bankrupt. Other companies have gone bankrupt. Big companies. Not as big as Enron, but the reality is that the public markets knew that there were problems with those companies.

The reality is in the case of Enron, until Enron vaporized, the public markets did not really know of the level problem. So, Mr. Derrick, I really want to at least give you the opportunity, because if you can—if you can respond.

Mr. DERRICK. Well, Congressman, I will attempt to respond to the best of my ability. As I mentioned earlier, I was not involved in the structure of that transaction, and I can't speak to the details of it. I will say, to the best of my recollection, that it was certainly considered at the time that the Board approved that there was a legitimate business purpose, and that was to help ensure that the shareholders of Enron would be able to retain as much value as possible with respect to the investment that had been made in Rhythms.

As to what later transpired, I can't speak to that. I have not certainly been told, and was not aware, that these structures had been considered to be illegal. I know that there are great concerns with respect to the appropriate accounting treatment, but I was not aware that anyone had challenged the actual legality of the——

Mr. DEUTSCH. Is that within Enron or within your outside counsel, or am I the first person to suggest to you that they are illegal?

Mr. DERRICK. Well, I don't claim to have read everything that may be out there, Congressman. But my understanding is that the concern here has been primarily related to whether the appropriate accounting treatment was followed——

Mr. DEUTSCH. Is it an SEC violation to have a non-business purpose in terms of that? That that is a violation? That is a criminal violation?

Mr. DERRICK. Well, again, my——

Mr. DEUTSCH. I mean, if it is a non-business purpose, it is a criminal violation. People will go to jail.

Mr. DERRICK. My understanding at the time that the Board approved this was that it was certainly considered to have a legitimate business purpose—that is, to protect the value of the Enron shareholders and their investment in Rhythms.

Mr. DEUTSCH. Okay.

Mr. GREENWOOD. The time of the gentleman has expired.

The Chair recognizes the Chairman of the full committee, Mr. Tauzin.

Chairman TAUZIN. Thank you, Mr. Chairman.

Mr. Dilg, on October 30 when Sherron Watkins met with Ken Lay and provided him with the memo that we have as a part of our record, she listed two mistakes, apparently. One was that Lay should have appropriately taken the matter seriously in the beginning of the investigation. However, mistake No. 2 she lists, "is that he relied upon V & E and Arthur Anderson to opine on their own work." And she quotes your statement on October 16 to her when supposedly Sherron Watkins said to Lay that he should probably come clean and admit the problems and restate the 2000 Raptor in order to preserve his legacy and possibly the company. And your statement was, are you suggesting that Ken Lay should ignore the advice of his counsel and the auditors concerning this matter? She was apparently complaining when she went to Mr. Lay, he made the mistake and relied upon the very same law firm that had done the work on these transactions, to comment on their work and to comment on the criticisms of that work instead of hiring outside counsel and outside auditors and that you indicated to her that Ken Lay should simply continue to take the advice of his counsel and his auditors concerning this matter.

Was that an accurate statement to Mr. Lay on October 30?

Mr. DILG. I don't have a copy, I don't believe, of that memorandum Chairman Tauzin.

Chairman TAUZIN. I'll put it in front of you right now.

Mr. DILG. Thank you very much.

Chairman TAUZIN. I have the cite, but here's an actual copy and you can see where I've underlined it. She's basically saying it was a great mistake for him to end up relying upon your firm, to comment on your firm's work. And that you said, are you telling me that Ken Lay shouldn't rely upon his counsel and his auditors? Is that accurate?

Mr. DILG. I don't remember making that specific statement.

Chairman TAUZIN. You do remember, however, filling a report out on October 15 that you and I believe Mr. Mark Hendricks, III, prepared for Mr. Derrick. Is that correct?

Mr. DILG. Yes sir.

Chairman TAUZIN. And in that report your conclusions are that your "preliminary investigation do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors." Is that correct?

Mr. DILG. That's correct.

Chairman TAUZIN. Do you stand by that decision?

Mr. DILG. Yes sir.

Chairman TAUZIN. You also say that while there's some bad cosmetics involved that your response to the response of Mr. Derrick should be to Ms. Watkins that "we should assure her that her concerns were thoroughly reviewed, analyzed and were found not to raise new or undisclosed information given serious consideration." Is that correct?

Mr. DILG. Yes sir.

Chairman TAUZIN. But if we look at the beginning of your report and this is where I want you to comment, Mr. Derrick, because this is a letter to you, and obviously the "you" in this sentence refers to you, Mr. Derrick.

In preliminary discussions, the second page of the report, in preliminary discussions with you, it was decided that our initial approach would not involve the second guessing of accounting advice and treatment provided by Arthur Anderson, that there would be no detailed analysis of each and every transaction and there would be no full-scale discovery style inquiry. Instead, inquiries should continue to determine whether the anonymous letter and supplemental materials raise new factual information that would warrant a broader investigation."

Isn't it true, Mr. Derrick, that while Mr. Dilg is writing a report advising you to tell Ms. Sherron Watkins that you've given her complaints thorough—I want to quote you accurately, "thoroughly reviewed, analyzed" although you were being told by Mr. Dilg to tell Ms. Watkins that her complaints were thoroughly reviewed and analyzed. But nevertheless, you gave instructions to Mr. Dilg and Vinson & Elkins not to do that. You told them, according to his, letter, don't look at the accounting treatment, don't look at these transactions in detail and for heavens sake, don't do a full style discovery. Isn't that correct?

Mr. DERRICK. Chairman Tauzin, if I understand your question correctly, this goes to the point that I was speaking to in my opening remarks which is in the context of last August, recall that as the Powers Report indicated, despite the fact that there were literally hundreds of people who were involved in these transactions and despite the fact that under the Enron Code of Conduct, there are three different ways of reporting anonymously any concerns that one may have to the company which does trigger an investigation.

To the best of my knowledge, the only report that had been presented on this issue was that at the time it was an anonymous report. We took this extremely seriously. The question was at the time do we launch into—and this was not something I instructed Vinson & Elkins. This was part of our initial discussions.

The question was how do we, as promptly, as practical——

Chairman TAUZIN. Mr. Derrick, Sherron Watkins met with Mr. Derrick and Mr. Rogers, 3 days before the 15th. You can't possibly sit here and tell me that you thought this was still an anonymous complaint.

Mr. DERRICK. I'm saying at the time that we received the initial report, it was an anonymous letter. Obviously, at some point and I can't recall exactly which day that would have been, but yes, at some point we certainly understood it was Ms. Watkins, but I don't know her.

Chairman TAUZIN. I want you to explain to us, because I'm totally—I can't understand for the life of me why the general counsel of this corporation, when he's approached by Ken Lay, when Sherron Watkins meets with you, Mr. Rogers, to go over all this stuff, not anonymous any more, why you when asked to considered her request that outside counsel, she says this is our recommendation in an initial letter. Involve Jim Derrick and Rex Rogers to hire a law firm to investigate the Condor and Raptor transactions to give Enron attorney-client privilege on this work product, can't use V & E due to conflict. They provided some true sale opinions on these deals. Why, when Mr. Lay comes to you and says I need to know whether all this is true, why you turn right around and get Vinson & Elkins to do this extraordinarily limited investigation and instruct them don't look at the accounting treatment and don't do a full-scale discovery style inquiry and by the way, I should look at the next paragraph where Mr. Dilg, you point out that you only looked at selected documents, provided you by Enron.

It appears to me, Mr. Dilg, Mr. Derrick was severely limiting your ability to examine whether or not, No. 1, Sherron Watkins' allegations were correct, because you were told not to look at them. And two, whether anybody else really ought to look over your shoulder and see whether or not Vinson & Elkins had done a good job in recommending these deals when you issued approval letters on them.

Is that correct?

Mr. DILG. I don't believe that we were instructed to be limited, Chairman Tauzin.

Chairman TAUZIN. I'm reading your statement, Mr. Dilg. Listen, let me read it again. "In preliminary discussions with you, Mr. Derrick, it was decided"—sounds like both of you talked about it and decided together that our initial approach would not involve the second guessing of the accounting advice and treatment provided by AA. And there would be no detailed analysis of every transaction. And there would be no full-scale discovery style inquiry. And second, that you would only review selected documents. You're trying to tell me that wasn't an extraordinarily limited review of Sherron Watkins' complaints?

Mr. DILG. I think the sentence you read did talk about our initial approach and again the scope of our review was to determine whether a further, more detailed——

Chairman TAUZIN. How could you know whether a further review would be required if you wouldn't even look at her allegation? How could you, the attorneys who advised the corporation on these deals, how could you possibly give the company objective information as to whether or not an outside counsel or an outside auditor ought to look at them if he never even looked at the deals again?

Mr. DILG. Ms. Watkins was raising some very serious business concerns that she wanted Mr. Lay to review and be aware of. We didn't feel that that involved and there is nothing in her letter——

Chairman TAUZIN. Did you even bother to interview Skilling?

Mr. DILG. Mr. Skilling was no longer with the company.

Chairman TAUZIN. But you never tried to interview him?

Mr. DILG. No sir.

Chairman TAUZIN. You never asked him about the so-called handshake deal where he promised that the partnership would be protected with Enron stock, they would never lose money?

Mr. DILG. No sir.

Chairman TAUZIN. You just asked Fastow about it, he denied it and that was enough?

Mr. DILG. He denied it. If there was a concern from the company's standpoint, Mr. Causey said that he was not aware, I believe Mr. Causey said he was not aware of any such transaction and——

Chairman TAUZIN. Ms. Watkins says that employees were asking this all the time, that people were saying that, that many similar comments are made when you ask about these deals. Employees quote our CFO as saying these are handshake deals. But Skilling and LJM will never lose money. Did you ever try to find out who these employees were who said that Fastow actually told them that he had such a handshake deal?

Mr. DILG. We did interview Ms. Watkins and she said a lot of it was rumors that she had heard. She did give us some names of other people that we should talk to on this specific aspect.

Chairman TAUZIN. Did you talk to them?

Mr. DILG. We did not.

Chairman TAUZIN. You didn't bother chasing down that allegation. You didn't talk to Mr. Skilling. You lived by Mr. Derrick's and your agreement not to look at the deals, not to do any discovery-style inquiry and you reported quite conveniently to Mr. Lay and Mr. Derrick that everything is okay, just cosmetic and tell Ms. Watkins that we looked at everything and she should go away. In fact, you did more than go away. This is a remarkable piece. This is a memo—Mr. Derrick, I want to ask you about this one. This is from someone who works in your office. This is from Ms. Sharon Butcher. It's to Sharon Butcher from Vinson & Elkins from Carl Jordan, but the letter is per your request. Some way or another, someone who worked for you, Sharon Butcher, made a request to Vinson & Elkins and she made two requests apparently. "Per your request, the following"——

Mr. GREENWOOD. It's Tab 4 in your books in case you need to——

Chairman TAUZIN. Tab 4 in your books. From Carl Jordan, August 24, 2 days after—I mean this is right about the time all this is coming about, to Sharon Butcher in your office, Mr. Derrick. Which says, "per your request, Sharon", so Sharon must have asked for this information. "Here are some thoughts on how to manage the situation with the employee who made the sensitive report" and there are all kind of thoughts about how thank God she's asking for reassignment herself. You can see she wanted a new job. And then the second one, you also ask that I include in this communication a summary of the possible risks associated with discharging or constructively discharging employees who report allegations of improper accounting practices. Did you, Mr. Derrick, instruct Sharon Butcher to make such a request on Vinson & Elkins?

Mr. DERRICK. Yes, I did, Congressman.

Chairman TAUZIN. Explain to me why.

Mr. DERRICK. Well, under our Code of Conduct, any employee who makes an anonymous report is guaranteed that there will be no retribution by the company, that the company will not tolerate any form——

Chairman TAUZIN. Why did you need the lawyers to tell you what the risk of doing something you knew you couldn't do?

Mr. DERRICK. We wanted to be absolutely correct in every way——

Chairman TAUZIN. That's a fine answer. You want to be absolutely correct. But let me ask you again what I asked you. If you already knew that your code of ethics prohibited you from discharging her, why on earth would you instruct one of your employees to ask Vinson & Elkins about what would happen if you did that, what the risks were to the company, including, for example the SEC might have some questions about that and that you might have problems with other oversight agencies of the government if you did that. Why would you even want to ask Vinson & Elkins to give you a list of all the horrible things that would occur if you knew you had no right under your own code of ethics to discharge this employee?

Mr. DERRICK. That gives us any information that we would need, Congressman, as a legal department, in order to be in the best position to protect any potential harassment or intimidation of Ms. Watkins. We had absolutely nothing other than her interest and the company's interest in acting properly in this regard. Not only was that the right thing——

Chairman TAUZIN. Mr. Derrick, you came from Vinson & Elkins, didn't you?

Mr. DERRICK. I certainly did.

Chairman TAUZIN. So you're the lead counsel for Enron. The guy Mr. Lay turns to to get help with these allegations.

Mr. DERRICK. Correct.

Chairman TAUZIN. Formerly with Vinson & Elkins. You turn back to Vinson & Elkins to investigate it, but you tell them don't look too hard. That's the common sense review of what I've just read to you.

How do you explain that?

Mr. DERRICK. I would respectfully disagree with that construction, Congressman. As I mentioned, Mr. Lay and I both proceeded in absolute good faith to take Ms. Watkins' allegations extremely seriously. What you were pointing to as the downside of Vinson & Elkins was also the great strength of Vinson & Elkins——

Chairman TAUZIN. Why did you tell them not to look at the deals—why did you tell them not to do a thorough discovery-style inquiry? Why did you tell them not to do that?

Mr. DERRICK. Let me say again I did not instruct them to do that. That was part of our initial discussion in how best to proceed with a preliminary investigation. It was always the purpose of this investigation that the recommendation to engage an additional accounting firm could well have been made.

Chairman TAUZIN. My time is up, but I want to make it clear. You call this a preliminary investigation, but it's the only one you did, right? It's the only one Vinson & Elkins did, the only one you did, right?

Mr. DERRICK. We followed the recommendation that we received from the outside firm——

Chairman TAUZIN. From Vinson & Elkins saying we don't think anybody ought to overlook our work and check it. Did that surprise you that Vinson & Elkins would tell you we don't think anybody has to look at what we did to see if it's legally correct?

Mr. DERRICK. I have the utmost faith in Vinson & Elkins and in their integrity. I believe that they had truly believed that we should have proceeded——

Chairman TAUZIN. You knew that Vinson & Elkins were the attorneys on the Raptor deal.

Mr. DERRICK. As I said, Congressman, I don't know that I was aware that they were attorneys on all the deals, but we were certainly aware that they had been involved in the transactions which gave them the great ability to quickly start on the investigation.

Mr. GREENWOOD. The time of the gentleman has expired. The chair is about to recognize the gentlelady from Colorado, but before I do just one question, Mr. Dilg. Your preliminary investigation was not a cover up, was it?

Mr. DILG. It was definitely not a cover up.

Mr. GREENWOOD. In what ways would a cover up look different than your preliminary investigation?

Mr. DILG. I'm not sure. I've never participated in a cover up, Chairman. Again, you need to take our preliminary report in the context of what Enron was doing at the time in terminating the Raptor transactions and having already removed Mr. Fastow from the conflict of interest position.

Mr. GREENWOOD. The chair recognizes the gentlelady from Colorado for 10 minutes.

Ms. DEGETTE. Thank you so much, Mr. Chairman. Mr. Derrick, I'm sure you didn't mean to imply to the chairman that you gave any less shrift to the allegations being made by Ms. Watkins because they were initially made anonymously, did you?

Mr. DERRICK. To the contrary, Congresswoman——

Ms. DEGETTE. I'm serious, didn't you.

Mr. DERRICK. We absolutely did.

Ms. DEGETTE. Thank you. Now also, I'm sure that when you asked Vinson & Elkins to do an investigation, you yourself didn't intend to have them do a cover up, did you?

Mr. DERRICK. My integrity is not for sale, Congresswoman. I would not participate in a cover up.

Ms. DEGETTE. Thank you. So you thought that they would do an independent investigation.

Mr. DERRICK. Yes, I did.

Ms. DEGETTE. Is that your testimony?

Mr. DERRICK. Yes.

Ms. DEGETTE. Thank you. Now Mr. Dilg, in your written testimony, you point out to us very helpfully that Enron's legal affairs were directed by a highly sophisticated in-house legal department consisting of approximately 250 attorneys, some of which by the way, came from your organization, correct?

Mr. DILG. That's correct.

Ms. DEGETTE. And so for most of the financial transactions, your lawyers would interface with the in-house attorneys and also, by the way, with Arthur Anderson who provided the auditing and accounting advice for Enron, correct?

Mr. DILG. We would usually interface with the legal department. I'm not sure that we would interface with Arthur Anderson.

Ms. DEGETTE. You assumed that the in-house lawyers were interfacing with Arthur Anderson for routine transactions, right?

Mr. DILG. I'm not sure it would be the in-house counsel as much as it would be the in-house financial department or accounting department.

Ms. DEGETTE. So you don't even know if the in-house lawyers were working with Arthur Anderson on these issues?

Mr. DILG. That's correct. I do not know.

Ms. DEGETTE. As far as you know, there may have been no lawyers working with Arthur Anderson?

Mr. DILG. That could be.

Ms. DEGETTE. Mr. Derrick, do you know if your lawyers worked with Arthur Anderson?

Mr. DERRICK. I can only say that I personally did not work with Arthur Anderson. It wouldn't surprise me——

Ms. DEGETTE. You were the head of the legal department. Do you know whether any of your lawyers worked with them?

Mr. DERRICK. As I was going to say, Congresswoman, it wouldn't surprise me that on some matters there was interface between some in-house lawyers and Anderson. I personally was not.

Ms. DEGETTE. If you wouldn't mind supplementing your answer, find out if anybody did, that would be helpful in this investigation.

Now Mr. Derrick, the investigation of Sherron Watkins' claims, that was kind of a different assignment than the normal assignments that you got, wasn't it?

Mr. DILG. Is that question addressed to me, Congresswoman?

Ms. DEGETTE. I'm sorry. Yes, it is, Mr. Dilg.

Mr. DILG. Yes, that was not a normal assignment as far as—I'm a transactional lawyer.

Ms. DEGETTE. Did you understand that that was to be an independent investigation of these claims?

Mr. DILG. I understood we were to make a preliminary review. We discussed——

Ms. DEGETTE. Did you think it would be an independent preliminary review?

Mr. DILG. It depends on—it's not an independent review such that you would have to respond to a derivative suit or if you were going to have an independent committee of the board directing their own counsel.

Ms. DEGETTE. So you didn't think it was particularly independent. The reason I'm asking this question is because and we've talked about this at length with the chairman and others, you limited the scope of the investigation right from the get go. You said that you're not going to second guess Arthur Anderson's accounting, right?

Mr. DILG. We——

Ms. DEGETTE. Wasn't that one of your premises in the investigation?

Mr. DILG. In our preliminary review, we were not to review the accounting.

Ms. DEGETTE. And in fact you never did review Arthur Anderson's accounting, did you?

Mr. DILG. No, we did not.

Ms. DEGETTE. Okay, the investigation team was you and Mr. Hendricks only, right?

Mr. DILG. That's correct.

Ms. DEGETTE. You didn't use any associates, right?

Mr. DILG. That's correct.

Ms. DEGETTE. You didn't have any accountant helping you with the investigation, did you?

Mr. DILG. That's correct.

Ms. DeGETTE. So you would really have no way—I mean do you have an accounting background?

Mr. DILG. I do not.

Ms. DeGETTE. I don't know how you are, the way I am, before I went to law school I had one accounting course in college. I assume it's probably pretty much the same with you, is that right?

Mr. DILG. I believe I had two semesters of accounting in undergraduate school.

Ms. DeGETTE. Okay. So you don't really understand complicated accounting transactions or standards, do you?

Mr. DILG. No ma'am.

Ms. DeGETTE. Do you know whether Mr. Hendrick does?

Mr. DILG. I do not believe he does.

Ms. DeGETTE. So the two of you, you interviewed witnesses, just the two of you. You never reviewed these transactions, did you?

Mr. DILG. No, we did not get into the details of the transaction.

Ms. DeGETTE. Now you did know, didn't you, that Sherron Watkins' allegations were that the accounting scandals were the problem. Isn't that correct?

Mr. DILG. She raised a number of different things in her correspondence with Mr. Lay.

Ms. DeGETTE. Right, but I mean basically she said we will implode in a way the accounting scandals and there's an elaborate accounting hoax and then her supplemental information indicated she thought there were accounting problems with a number of the transactions, most particularly Raptor, correct?

Mr. DILG. She was concerned about the Raptor transaction, primarily.

Ms. DeGETTE. Right.

Mr. DILG. Her main concern was that Mr. Lay, in coming back in as CEO, thoroughly understand the issues he had with the business issues of the vehicles unwinding 2 years hence and the problems that might cause.

Ms. DeGETTE. If you'll excuse me, I've looked at—I assume you reviewed all of her—both her letter of concern and also the attached specific concern she raised, didn't you?

Mr. DILG. Yes, we did.

Ms. DeGETTE. Well, because she says here about Raptor, the accounting treatment looks questionable, and talks about equity derivatives. "The equity derivative transactions do not appear to be at arm's length. There's a veil of secrecy. Employees are questioning our accounting propriety" etcetera. Aren't those all issues around accounting?

Mr. DILG. Yes. All those statements relate to accounting.

Ms. DeGETTE. Did you understand what those allegations were?

Mr. DILG. We understood her base allegation to be concern about the fact that the Raptor vehicles were supported by Enron stock and that Enron had hedged investments made against those.

Ms. DeGETTE. Right, and she had specific concerns about specific transactions. Did you ever have any independent accountant look at those transactions?

Mr. DILG. We did not.

Ms. DeGETTE. Now, why not?

Mr. DILG. Our charge for the initial review was to determine whether there were facts sufficient for a further review. We were not to review the accounting advice given by the accounts that Enron's audit committee had decided to use for accounting advice.

Ms. DEGETTE. If the allegation is that the accounting is funny, and you rely on the accounting to come to your conclusion, how can you conclude that there's not a problem with the accounting without any kind of outside analysis?

Mr. DILG. We were concerned with making sure that Arthur Anderson had at their disposal all the material facts relating to the transactions and we did try to verify that.

Ms. DEGETTE. And did you find that out? Did they?

Mr. DILG. Yes.

Ms. DEGETTE. How did you find that out?

Mr. DILG. We gave them Ms. Watkins' letter and walked through with their engagement partners point by point under Ms. Watkins' letter and——

Ms. DEGETTE. Did they have the information, so, from that you concluded yes?

Mr. DILG. They were very well aware of the issues that she was raising and that they felt very comfortable with the accounting decisions they had made in connection with the transaction.

Ms. DEGETTE. Let me ask you this, did you ask Anderson to provide you a detailed analysis of the allegations that Ms. Watkins made in her memo, most specifically, the Raptor deals and the other deals? Did you ask them for a detailed analysis or did you just say, does this look okay to you and they said yes, and that was it?

Mr. DILG. We gave them the letter, I believe, a day or so before a meeting that we had with Mr. Duncan and Ms. Cash. We did not ask for a detailed, written analysis.

Ms. DEGETTE. So you don't know to this day what Arthur Anderson's analysis would have been of the transactions that formed the basis of Ms. Watkins' concerns?

Mr. DILG. Arthur Anderson had included those transactions in the scope of their overall audit of the company and they confirmed to us verbally that they were still comfortable——

Ms. DEGETTE. This seems like an incredible circle to me. She says well, there's problems with the audit, so you go ask the people that did the audit. They say the audit was okay, so it just comes back to point one.

How could you decide independently if it was true or not?

Mr. DILG. We could not decide on whether the accounting was correct. We're not in position to do that. We could decide whether the Big Five accounting firm that the company's audit committee had decided to rely on for accounting advice were aware of the concerns and that they were still satisfied with their accounting advice.

Ms. DEGETTE. But if the accounting—if the concern of the whistle blower is that the accounting is wrong, then how can you determine there's not a problem if you're relying on the people doing the accounting to give you the analysis?

Mr. DILG. I think Ms. Watkins' concerns, and I don't want to speak for Ms. Watkins, but based on her letter and our interviews were not with the technical accounting side. She disagreed with the concept that you could support a transaction with your own stock.

Ms. DEGETTE. Okay, let me ask you one more question. Now you said here there's some problems with cosmetics. You thought it might look bad, right, in your report?

Mr. DILG. We laid out——

Ms. DEGETTE. You used that word, you said that there's some problems with cosmetics.

Mr. DILG. We did use the word cosmetics.

Ms. DEGETTE. But then you said you had some concerns that there might be litigation as a result of this, correct?

Mr. DILG. We had concerns that we expressed both in the letter and in oral conversations that in the event of the litigation, these transactions could be portrayed very badly.

Ms. DEGETTE. Well, actually, you said that you were concerned that there might be litigation. Right? You said, "there is a serious risk of adverse publicity and litigation." That's the last page, page 9 of the October 15 letter.

Mr. DILG. Yes.

Ms. DEGETTE. She's handing it to you right now.

Mr. DILG. Thank you.

Ms. DEGETTE. Did you undertake any other, any further risk analysis on behalf of your client, Enron, to let them know what those litigation risks were so that they could rely on your advice and conduct a narrow internal affairs?

Mr. DILG. We did advise the company of the litigation risk. Again, these were transactions that had been entered into by the company some 18 months to 2 years before. There had been serious declines in the market value of the investments that had been hedged against them. The company terminated these vehicles shortly after our initial meeting with Mr. Lay and Mr. Derrick.

Ms. DEGETTE. Can I just stop you? We don't have any document that would indicate the advice you gave to Enron relating to the litigation risk. Does such a document exist or did you give that advice verbally?

Mr. DILG. It's here in the October 15 letter.

Ms. DEGETTE. So there's no additional documentation other than this?

Mr. DILG. There was an outline, I believe that the committee has of our discussion of Mr. Lay and Mr. Derrick.

Ms. DEGETTE. But there's no additional memo about litigation risk?

Mr. DILG. That's correct.

Ms. DEGETTE. Thank you very much, Mr. Chairman.

Mr. GREENWOOD. The chair thanks the gentlelady from Colorado and recognizes the gentleman from Florida for 10 minutes for purposes of inquiry.

Mr. STEARNS. Thank you, Mr. Chairman. Mr. Dilg, I saw in your opening statement, I just re-read it, you talked about that you felt the lawyers that you dealt with with Enron were highly capable, well qualified attorneys. Then you talked about your relationship with Enron and you were proud of it. I think that's what you said in your opening statement?

Mr. DILG. Yes sir.

Mr. STEARNS. In hindsight, do you think there's anything you would have done differently dealing with Enron?

Mr. DILG. I do not think so.

Mr. STEARNS. So you would not have changed an iota of anything that you did with Enron in your advising, in your consulting, in your procedures with them?

Mr. DILG. We performed a great deal of work on very many projects for Enron over a long period of time. To my knowledge, there's nothing that I'm aware of that we would change.

Mr. STEARNS. Okay, so we've established the record that everything you did during that time with Enron, you would do it again, the same thing. Is that correct?

Mr. DILG. From my personal standpoint, yes.

Mr. STEARNS. This, to me is a little bit far fetched. If I were you, I would say look, we made some mistakes. We're sorry, we could have improved. There are some areas we could have changed. But to come up here and say there's absolutely nothing you would change, did you ever think about not continuing Enron as a client?

Mr. DILG. No sir, not until after the bankruptcy.

Mr. STEARNS. So it took you to the absolute meltdown of this corporation before you said we'll just not have Enron as a client. Is that true?

Mr. DILG. That's correct.

Mr. STEARNS. And all during that time, there were no indications to you that Enron was performing functions that were illegal in your opinion?

Mr. DILG. Never had any information that would indicate to me that Enron was performing an illegal act.

Mr. STEARNS. How much did you charge V & E for its investigation of the Watkins letter?

Mr. DILG. How much did we charge Enron?

Mr. STEARNS. How much did V & E charge Enron for the investigation of the Sherron Watkins letter?

Mr. DILG. I don't have the precise figures. I believe it's around $60,000. We conducted that very quickly.

Mr. STEARNS. In your testimony, you define the role of legal counsel. Let me just read from this. "If a transaction", you say, "is not illegal and has been approved by the appropriate levels of a corporate management, lawyers, whether corporate counsel or with an outside firm, may appropriately provide the requisite legal advice."

So if a transaction is not illegal, not illegal and it's been approved by the corporate management, who determines whether a transaction is legal or not? Isn't that your job?

Mr. DILG. Based on the information we would have at the time we were rendering the legal services, that's certain advice that we would give.

Mr. STEARNS. That kind of answer gets me concerned. If I understand, the whole purpose of V & E is to take the facts that are given to you, figure out if there is a legally appropriate way to do it, isn't that what your law firm does? Anderson comes to you, we want to do this, you show them how to do it legally. Isn't that the whole purpose of your law firm?

Mr. DILG. That is the type of advice we render on certain matters, when we're asked. We do litigation matters. We do lots of different things.

Mr. STEARNS. I think every law firm in America is trying to advise their clients what's legal to do. And you're saying that you, as the counsel for Enron, never saw anything egregious about anything they did during the entire relationship you had with Enron. That's what you're telling us today?

Mr. DILG. Yes sir.

Mr. STEARNS. Now when Mr. Skilling came here, he gave pretty much the same tact you have done, you know. I used the term with him "plausible deniability."

I don't know if that term fits you, but the approach you're taking here is total unrepentence, a feeling that you did nothing wrong and that you and your entire legal firm with all these high powered lawyers, never saw a red flag during the whole process and you never thought about separating your relationship with Enron until the meltdown and until the bankruptcy. That's what you're telling us today.

Mr. DILG. I believe the earlier question was whether we ever saw anything illegal. That's what we're qualified to determine. Red flag is a term that I'm not sure that I feel comfortable with. But then again, it's to my knowledge we never saw anything at Enron that we considered illegal. Our ethical obligations would require us to withdraw if we did and if they did not follow our advice in pursuing an illegal action.

Mr. STEARNS. Mr. Sefton, prior to your coming here, I had the opportunity to question Mr. Mintz, your successor. He testified that when he saw virtually identical language that was in the LJM2, identical language in the PPM for LJM3 in late 2000, he became very concerned. He was alarmed, because it suggested that Fastow was promoting his access to inside information as a way to promote investment in his partnership.

He raised his concern with Enron's legal team and V & E. Mr. Dilg, did you know that he raised that? Mr. Mintz raised that with you folks about his concern about Fastow's inside—promoting his access to inside information? Did you ever know about that? Just yes or no?

Mr. DILG. I don't believe I recall any specific conversations with Mr. Mintz.

Mr. STEARNS. Mr. Sefton, did you know about Fastow and what he was doing? Because you prepared the LJM2 papers, didn't you?

Mr. SEFTON. No, I did not prepare those papers.

Mr. STEARNS. Didn't you review them?

Mr. SEFTON. I saw some of the documents relating to LJM2.

Mr. STEARNS. How can you see some and not the entire document? Do they come one page at a time?

Mr. SEFTON. LJM2 was represented by Kirkland & Ellis which was their outside counsel. They did essentially all the work on putting that deal together.

Mr. STEARNS. Well, did you review the private placement memorandum?

Mr. SEFTON. Yes, I did.

Mr. STEARNS. And there was no concern by you on this, even though your successor, Mr. Mintz, testified that he had great concern about the PPM for LJM3 and yet you had no concern, is that correct?

Mr. SEFTON. I have never discussed with Mr. Mintz the reasons for his concerns.

Mr. STEARNS. Mr. Skilling did not sign any of these documents. Should Mr. Skilling have signed some of these documents?

Mr. SEFTON. His signature was called for on the form, yes.

Mr. STEARNS. When I go to a closing on my home, if I don't sign the document, my lawyers says, "Mr. Stearns, you better sign this document or the deal is not going to be credible."

Now your job was to review these partnerships, is that correct?

Mr. SEFTON. No, that's not correct.

Mr. STEARNS. Okay. Did you see these partnership agreements?

Mr. SEFTON. No, I did not.

Mr. STEARNS. But you just told me earlier that you saw a part of LJM2?

Mr. SEFTON. I saw the private placement memorandum.

Mr. STEARNS. Okay, would you have discerned whether Skilling signed or not that? Could you recognize in that he did not sign it?

Mr. SEFTON. I don't believe his signature was called for in connection with the private placement memorandum.

Mr. STEARNS. If you don't mind, pull the mike a little closer.

Mr. SEFTON. Sorry.

Mr. STEARNS. Did you sign the approval sheets for the LJM2? Did you sign them?

Mr. SEFTON. Yes, I did.

Mr. STEARNS. Now if you signed them that meant that you were approving the LJM2 partnership, is that correct?

Mr. SEFTON. That is not my understanding.

Mr. STEARNS. So when you sign a document that's the approval sheet, it's your understanding that that does not mean it's an approval sheet?

Mr. SEFTON. The approval sheet requires approval by Mr. Buy and Mr. Causey. Those were the two senior executive officers of the company who were required to approve the transactions by the board of directors.

Mr. STEARNS. Mr. Derrick, what was your role in helping the board of directors understand the LJM transactions? As general counsel, did you advise them on the controls they implemented to avoid conflicts in doing business with LJM and did you recommend that they implement any additional controls?

Mr. DERRICK. Congressman, the only—best of my recollection, the only board meeting that I was at with respect to the LJM was the LJM1 transaction in which was viewed as simply a on-off transaction. There were no controls, as I recall the discussion at that point, because it was already a deal that they were looking at specifically with a fairness opinion.

With respect to the other LJM matters, I did not personally participate in the controls and I was not at the meetings at which LJM2 was——

Mr. STEARNS. Mr. Derrick, I just have a little time left. All of us on this committee are just having a difficult understanding why

Mr. Skilling didn't sign these documents and why you, as a former general counsel of Enron didn't get a concern when Skilling didn't sign these documents because I would think part of your job as the former general counsel of Enron is to make sure all the documents are properly signed.

Mr. DERRICK. Well, Congressman, as we have said, we had almost 250 lawyers in a decentralized department——

Mr. STEARNS. You had too many people to enforce the signing of the document?

Mr. DERRICK. No, but the responsibility for that was allocated by the board to Enron Global Finance and their attorneys. Those were not documents that were toward me.

Mr. STEARNS. Mr. Sefton, what's your comment?

Mr. SEFTON. With respect to what?

Mr. STEARNS. Documents that Mr. Skilling should have signed, were not signed. Shouldn't that raise some flags?

Mr. SEFTON. Yes, and it did.

Mr. STEARNS. I mean because Mr. Derrick is saying you're supposed to have done it, so he's bouncing—aren't you, Mr. Derrick, bouncing the ball back to Mr. Sefton and saying Mr. Sefton was supposed to do that? Isn't that what you just said?

Mr. DERRICK. I don't mean to be bouncing balls, Congressman. I'm just saying the board had allocated that responsibility to a particular group, a legal group in our organization.

Mr. STEARNS. I would think the general counsel of Enron might be that particular group you're talking about. So Mr. Sefton, at this point I'm finding it hard to believe that you wouldn't be involved in making sure all these documents were properly signed.

Mr. SEFTON. I'd like to just say that it was never my understanding that the board delegated this job to Enron Global Finance legal. That was never my understanding.

Mr. STEARNS. Whose responsibility was it? If it wasn't yours, whose responsibility? You ere the top poobah here, the former—you were the counsel for Enron. I mean if you're not responsible, the Global Finance, who else could there be?

Mr. SEFTON. I believe the approval process called for the business unit that was doing the transaction to complete the signatures and get the signatures on the form.

Mr. STEARNS. Well, Mr.——

Ms. DEGETTE. Will the gentleman yield real quick——

Mr. STEARNS. I want to finish. The general counsel, Mr. Mintz, I mean he tried. He said I sent him a memo in May 2001. I gave him about a week to respond. This is Mr. Mintz saying. I didn't hear from him. I asked my secretary to call his secretary to see if I could get him on the schedule. He tried and tried and tried. And Mr. Mintz was unable to get the signature on the approval sheets. I mean who should he have gone to? I mean aren't you the responsible one to help out here?

Mr. SEFTON. No, Mr. Mintz is my successor.

Mr. STEARNS. Yeah. I mean you weren't aware of this problem at all with Mr. Skilling? Are you saying today you had no knowledge about Skilling not signing these documents, is that your statement today?

Mr. SEFTON. No, I'm not.

Mr. STEARNS. You knew he didn't sign the documents?

Mr. SEFTON. I know that his signature wasn't on all the forms.

Mr. STEARNS. Okay, so if they weren't on all the forms, should they have been on all the forms? Just yes or no?

As a general counsel, should his name have been on the forms, yes or no?

Mr. SEFTON. I understand that the——

Mr. STEARNS. No, just yes or no. Should they be on the forms?

Mr. SEFTON. Well, I'd like to answer by saying that the approvals required by the board of directors required approval by Mr. Buy and Mr. Causey and that's what the board said had to be done in order to approve these transactions because of the conflict of interest.

Mr. STEARNS. No. I'm just asking your general, your legal opinion here as a general counsel. Should Skilling's name have been on those forms?

Mr. SEFTON. The board did not call for that.

Mr. STEARNS. So they don't have to be on the forms, is that what you're saying?

Mr. SEFTON. The board did not recall Jeff Skilling to sign those forms.

Mr. STEARNS. But you just told me earlier that his name should have been on the forms. You just told me a moment ago.

Mr. SEFTON. His signature was called for by the form itself, but it wasn't required by the board procedures.

Mr. STEARNS. Didn't you create the form? Who created the form?

Mr. SEFTON. I did assist in preparing the form.

Mr. STEARNS. Assist, now wait a second. You created the form, Mr. Sefton. You asked that his name be on that form. You told me his name should have been on that form and it wasn't on the form.

Mr. SEFTON. No, I——

Mr. STEARNS. That's the facts we've just established.

Mr. SEFTON. No, I did not ask that his name be on the form.

Mr. STEARNS. Who did, because you said his name should have been. And you prepared the form, so who else could there be?

Mr. SEFTON. Mr. Fastow suggested that Mr. Skilling's name be added.

Mr. STEARNS. And did you make sure that that name was added in the nomenclature underneath saying blank line, Mr. Skilling?

Mr. SEFTON. Yes, I did.

Mr. STEARNS. So you had on the form that Mr. Skilling's name should have been there. You prepared the forms. You said he should have been on there. Now tell me why didn't you make sure it was not on the form?

Mr. SEFTON. Well, what I haven't mentioned to you is that when I became aware of the fact that some of the forms had not been signed by Mr. Skilling, I raised this issue with Mr. Fastow and told him that there was an issue here that we needed to deal with.

Mr. STEARNS. Needed to deal with is probably a good way to summarize this.

Mr. Chairman——

Ms. DEGETTE. Mr. Chairman, can I ask unanimous consent for 15 seconds?

Mr. GREENWOOD. Without objection.

Ms. DEGETTE. Mr. Rogers, in your position, did you think that Mr. Skilling was supposed to sign those forms?

Mr. ROGERS. Madame Chairman, let me reach over here. This is pretty uncomfortable. Congresswoman, excuse me. I'm getting off to a bad start. I think these processes for policies and procedures for ensuring that these transactions with LJM were not adverse to the best interest of Enron and that they were arm's length——

Ms. DEGETTE. I asked a kind of a simple question. Can I get kind of a simple answer? Did you think Mr. Skilling was supposed to sign the forms?

Mr. ROGERS. In the beginning, that was not my understanding.

Ms. DEGETTE. Okay.

Mr. ROGERS. That was an important factor for the Board. When I said earlier, as these processes evolved and the in-house counsel reviewed the policies and procedure to see how they could be refined and improved, it was clear to me through reading minutes of the board that the board considered Mr. Skilling's approval to be important.

Ms. DEGETTE. Thank you. And so you thought he was supposed to sign the forms as it went on?

Mr. ROGERS. I did think he was supposed to sign the forms as it went on.

Ms. DEGETTE. Thank you.

Mr. GREENWOOD. The time of the gentlelady has expired. The chair would inform the witnesses and the members of the committee that we have what appears to be a relatively brief series of votes that we must address on the floor, so we will recess now for at least 20 minutes and I can't give you a precise time because of the uncertainty of the votes, but it will be about 20 minutes.

[Off the record.]

Mr. GREENWOOD. The hearing will come to order. The chair recognizes the gentleman from Michigan, Mr. Stupak for 10 minutes for inquiry.

Mr. STUPAK. Thank you, Mr. Chairman. Mr. Dilg, just to ask you some questions and you had indicated in your response that there was this litigation risk and then you went on and said that because of serious decline in the market that there would be a litigation risk. Is that some quick summary of what you said to Ms. DeGette, that there would a litigation risk because of serious decline in the market?

Mr. DILG. Right, Enron shares dropped possibly 60 percent or so in the last year, at a point in time in August and in September when we were writing this report.

Mr. STUPAK. So as long as the market stayed up, Enron would never be in trouble, is that correct?

Mr. DILG. No sir, I don't believe that was the rationale.

Mr. STUPAK. There wouldn't be any problem unless there was lawsuits. The only lawsuits are going to come when people start losing money. So all these transactions, partnerships, these SPEs, that's okay, as long as the market stays up and Enron can cover the cost? Is that sort of the conclusion of the logarithm?

Mr. DILG. No sir. The Raptor vehicles had had some very severe losses hedged against them. I think it was Mr. Causey that told us in our interviews that they were designed to deal with volatility, not a complete collapse of market.

Mr. STUPAK. Sure, they're supposed to hedge in case there's a fall, and they're supposed to hedge, right, or put says Mr. Deutsche likes to put it, right?

Mr. DILG. That's as I understood the purpose of the transactions.

Mr. STUPAK. But puts and hedges are not legal, if you're putting up your own company's stock as Enron did, correct?

Mr. DILG. I don't believe that's correct.

Mr. STUPAK. What do you believe is correct, if my statement was incorrect?

Mr. DILG. I believe there was a business purpose. The fact that the vehicles were supported by Enron stock, we saw in our review nothing that made them illegal because of that.

Mr. STUPAK. So there was no business purpose to these SPEs, is that what you're saying? That's what made them improper?

Mr. DILG. No, I didn't say they were improper. The business purpose, as I understood from Mr. Causey during our review was that they were to hedge against volatility in some of the stock, some of the investments that Enron had made.

Mr. STUPAK. You know everyone up here at the table at least all say I don't have an accounting background. I'm not an accountant, you know. I only know the legal/technical merits. But none of us on this committee has accounting backgrounds. We're not accountants. We can figure out a few things and it doesn't take a lot for us to figure out. We've only had 4 or 5 hearings. You guys have spent more time, in fact, with Enron for many, many years. It seems to me, it seems to me that when you get the memo from Ms. Watkins, and if you just took a look at the letter, not even all the details. If you just read the letter. It said Skilling's abrupt departure will raise suspicions of accounting improprieties. I'm on 14 if you care to follow along, second paragraph. "Will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in accounting, most notably in the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions."

So her letter is more than just Raptor and Condor. If you go down to the fourth paragraph, excuse me, fifth paragraph, second line it says "the value in the swaps won't be there for Raptor. So once again, Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to laymen on the street that we're hiding losses in a related company and will compensate that company with Enron stock in the future."

So she's really just laying it out there. You don't need to be an accountant. You don't need to be a Member of Congress. She said a lay person on the street can understand this. The problem I'm having and some of my colleagues are as we're talking at the votes, all these smart attorneys up here, they can't figure it out, but the lay person on the street can figure it out. Our concern is what's the relationship here? If you take a look at, if we just take a look at the table here, I believe what, Mr. Derrick worked for many years for Vinson & Elkins on the Enron account and you were at Enron, right?

Mr. DERRICK. Right.

Mr. STUPAK. So you have 25 years there at least.

Mr. DERRICK. It was 20 years, Congressman.

Mr. STUPAK. But Mr. Dilg, you replaced Mr. Derrick and Vinson & Elkins. It just seems like such a cozy relationship that even when you get a memo that says even the common lay person on the street can figure it out, none of you guys can figure it out.

Mr. DILG. I'm not positive how to respond, Congressman. We did understand that the Raptor partnerships were supported largely by Enron stock. That was in Enron's disclosures in the 10(k) and 10(q)s, etcetera.

What I don't understand from your question is the assumed illegality of that.

Mr. STUPAK. Well, okay, I'm not asking for a legal conclusion. You said you charged $60,000 to review the Watkins memo. Now with that $60,000, I'm sure it's not just for your technical, legal merit. I'm sure whatever rate you charge is based upon reputation of the firm, common sense, knowledge. In fact, you didn't go outside Enron because you guys had all the knowledge and therefore it would be easier to do a good review.

I guess my concern is you bring all this experience and expertise, but when we get to a real question, it's either I don't have accounting experience or we didn't see the technical/legal merit. You come and you're hired and you bring other attributes with you as individuals, as attorneys and as professional people. It seems like to some of us up here that those other attributes were just a blind eye was cast when you looked at this memo because it's all within the house. I would think when you look at this memo words like "aggressive accounting, creative accounting" would sort of send a signal to someone with all this experience not only within Enron and Vinson & Elkins, but even the lay person on the street, those are red flags and we should take a more serious in-depth look at it which you don't even hire an accountant, where admittedly you say you're not an accountant. I would then think, as Ms. DeGette was trying to say, you'd at least hire an account when you have these red flags out here and you're charging this company. There seems to be a circle that you don't want to connect here.

Mr. DILG. I do think our October 11 and our earlier conversations with Mr. Lay and Mr. Derrick pointed out that the accounting, even though Arthur Anderson said they stood by it and still felt that it was proper, was aggressive and creative. We did see that as a red flag and we did put that in our letter to make sure that people understood that.

I think Mr. Lay and I'm not sure all the reasons that went into it, but that may well have been one of the reasons they terminated the Raptor transactions in the third quarter of 2001.

Mr. STUPAK. Well, okay. Let me ask Mr. Rogers. You were certainly throughout this year the vice president, associate general counsel. Have you ever heard the words aggressive or creative applied to any Enron accounting before?

Mr. ROGERS. By anyone? I certainly heard of it——

Mr. STUPAK. No, no. I mean before this whole mess started. Is creative and aggressive accounting, is that proper terminology you use?

Mr. ROGERS. That's not terminology that I would use. I hadn't heard that referred to with Enron's accounting practices.

Mr. STUPAK. What does aggressive and creating accounting mean?

Mr. ROGERS. I don't know what it means.

Mr. STUPAK. How about Mr. Derrick, Mr. Dilg? Mr. Rogers doesn't know what it means, but yet you guys used it in your report. So what does it mean, aggressive and creative? Mr. Derrick?

Mr. DERRICK. Well, it actually was not my report, Congressman, but no, I can't——

Mr. STUPAK. It was a report to you from Vinson & Elkins.

Mr. DERRICK. Right, I can't explain what aggressive and creative accounting——

Mr. STUPAK. What did you think of it then when they sent you this report. You paid $60,000. They send you a report and it says "aggressive and creative."

Mr. DERRICK. I think the comfort that we took from the report was that they had discussed these very things with Anderson that we paid millions of dollars——

Mr. STUPAK. Let's back to the words though. What did it mean to you? What did it mean to you when you saw on page 7, you got this report and you're anxious because there's some allegations being made. You read it. You get to page 7, there's "aggressive and creative accounting." Did you take great comfort in that?

Mr. DERRICK. It was, I believe, the following sentence where it was no one had any reason to believe that the accounting was not technically correct and they had discussed these very issues with the firm that our audit committee had determined was the appropriate accounting firm for the company.

Mr. STUPAK. So even though you saw the words aggressive and creative, you thought, oh, it's no big deal because Anderson said it was okay?

Mr. DERRICK. If the next sentence it says "and by the way, Anderson does not believe it's okay" that would have been obviously a great cause of concern.

Mr. STUPAK. Mr. Dilg, you wrote the memo then. What did aggressive and creative mean in accounting? What does that mean?

Mr. DILG. I'm not sure that we put a terminology on it, Representative. We were reporting what we'd been told during our interviews. I think Mr. Buy used the word aggressive.

Mr. STUPAK. Mr. Buy did?

Mr. DILG. I'm not sure. I need to look back through the interview memos to see exactly where, but those words, obviously, were things that we felt like we needed to convey, even though Arthur Anderson said they were still satisfied with the accounting and had reviewed Ms. Watkins' letter and the allegation she made.

Mr. STUPAK. But you'd agree that those aren't generally accepted terminology we used in accounting, right?

Mr. DILG. Uh——

Mr. STUPAK. Again, you don't have to be an accountant to answer this one.

Mr. DILG. I don't believe they're part of generally accepted accounting practices, but I understand that Arthur Anderson was very convinced that these met generally accepted accounting principles.

Mr. STUPAK. All right. If you take a look at the report there. Let me get the exact report here, the Powers Report. And if you take a look on page 176, again, The Rogers Commission, Report or whatever you want to call it, sees this very different. If you look on page 176, it talks about the shared Watkins letter. I'm quoting now, "provided a road map to a number of the troubling issues presented by Raptors." It goes on next paragraph, "We identified the most serious problems in the Raptor transactions only after detailed examination of the relevant transaction and most importantly discussions with our accounting advisors. Both steps at Enron and V & E excepted, would not be part of B & E's investigation. With the exception of Watkins, B & E spoke only with the very senior people at Enron and Anderson. Those people, with few exceptions, had substantial professional and personal stakes in the matter under review." That's the part that's probably troubling most of us. This circle, as I spoke of, will you take a look at these transactions, who's the approving legal counsel but Vinson and Elkins? And you were asked to look at these transactions that you had previously approved and yet you never even had an accountant when you all say you're not accountants even look at it. The closeness, the coziness of the relationship is the part that's bothering a lot of us on this committee.

Do you care to add anything to that?

Mr. DILG. Only that we were asked to do a preliminary review and we did talk to the people that Ms. Watkins laid out in her letter to check with. I think she said to see if I'm all wet.

Mr. STUPAK. But preliminary review, I mean you did nothing further after this.

Mr. DILG. I'm sorry?

Mr. STUPAK. You used the word "preliminary review" as been established early. You really did nothing after this.

Mr. DILG. Our preliminary review was to determine whether a further review was necessary.

Mr. STUPAK. And you determined there was no further review.

Mr. DILG. And we believed at the time we gave the report, no further review was necessary.

Mr. STUPAK. Not even by accountants?

Mr. DILG. I'm sorry?

Mr. STUPAK. Not even by an accounting firm outside of Arthur Anderson?

Mr. DILG. Arthur Anderson, again, was one of the Big Five accounting firms that had been chosen by the Audit Committee at Enron.

Mr. STUPAK. Right. All in-house, right? All in-house. Arthur Anderson, in-house. They had attorneys in-house. They had accountants in-house, right? And you never talked to any of those people.

Mr. DILG. We talked to the leading engagement partner for Arthur Anderson.

Mr. STUPAK. Head guy at Anderson. Those people had substantial professional and personal stakes in the matter under review as it says in the Powers Report, right? Those were the people that were talked to.

Mr. DILG. I don't know how they characterized the personal stakes they had in it. They had the credibility of their veracity on the line.

Mr. STUPAK. They had a dog in the fight, let's put it like that.

Mr. DILG. We had no reason to believe that we couldn't believe them.

Mr. GREENWOOD. The time of the gentleman has expired. The chair recognizes the gentleman from North Carolina, Mr. Burr for 10 minutes to inquire.

Mr. BURR. Thank you, Mr. Chairman. Mr. Sefton, let me ask you, I would take for granted everybody at the table has kept up with the hearings that have happened in the house and with the publicity that exists around Mr. Skilling's testimony, I think most of you probably know that he lacked the ability to remember a lot of things and in some cases suggested that he had no relation to the involvement of the partnership.

Let me ask you, Mr. Sefton, do you believe that Mr. Skilling was accurate in his testimony in front of Congress?

Mr. SEFTON. During my time in Enron Global Finance, I don't believe I had any conversations with Mr. Skilling at all. So I have no basis on which to judge.

Mr. BURR. But you did leave some handwritten notes about your understanding of the makeup of the partnerships and the need for Mr. Skilling's signature to accompany the approval, didn't you?

Mr. SEFTON. I'm not sure that my notes talk about his——

Mr. BURR. Who replaced you?

Mr. SEFTON. Jordan Mintz.

Mr. BURR. And didn't Mr. Mintz testify to us that it was, in fact, the notes that you left when you served in his role that sort of guided him as to what everybody's involvement was and who had to sign off?

Mr. SEFTON. I didn't hear Mr. Mintz testify to that.

Mr. BURR. Was that the intention of any of the notes that you wrote, if they referred to the need for Mr. Skilling's signature, is that something that you understood was needed?

Mr. SEFTON. As I explained earlier, I did not understand that it was required by the Board when they waived the conflict of interest.

Mr. BURR. Mr. Derrick, do you believe that from what you know, Mr. Skilling was completely candid with his testimony in front of Congress?

Mr. DERRICK. Well, Congressman, as you can appreciate, I have no way of knowing, in fact, what Mr. Skilling did or did not know. If your question relates to whether it was my view that his signature was required on the documents, certainly based on my conversations with Mr. Mintz, that would have been my understanding.

Mr. BURR. Did Mr. Mintz dream this up? Was it printed somewhere or did he get it from the notes that Mr. Sefton left?

Mr. DERRICK. I don't know where Mr. Mintz received his information. I do recall though that at one of the Audit Committee meetings that it was presented as a control mechanism by Mr. Causey, as I recall, and Mr. Mintz was there. But as to the basis for where that came from, I don't have personal knowledge of that.

Mr. BURR. There was one thing that I know was printed at Enron and that was the Code of Conduct, correct?

Mr. DERRICK. Correct, yes sir.

Mr. BURR. The Code of Conduct was waived by the board in at least two instances for Andy Fastow, am I correct?

Mr. DERRICK. You are correct.

Mr. BURR. Were you ever consulted as counsel on whether that was a smart thing for Enron to do?

Mr. DERRICK. Congressman, I don't ever recall being consulted.

Mr. BURR. Did you ever supply a recommendation on whether as counsel the board should waive the Code of Conduct?

Mr. DERRICK. I don't recall being consulted on that.

Mr. BURR. Mr. Dilg, was your law firm consulted on the board's decision whether they should waive the Code of Conduct?

Mr. DILG. We did not advise the board.

Mr. BURR. It's a very reputable law firm nationally. Is it common for companies to have a Code of Conduct that is waived the way that Enron has waived this Code of Conduct or waive a Code of Conduct at all?

Mr. DILG. I could speak to what's common, Representative, by companies that have Codes of Conduct have them there for a purpose which is to make sure they know where there is a conflict of interest and they feel that they've dealt with it appropriately.

Mr. BURR. That's my understanding from CO's as well and they have also expressed to me in my conversations that they can't imagine that it would take an unbelievable circumstance within their company for a Code of Conduct to be waived.

Let me go back to you, Mr. Sefton. I think the LJM2 approval sheet was your creation and I just want to ask you because as I go down the sheet from that sheet it says the persons negotiating for Enron, Ben Glisson. Excuse me, this is for Raptor. Persons negotiating for LJM, Michael Kopper. Both who work for Fastow, correct?

Mr. SEFTON. Yes.

Mr. BURR. In the 2000 Proxy, as it relates to it, it says these transactions occurred in the ordinary course of Enron's business and were negotiated on an arm's length basis with senior officers of Enron other than Mr. Fastow.

Is the term "at arm's length" in this proxy statement an accurate depiction of the negotiations that took place between Mr. Glisson and Mr. Kopper, in your opinion?

Mr. SEFTON. I believe the reference to senior officer is to Mr. Causey and Mr. Buy.

Mr. BURR. I'm reading off the sheet. Listen, persons negotiating for LJM, Michael Kopper. As counsel, how did you monitor the negotiations or did you?

Mr. SEFTON. I don't believe I monitored the negotiations.

Mr. BURR. Mr. Sefton, on June 28, 2000 you signed this approval sheet. So I would take for granted it was your understanding that at that time what was on this sheet was accurate, that the negotiations took place between Glisan. He also signed the sheet. In addition, Mr. Rogers, is your name Rex?

Mr. ROGERS. Yes sir.

Mr. BURR. You signed this sheet too.

Mr. ROGERS. Yes sir, my signing those deal approval sheets were for the limited purpose of Section 4(a) which was——

Mr. BURR. Just share with us, if you will, since there's some confusion. Who negotiated for Enron and who negotiated for the partnership?

Mr. ROGERS. On this particular transaction or any transaction?

Mr. BURR. This one.

Mr. ROGERS. I don't know the answer to that.

Mr. BURR. Mr. Derrick, on October 17, Enron was informed by the SEC of an inquiry, correct?

Mr. DERRICK. That is correct.

Mr. BURR. And what date was the first memo that went company-wide to Enron relative to a change in the document protection of rules at Enron?

Mr. DERRICK. If memory serves me correctly, Congressman, I believe it was on October 25 with respect to the litigation that had been filed.

Mr. BURR. Share with me with all the concerns that didn't start with October 17, what transpired in an 8-day period at Enron and specifically in the legal counsel's office that would delay for 8 days a memorandum to protect all documents given that you knew that there was an SEC inquiry?

Mr. DERRICK. As you know, Congressman, we sent out a number of e-mails with respect to document presentation, preservation. I think with respect to the limited time that you're referring to, following the communication from the Securities and Exchange Commission, Mr. Rogers became involved in that as our representative, having been a former member of the SEC's organization.

If your point is were we concerned about any document destruction at that time——

Mr. BURR. Was this the first SEC inquiry that had been presented to Enron?

Mr. DERRICK. I'll have to refer to Mr. Rogers. I don't personally recall another SEC inquiry.

Mr. BURR. Mr. Rogers, is an SEC inquiry, given that you've got some SEC experience, is that a serious thing?

Mr. ROGERS. Very serious.

Mr. BURR. Would you as with your knowledge of SEC and law background, is that something that would immediately send off a signal we need to protect everything that's here?

Mr. ROGERS. Yes sir.

Mr. BURR. And what would take 8 days in your opinion to determine it's time to send out a company-wide memo to say don't throw anything away, this is serious.

Mr. ROGERS. I don't know the answer to that. I think in those first several days after the notice or the inquiry from the SEC, there was a lot of activity at Enron through responses to media requests.

Mr. BURR. But you served in a legal capacity, correct?

Mr. ROGERS. That's correct.

Mr. BURR. And in a legal capacity with an SEC background, you couldn't have been distracted by media requests, given the seriousness that you knew this inquiry weighted?

Mr. ROGERS. No sir, our immediate reaction was to respond to the SEC request for documentation, for information. That was the immediate response.

Mr. BURR. Is part of an SEC inquiry and the request that goes along with it the protection of documents?

Mr. ROGERS. I don't recall that being part of the request, but certainly anyone at the company, certainly anyone in the legal staff is going to——

Mr. BURR. Knows that document destruction after that inquiry is noticed to be a serious, serious thing, right?

Mr. ROGERS. Yes sir.

Mr. BURR. And let me ask you, were you aware of any document destruction that took place at Enron?

Mr. ROGERS. I am not aware of any document destruction at Enron Corp.

Mr. BURR. Mr. Derrick, are you aware of any document destruction that took place at Enron?

Mr. DERRICK. I'm not aware of any relevant document—if you mean literally any document destruction, there are various things, trade secret issues that, of course, would legitimately be being disposed of, but in terms of any relevant document destruction, Congressman, I am not, and as you recall, later when there was a report which was widely publicized with respect to potential concerns about that, the response of Enron was to request the FBI to come in. We opened our doors and cooperated fully with them.

Mr. BURR. Clearly, you did, and I think there was a lag and I'm truly concerned on the 8 days. And my time has run out, but I would like to ask Mr. Dilg, short answer if you will, for the chairman's indulgence.

Were there legal opinions and/or work provided by Vinson & Elkins that were ignored by Enron?

Mr. DILG. Again, as I stated earlier——

Mr. BURR. You have advised them on numerous legal opinions. You've stated that.

Mr. DILG. We've advised on numerous legal matters. As I mentioned earlier, there's never a situation that I'm aware of where we advised the company that something would be illegal that they ignored that advice. We give advice on a daily basis to our clients as far as things that we think may be a better way to do something or often offer even business advice that companies may decide not to follow. That is sort of a normal occurrence, but when it comes to whether something is illegal, I'm not aware of Enron ever not following our advice in that connection.

Mr. BURR. I once again would like to thank all of you for your testimony today. I hope in the end, we're able to go back and read the transcripts and understand a little bit better what happened, but I've got to share with you that is frustrating from this end to actually hold documents that were at Enron that named partners, that named negotiators, that named participants. Nobody can remember whether they were involved or not, that from the top of Enron to the legal counsel at Enron that it seems like the only person that knew what was going on was Sherron Watkins. And I question whether she was taken seriously by anybody, including the review. It's quite honest that Enron probably got what they paid for, $60,000 you said, was—I thought that was a drop in the bucket for the degree of the accusations that were made. But I think that gives me some idea of exactly the extent of what you were asked to review. I thank you.

Mr. GREENWOOD. The gentleman's time has expired. The committee is joined by two members who are members of the full committee, but not the Subcommittee and I'm going to recognize them in one moment for inquiry. Before I do, I'm going to exercise the prerogative of the chair to follow up on something here.

I'm looking at an LJM2 approval sheet. It's Tab 20 in your notebooks. You may all want to refer to this. And it's about halfway through the set of documents in your notebooks in Tab 20. And this describes a deal between Talon, which is a Special Purpose Entity organized for the purpose of entering into certain derivative transactions. LJM2 says—it says that LJM2 through its 100 percent voting control, Talon has unilateral ability to make investment decisions for Talon. Now—it's the Raptor deal.

It indicates in the person negotiating for Enron in this case is Ben Glisan. The person negotiating for LJM is Michael Kopper. Obviously, both of these gentleman work for Mr. Fastow and each working for him under one of his different hats that he wore.

A number of you folks signed the approval deal. These transactions were negotiated by Enron employees who were working for both Enron and LJM2 at the same time. Enron's Year 2000 proxy statement reads, "These transactions occurred in the ordinary course of Enron's business and were negotiated on an arm's length basis, that senior officers of Enron other than Mr. Fastow" and that was signed by, among others, Mr. Rogers and Mr. Sefton.

My question is Mr. Sefton and Mr. Rogers, beginning with you, how did you ascertain that, in fact, these were arm's length—these negotiations were at an arm's length basis?

Mr. ROGERS. I'll respond first. Again, my signing off on all of these deal approval sheets was for the limited purpose of Section 4(a). Will this transaction require disclosure as a certain transaction in Enron's proxy statement? And the answer is yes. If any of the transactions has a value of $60,000 or more it will be disclosed in the proxy statement.

Mr. GREENWOOD. Were you aware that these two gentlemen were negotiating against one another?

You signed a document that said that you knew that they were, but that you knew that it was arm's length.

Mr. ROGERS. Again, I was signing for the limited purpose of Section 4(a).

Mr. GREENWOOD. Did you know that they were negotiating against one another? That's—let's take it one question at a time. Did you know that these two gentlemen were negotiating against one another?

Mr. ROGERS. I don't recall.

Mr. GREENWOOD. But you signed a form that said that you did and that, in fact, not only did you know that they did, but you knew that it was arm's length.

Mr. ROGERS. Well, signed for the purposes of Section 4(a).

Mr. GREENWOOD. Mr. Sefton, how about you? Did you know that these individuals were negotiating against one another?

Mr. SEFTON. Yes.

Mr. GREENWOOD. And did you sign a form saying that you knew that they were negotiating at this negotiation was at arm's length?

Mr. SEFTON. I signed the form.

Mr. GREENWOOD. Did you in signing that form, in fact, certify that they were negotiating at arm's length?

Mr. SEFTON. No, I did not.

Mr. GREENWOOD. What is the significance of your signature on the form? What were you certifying? What were you proving?

Mr. SEFTON. I think the important thing to remember is that this transaction is being approved by Mr. Buy and Mr. Causey, and that is the procedure that the board had put in place to ensure that the transactions were being done at an arm's length basis.

Mr. GREENWOOD. And how did you know that it was approved by Causey?

Mr. SEFTON. Because they are signing the form as well.

Mr. GREENWOOD. So in other words, your role when you get this form is to look on it and see if Mr. Causey's signature is on it and then certify that his signature is on it and put your signature on it to certify that his signature is on it. Is that right?

Mr. SEFTON. What? The board required——

Mr. GREENWOOD. Is that—just answer that question. When you signed these approval forms, what you were doing was saying, yup, I see Causey's signature on here. It's right above mine. I'll sign mine name to certify that I see Mr. Causey's signature. Is that what you did?

Mr. SEFTON. No.

Mr. GREENWOOD. What did you do?

Mr. SEFTON. I would also review the form and make sure it had been completed, all the blanks filled in. That it was properly filled out. Since I had been involved in creating the form, I was——

Mr. GREENWOOD. Whose job was it to—who certifies that, in fact, these transactions occurred in the ordinary course of Enron's business and were negotiated on an arm's length basis with senior officers of Enron's, other than Mr. Fastow? Whose job was that?

Mr. Derrick, can you tell us whose job it was to certify this was arm's length? This goes right to the core of the conflict of interest?

Mr. DERRICK. Well, I believe that it was Mr. Causey and Mr. Buy who were charged with the responsibility on the business side of that, in determining that. If there had been matters that were unlawful, I think that the lawyers would have been signing this. And let me say I did not create this form, but that would be my understanding, Mr. Chairman, is that the lawyers were there to ensure——

Mr. GREENWOOD. You were aware that they were negotiating against one another?

Mr. DERRICK. No, this is not a form that came to me, Mr. Chairman.

Mr. GREENWOOD. Would you have considered it improper if you knew that they were negotiating against one another?

Mr. DERRICK. At the time of this, again, I'm not sure what the date here was, but I don't think that we became aware that Mr. Glisan had any interest that was not tantamount to Enron's interest until after the investigation began.

Mr. GREENWOOD. The private placement memorandums list the principals. It says the day to day activities of the partnership will be managed by Mssrs. Fastow, Kopper and Glisan. So Mr. Sefton saw this form. Mr. Astin saw this form. Mr. Rogers saw this form. You all reviewed it and that didn't tell you that there was something less than an arm's length negotiation going on here?

Mr. ROGERS. I'm sorry, what form are you referring to?

Mr. GREENWOOD. It's the LJM2 co-investment LP. It's the private placement memorandum.

Mr. ROGERS. That's not an Enron document.

Mr. GREENWOOD. That's 21.

Mr. ROGERS. Okay. It's a private placement memorandum.

Mr. GREENWOOD. Right.

Mr. ROGERS. Of LJM. I reviewed a draft of it. I didn't see the final version of it.

Mr. GREENWOOD. Do you think the draft of it indicated that the partners were—that the day to day activities of the partnership will be managed by Fastow, Kopper and Glisan?

Mr. ROGERS. It was my understanding that Glisan was not in the final draft. I didn't see the final, but it was my understanding that wasn't going to be Glisan's role.

Mr. GREENWOOD. You can remember that?

Mr. ROGERS. I do remember that.

Mr. GREENWOOD. You remember that—why do you think that sticks out in your mind? Why would you have recalled that?

Mr. ROGERS. I recall that because——

Mr. GREENWOOD. Had it been otherwise, you would have been concerned?

Mr. ROGERS. I recall it because we had a senior corporate securities lawyer at Vinson & Elkins review the memorandum. Again, it's not a memorandum.

Mr. GREENWOOD. Who was that?

Mr. ROGERS. It was Bob Baird. It wasn't a memorandum. It's not an Enron Corp. memorandum. It was prepared by LJM and their counsel. And the draft that I saw had, among other things, Ben Glisan, my understanding, I didn't see the final draft, but it wasn't my understanding that Ben Glisan was going to be acting on behalf of LJM.

Mr. GREENWOOD. Would you have thought it proper for these guys to be negotiating against one another, one on behalf of the partnership and one on behalf of the company? Could that ever have been proper?

Mr. ROGERS. My understanding at the time is that Mr. Glisan was the treasurer of Enron Corp. and that he would have been acting on behalf of Enron Corp.

I didn't have any information at the time that indicated otherwise.

Mr. GREENWOOD. The chair recognizes the gentleman from Massachusetts, Mr. Markey for 10 minutes.

Mr. MARKEY. Thank you, Mr. Chairman, very much. Mr. Derrick, I want to recap where we are right now in this hearing. You've testified that when Sherron Watkins' allegation came to your attention Enron and Vinson & Elkins designed (1) to ignore her warnings, that Vinson & Elkins and Arthur Anderson had conflicts and shouldn't be used to investigate the allegations; (2) you also decided to limit the nature and scope of Vinson & Elkins inquiry so that it didn't examine the underlying accounting, didn't employ full discovery and investigative techniques; (3) you also decided notwithstanding this blistering, scalding indictment of a memo which Ms. Watkins delivered to Mr. Lay and to you, subsequently, you also decided, No. 3, not to interview any former employees, like Jeff Skilling or Cliff Baxter who might have been able to shed some light on the transaction; (4) not to follow-up on leads Sherron Watkins provided with respect to other employees who could substantiate her allegations, notwithstanding the fact that she has almost been completely vindicated in retrospect; and (5) to largely limit your inquiry to interviewing individuals like Andy Fastow and Doug Duncan who were responsible for putting together these transactions or reviewing and approving them and who would therefore be likely to defend these transactions as appropriate and lawful.

So Mr. Derrick, what I'd like to do is just go back to the beginning of the process which you put in place. According to your testimony to the Powers Committee, you first learned of the Sherron Watkins letter when Ken Lay gave it to you. What did Mr. Lay say to you when he gave you this letter?

Mr. DERRICK. I don't recall the specific conversation, and I don't recall whether, as I think I made it clear there, whether he walked it over, whether he sent it over, but immediately upon receiving it I distributed the copies of that memorandum to what I thought at the time were the appropriate people, which included Sharon Butcher, who keeps care of our tracking log, to Mr. Fastow, Mr.——

Mr. MARKEY. So you are saying you cannot remember if Mr. Lay handed this to you personally? You cannot remember that.

Mr. DERRICK. Congressman, all I can testify to is what I personally recall.

Mr. MARKEY. This is a bombshell. He handed you dynamite that could blow up the Corporation or he did not. You don't remember if he did.

Mr. DERRICK. I don't recall whether it was carried over or whether he brought it over. No, I'm sorry, I just don't.

Mr. MARKEY. That is hard to believe. Now, let me ask you this: Did you and Mr. Lay discuss whether the issues raised in the letter might arise at an all-employee meeting scheduled to be held in a few days?

Mr. DERRICK. There was an all-employee meeting, and the question was——

Mr. MARKEY. You discussed that subject with Mr. Lay.

Mr. DERRICK. I think we did, yes. I can't say that it was the time that I received the letter.

Mr. MARKEY. You told the Power Committee that in fact you did discuss subject with——

Mr. DERRICK. Yes, but the question, Congressman, is whether it was at the time I received the letter. I don't recall whether it was at the time I received the letter.

Mr. MARKEY. Subsequent to the receipt of the letter, within the next several days, did you discuss it with him?

Mr. DERRICK. Yes.

Mr. MARKEY. You did. Now, you and Mr. Lay discussed the need to have an investigation done into these allegations. Who proposed selection of Vinson & Elkins, you or Mr. Lay?

Mr. DERRICK. I believe—well, it was a mutual discussion, but I think it would have been me who proposed Vinson & Elkins.

Mr. MARKEY. Okay. Did you discuss with Mr. Lay the potential conflict of interest which Vinson & Elkins had with Enron?

Mr. DERRICK. Yes, we did. We discussed the possible downside because they had been involved in it. On the other hand, there was, as I've said before, the great strength that they had the background, and following up on that—but the question ultimately would be for the law firm to determine whether in fact there was a conflict of interest.

Mr. MARKEY. Did Mr. Lay suggest that Vison & Elkins' investigation be limited in scope and that it not examine the accounting and that it not be a full-scale inquiry with discovery and interviews with both current and former employees? Did he ever suggest that to you?

Mr. DERRICK. We discussed it. I don't recall that Mr. Lay proposed that. The question was how do we, as quickly as practical, get an investigation that will enable us to have recommendations as to whether to launch a full-scale investigation.

Mr. MARKEY. So did Mr. Lay say to you that it would preferable if we did not have to go outside of Vinson & Elkins or Arthur Andersen?

Mr. DERRICK. To the best of my knowledge, he never expressed that.

Mr. MARKEY. He did not.

Mr. DERRICK. He did not.

Mr. MARKEY. Okay. Did you and Mr. Lay discuss potential adverse publicity that would result if Ms. Watkins' allegations became public?

Mr. DERRICK. To the best of my recollection, there was never a discussion with respect to that.

Mr. MARKEY. Did you and Mr. Lay discuss the potential litigation that could result if these allegations became public?

Mr. DERRICK. To the best of my knowledge, we never had a discussion. Our sole purpose was to address these as quickly as——

Mr. MARKEY. You are saying absolutely not. Mr. Lay never raised the public relations aspect of this, the consequences to the corporation if this ever became public. He never said that to you during any of these meeting?

Mr. DERRICK. I believe that you are referring to the initial meetings we had.

Mr. MARKEY. I am referring now to all of the meetings up to the point at which ultimately we have a release of this report by Vinson & Elkins. Did he ever mention at any time his great concerns about—remember now, you are a former partner of Vinson & Elkins now dealing with the managing partner of Vinson & Elkins, so we are very concerned about this conflict that exists, at least in your mind, to preexisting loyalty to a firm that basically gave you the opportunity to work at Enron. So what about any conversation—did Mr. Lay at any time ever have any conversations with you about the publicity consequences if this report was devastating?

Mr. DERRICK. Congressman, the only recollection I have would be at the time that Vinson & Elkins presented their presentation to us, pointing out the possibility of adverse publicity and litigation, but I don't recall Mr. Lay ever raising that as an issue.

Mr. MARKEY. Did you ever discuss with Mr. Lay whether Ms. Watkins could or should be dismissed?

Mr. DERRICK. No, I do not recall ever having a conversation with Mr. Lay. He mentioned that she had requested that she be reassigned from Mr. Fastow, but there was never any indication in any conversation I had with Mr. Lay with respect to any firing of Ms. Watkins.

Mr. MARKEY. Okay. Now, Mr. Dilg, did Mr. Derrick at any time say to you that he would prefer that you resolve this question in a way in which you did not have to recommend another firm do the investigation?

Mr. DILG. No, sir.

Mr. MARKEY. He never did.

Mr. DILG. No, sir.

Mr. MARKEY. Did you ever recommend to him that you would prefer that it stay in-house and that another firm not be called in to do an independent investigation?

Mr. DILG. No, sir. Our final recommendation in the October 15 letter was that there was no further investigation.

Mr. MARKEY. When Mr. Lay—did you ever talk to Mr. Lay about this case, Mr. Dilg?

Mr. DILG. We had one meeting with Mr. Derrick and Mr. Lay I believe—I think the date was September 21, but I am not positive.

Mr. MARKEY. And at that meeting, did Mr. Lay say to you that he would prefer if you did the investigation, that is Vinson & Elkins, and not some outside firm?

Mr. DILG. No, sir. We were reporting on the investigation we had done thus far.

Mr. MARKEY. And at that point, you had not reached any conclusions that would indicate that the accounting practices or other practices would cause problems for the firm?

Mr. DILG. We reported on what we had heard from Arthur Andersen with respect to the accounting.

Mr. MARKEY. And you were satisfied that there were no problems?

Mr. DILG. I am not an accountant, so we alerted him to the references to creative and aggressive, et cetera, that we had heard during our interviews, but we did tell him that Arthur Andersen was fully comfortable with their accounting treatment.

Mr. MARKEY. You know, I have a real problem with all of this. Obviously, the Powers Committee conducted a real investigation. Enron and Vinson & Elkins did not in fact conduct a real investigation. When the ordinary investor or employee at Enron thinks that an investigation is being done, they think that people, that is the investigators, are acting like Columbo, asking all the questions that no one else would think of in order to make sure that the truth was obtained. In fact, what you did was act more like Inspector Clueso, stumbling over obvious evidence, not interviewing obvious suspects or witnesses, and in fact coming to conclusions that delayed the point at which a real reckoning was in fact possible.

And I think if you had not conducted this phony investigation, that it might have been possible that we would not have seen the collapse of Enron, that we would have had enough time to take the types of actions, not we, but rather the corporation and others, in order to save that corporation, the employees' jobs, the investors' savings. And so I have absolutely no question in my mind that there was a decision made here. I wish I knew definitively who made the decision that this was going to be too dangerous. We don't know that at this point.

I disagree with Ms. Watkins. She rules out Mr. Lay. I don't think that this committee should rule him out. I don't think yet we know what took place in those conversations initially after he received this memo from her. It is such a blistering, scalding indictment of the practices at the firm that ultimately have been almost completely vindicated, that much more is going to have to be found by this committee. I thank you once again, Mr. Chairman.

Chairman TAUZIN. I thank my friend from Massachusetts, and I am pleased now to recognize a round of questions my friend from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman, and I appreciate the opportunity to wave in on the subcommittee, and I have an opening statement that we have submitted. And I guess before I go into questions, the frustrations that someone—particularly someone from Houston for 30 years had the utmost respect for Arthur Andersen and Vinson & Elkins and the last 16 for Enron, even if we are on a different sides of a political issues oftentimes, and to see what has happened. And that is the frustration that we see, and you see if from other members who maybe aren't directly related to what has happened in Houston.

Mr. Rogers, first, who did Mr. Glisan report to at Enron?

Mr. ROGERS. He reported to Mr. Fastow.

Mr. GREEN. Okay. So he wasn't independent of Mr. Fastow?

Mr. ROGERS. I am sorry?

Mr. GREEN. So he was not independent of Mr. Fastow if he reported to Mr. Fastow.

Mr. ROGERS. When you say independent, I mean he reported to Mr. Fastow, that was his superior officer, that is correct.

Mr. GREEN. Okay. Mr. Sefton, according to your notes, and they are under Tab 18, and it is actually 24309, on September 29, 1999, shortly after you arrived in Houston to begin working for Mr. Fastow, you had a meeting with Mr. Fastow, is that correct?

Mr. SEFTON. These notes would indicate that I did, yes.

Mr. GREEN. Okay. And he explained the LJM deals to you, didn't he?

Mr. SEFTON. I don't recall that meeting. My best recollection of what happened at that meeting is in these notes.

Mr. GREEN. Okay. And your notes reflect LJM1, and without having to read all the notes from September 29, they reflect LJM just some of the highlights, without having to go into them because I only 10 minutes, but your notes reflect discussion on LJM, is that correct, these notes that we have in Tab 18?

Mr. SEFTON. Yes. These notes were taken, I believe, during a discussion. I don't know what each individual means, whether it reflects a statement made by Mr. Fastow or whether it is sort of an observation on my own part.

Mr. GREEN. Well, assuming they were your notes and they were observations of your meeting, one of the purposes of LJM1 that your notes directly mention was to hedge Enron's investment in RythmsNet stock, which was very volatile. Enron's investment had gone from $10 million to $150 million in less than 6 months after RythmsNet went public; is that correct?

Mr. SEFTON. I don't know that.

Mr. GREEN. Okay.

Mr. SEFTON. I wasn't involved in the LJM1 transaction, that took place before I arrived.

Mr. GREEN. Okay. Well, but your notes that we are going from talk about your discussion with him, and maybe I need to read the notes to you, because they are there. "Two things led to LJM1: forward contents to purchase Enron stock, prices below market. Buying shares back would have increased equity, but we would have had to borrow money which would cause problems. Had the Rhythm stock position, huge volatility. We want to hedge the Rhythm stock position but couldn't do it in market." Those are your notes.

Mr. SEFTON. Yes.

Mr. GREEN. Okay. I would appreciate it if you would at least familiarize yourself with your notes. Then when I ask you the question, instead of me having to take up my 10 minutes in reading your notes to you.

Mr. SEFTON. I am sorry. That wasn't——

Mr. GREEN. Enron could not sell its Rhythm stock for another 6 months; is that correct?

Mr. SEFTON. Is that in my notes?

Mr. GREEN. No, it is not, but I am asking you from other knowledge other than these notes. Your notes reflect the volatility of the Rhythms stock position and the huge volatility. Do you know that Enron couldn't sell their investment in it for 6 months?

Mr. SEFTON. I am sorry, but I did not work on that transaction. I am not familiar with what happened there.

Mr. GREEN. Okay. That is what Vince Kaminski told the Powers Committee, though, that Vince Kaminski was the head or Enron's research group at the time, told the Power Committee that could not buy such a hedge in the market because it prohibitively expensive, obviously very volatile from your notes. In fact, yesterday the analyst from PricewaterhouseCoopers who valued that stock for Enron told our staff that the volatility was off the charts. So, again, reflects your notes from 1999.

According to your notes, Mr. Fastow told you that Enron couldn't hedge Rhythms in the market. Was it also your understanding that no outside third party would have taken the hedge at the price LJM did?

Mr. SEFTON. All that I recall from this meeting are these notes.

Mr. GREEN. Okay. Your notes, again, seem to refer to the Rhythms stock position had huge volatility, and your notes reflect, "We wanted to hedge the Rhythms stock position but couldn't do it in the market." So that agrees with what Mr. Kaminski shared with us yesterday, and also the analyst from PricewaterhouseCoopers.

It is very interesting in the 1999 annual report, footnote 16, that states that, "Management believes that the terms of the transactions related with the representative terms that would be negotiated with an unrelated third party." Did you see any evidence from your notes or from your memory other than your notes that that was an independent third party?

Mr. SEFTON. I am sorry, you are referring to what document?

Mr. GREEN. Okay. The annual report for Enron was 1999.

Mr. SEFTON. The annual report?

Mr. GREEN. Footnote 16. Just trust me I am——

Mr. SEFTON. Okay.

Mr. GREEN. [continuing] saying that footnote 16 states that, "Management believes that the terms of the transactions with related parties are representative of terms which would be negotiated with unrelated third parties." That is in that report. Do you have any evidence of that from your notes or your memory that that was really unrelated third parties in LJM1?

Mr. SEFTON. Well, I am not sure if I am answering your question, but I wasn't involved in the preparation of that annual report footnote. I am not familiar with——

Mr. GREEN. I know, but I am asking you do you have any information that would show that that footnote was correct from your notes here and any information at all, other than your recollection from these notes?

Mr. SEFTON. No, I don't think there is anything in my notes that would speak to that.

Mr. GREEN. Okay. The proxy says that same thing, the proxy statement. It states that, "Management believes that the terms of the transactions were reasonable and no less favorable than the terms of similar arrangements with unrelated third parties." Mr. Sefton, Mr. Derrick and Mr. Astin, tell me what basis you had on signing off on the statement, and what was the due diligence that these representations called for?

Mr. DERRICK. Congressman, speaking for myself, I didn't have a personal involvement in that. We had in place what we considered to be a large team of qualified people who would have been looking at that and preparing the proxy statements. And it would have been on the basis of what they did that would have been the basis for that statement.

Mr. GREEN. Who was in charge of making sure this proxy statement was correct then within the Enron legal team?

Mr. DERRICK. Well, internally, Mr. Rogers was leading our securities effort.

Mr. GREEN. Okay. Mr. Rogers, the statement that, "Management believes that the terms of the transactions were reasonable and no less favorable than the terms of similar arrangements with unrelated third parties," did you sign off on that statement to be in the proxy?

Mr. ROGERS. I was part of the team that was charged to gather the information. I did not do the personal due diligence on that.

Mr. GREEN. What was the due diligence from the team, if not yourself?

Mr. ROGERS. The due diligence were lawyers and accountants within Enron were assigned to gather the information. I didn't draft the proxy disclosure.

Mr. GREEN. But you signed off on it.

Mr. ROGERS. Well, when you say signed off on it, I reviewed it, and based on the information that was presented to us, we agreed with it.

Mr. GREEN. What information was presented to you from the lawyers and accountants to show that this was no less favorable than unrelated third parties?

Mr. ROGERS. The internal legal team that worked on the underlying transactions. My team did not work—was not assigned to work on any of the LJM or any of the structured finance transactions. So we had no personal knowledge of them. The parties that were assigned to draft the proxy disclosure were the parties that worked on the transactions and the lawyers and accountants that worked on the transactions that would have done the due diligence.

Mr. GREEN. Can you give us some names of who that would be, the lawyers that worked for your team—or that worked for that?

Mr. ROGERS. I don't know the specific lawyers and accountants. It would have been lawyers in the Enron Global Finance Unit and the accounting team that reports to Rick Causey who also signs off on all of the LJM transactions, along with the chief risk officer who was reviewing these transactions in terms of fairness to Enron.

Mr. GREEN. So someone told you in those teams that this statement was correct, and you signed off on it.

Mr. ROGERS. Based on that compilation of due diligence, correct.

Mr. GREEN. Mr. Rogers—and Mr. Chairman, I know—let me just ask, on the statements on the LJM approval sheet where you signed—in previous questions, you answered that you only signed off relating to 4(a).

Mr. ROGERS. That is correct.

Mr. GREEN. Is that 4(a) on the compliance sheet of this or is that some other——

Mr. ROGERS. No, it is 4(a) on this sheet. It is 4(a), does it require proxy disclosure, and the answer is yes, because Andrew Fastow, as the chief financial officer of Enron, is a related party. There is a clear conflict; it is required to be disclosed.

Mr. GREEN. It was required to be disclosed. I guess just as a lawyer, whenever I always sign for something that was specific only for, for example, 4(a) or whatever, I always wanted to make sure that was under my signature, and I think most documents I used to sign with Vinson & Elkins, if there was limited responsibility, I always spelled that out.

Mr. ROGERS. I wish I had done that.

Mr. GREEN. I understand. Thank you, Mr. Chairman.

Chairman TAUZIN. The Chair thanks the gentleman; his time has expired. The Chair recognizes the gentleman from California, Mr. Waxman, for a round of questions.

Mr. WAXMAN. Thank you very much, Mr. Chairman. Since the very first hearing on the Enron scandal before this committee, I have sought information about Enron's Special Purpose Entities.

What we know about these entities is very disturbing. While Enron employees made millions with no apparent risk, Enron shareholders and employees lost their shirts. And due to Enron's remarkable political clout, not a single regulator was in a position to prevent this debacle.

We are now 3 or 4 months into this investigation, yet we appear no closer to having a complete list of the partners and investors in Enron's many partnerships. Amazingly, in previous hearings, neither Enron's executives nor its accountants could tell us who the partners and investors were. Well, testifying before us today are the lawyers who actually worked on many of these partnerships. Surely it will help that you witnesses will be able to shed some light on these important questions.

Let me start with you, Ms. St. Clair. You worked on the legal aspects of the Jedi/Chewco transaction. How can we find out who the partners and investors were in Enron's many partnerships? Can you tell us who has this list and what the documents the committee should request to obtain this list?

Ms. ST. CLAIR. With respect to Jedi/Chewco? I mean that is the only transaction that I am familiar with.

Mr. WAXMAN. Well, how about any of the partnerships?

Ms. ST. CLAIR. I am not familiar with, other than looking at the partnership agreement itself and who signed it and whether it has a list of partners.

Mr. WAXMAN. Who signed it—I am sorry, I didn't hear what you said. You looked at the partnership agreement and who signed it.

Ms. ST. CLAIR. What partner signed it and whether or not it has a list of partners. Some partnership agreements do.

Mr. WAXMAN. Okay. And where would we be able to get a copy of those lists that were in those agreements, of partners?

Ms. ST. CLAIR. With respect to—I can only address with respect to the Chewco partnership.

Mr. WAXMAN. Well, let us go to Jedi/Chewco.

Ms. ST. CLAIR. Jedi/Chewco?

Mr. WAXMAN. Yes. Did that have a list of partners?

Ms. ST. CLAIR. I think the Chewco partnership agreement is in the files and has been available, yes.

Mr. WAXMAN. Okay. And do you know whether that has been requested by this committee?

Ms. ST. CLAIR. I don't know.

Mr. WAXMAN. Well, I am going to make a request to the chairman that he—Mr. Chairman, I would request since Ms. St. Clair believes the names of the partners are on the Jedi/Chewco—are in their files, that we request that information for the committee.

Chairman TAUZIN. My understanding, Mr. Waxman, is that request is already before Enron and its counsel, and I don't think we have yet received all of our responses. We have not received all the records, and if there is a need yet under that inquiry, that request for documents, to satisfy that, it has not been met, either by Vinson & Elkins or by the firm, I would renew it here today, and we will renew in writing if we need to.

Mr. STEARNS. Point of information, Mr. Chairman.

Chairman TAUZIN. The gentleman is recognized for a point of information.

Mr. WAXMAN. Mr. Chairman, this won't go against my time, will it?

Chairman TAUZIN. It will not go against your time. Depends how long his information is.

Mr. STEARNS. I think the gentleman's request is a very pertinent one, not only Chewco but for the other ones. As I understand from our staff, we have requested these documents to find out who the investors were for all these partnerships. And I think the question is, Mr. Chairman, how long ago did we request this information to find out who the partners were of these Special Purpose Entities? Just how long ago has it been, just approximately?

Chairman TAUZIN. My understanding it has been since December.

Mr. STEARNS. Okay.

Chairman TAUZIN. And we are still literally receiving documents from Enron as we speak. As you know, we are still trying to understand whether the documents we requested are available, or were they part of any potential shredding that went on at Enron, and that is still an open question.

Mr. STEARNS. And the last question I have for Mr. Chairman, would these gentlemen—was it asked of the law firm these documents or Enron? And if we are having a difficult time from Enron, can we ask the gentlemen here for the same set of documents, because surely they kept a copy?

Chairman TAUZIN. My understanding is the inquiries were directed to Enron itself, and obviously if we don't come into possession of that information from Enron, we will make a request upon Vinson & Elkins for that information. In fact, as I said, I am lodging that request publicly today that information be provided to us voluntarily, because we apparently are having some trouble getting it from Enron itself.

Mr. STEARNS. Thank you, Mr. Chairman.

Chairman TAUZIN. Thank the gentleman.

Mr. WAXMAN. Thank you, Mr. Chairman.

Chairman TAUZIN. Again, the gentleman has 8 minutes and 17 seconds to go.

Mr. WAXMAN. Well, I appreciate my colleague's very helpful line of inquiry, because we are trying to get this information, and we have gone all these months without getting it. And I would hope the law firms that have it would submit it to us.

Mr. Sefton, you were general counsel of Enron's Global Finance Unit. You worked on certain aspects of the LJM partnerships. Can you tell us where we can obtain a list of the partners and investors in the LJM partnerships or other partnerships? Let us say the LJM partnerships first.

Mr. SEFTON. It is my understanding that the partners in LJM are not known to Enron, because LJM was an outside entity, and I don't believe that information has been made available to the company.

Mr. WAXMAN. Who would have that information?

Mr. SEFTON. I believe Mr. Fastow would or I guess maybe now Mr. Kopper.

Mr. WAXMAN. And, Mr. Chairman, if I might ask whether that information has been requested from Mr. Kopper?

Mr. SEFTON. I believe that would be the correct person to ask.

Mr. GREENWOOD. I am sorry, would the gentleman from California reiterate which specific material?

Mr. WAXMAN. Well, I have asked Mr. Sefton about the LJM partnership, and he thinks that the investors and names of the LJM partners are with Mr. Kopper. So I don't know if this has been requested, but I think we ought—since he has identified where we can get that information, I would hope—rather than take up my time now, I will ask the Chair to get that information subpoenaed.

Mr. GREENWOOD. For the gentleman's information, we have requested those documents. We have some documents, and we will work with you to make sure that you have the opportunity to review them.

Mr. WAXMAN. Thank you very much. Mr. Sefton, so you think it is there. Who is Mr. Kopper?

Mr. SEFTON. Mr. Kopper is a gentleman who purchased Mr. Fastow's interest in LJM2, I understand.

Mr. WAXMAN. Do you know who else might have a copy of the—or a list of the investors in LJM?

Mr. SEFTON. Mr. Fastow, possibly.

Mr. WAXMAN. Okay. How about the other partnerships, do you have any information about the names of the partners and investors in any of the other partnerships?

Mr. SEFTON. I would think that the corporate secretary at Enron would have information about all of the entities that Enron has an ownership interest in, and I believe the records reflect who all the other owners are, if it is not entirely owned by Enron. But others here can possibly clarify that in case I am wrong.

Mr. WAXMAN. Does anybody want to make a clarification of that? Mr. Derrick?

Mr. DERRICK. Well, I could—I think it is—it would certainly be true that the Enron corporate secretary will have a list of all the Enron entities and in terms of the Enron ownership would certainly have that. Now, as to a third party, for example, LJM, which is not an Enron entity, it is unlikely, in my judgment, that that information would be available within the Enron corporate secretary's office.

Mr. WAXMAN. And where would that information be available?

Mr. DERRICK. Well, again, I assume, with respect to any of these third party entities, it would be that entity itself. In the same way that Enron would have knowledge of its side of the ownership, the third party ought to have records which will identify who their owners are.

Mr. WAXMAN. So would it be fair to say that Enron would have a list of all these entities, but then we have to go to the entities to get the names of the investors?

Mr. DERRICK. I think it would be fair to say, Congressman, that Enron would have a list of the entities in which it has an ownership interest and could identify the Enron side of that equation. The other side of the transaction would be, by definition, not an Enron entity, and I think it is unlikely, though I can't say with any certainty, but unlikely that the Enron record would disclose who the owners of that other entity are. And so my thought would be that a request to that other—that third party entity would produce the information that you are requesting.

Mr. WAXMAN. And do we have a complete list of all the third party entities?

Mr. DERRICK. I don't know the answer to that.

Mr. WAXMAN. Does Enron have a list of all the third party entities?

Mr. DERRICK. Well, Enron should have a list of all of the entities in which it, Enron, has an interest, which I hope is responsive to your question, I am not sure.

Mr. WAXMAN. And what third party entities are there that Enron wouldn't have an interest but are connected to the Enron issue?

Mr. DERRICK. Well, for example, there could be several tiers within the third party entity. I don't pretend to—I wasn't involved in these transactions in any detail, but, for example, some of the charts that have been shown disclosed that there are multi-tiers, and that is what I am referring to.

Mr. WAXMAN. So if we are trying to find all the information, we start with all the third parties where Enron had an interest. Then we would go to each of those separate entities and ask them about other entities that they may have dealt with.

Mr. DERRICK. Well, that would be my thought, yes.

Mr. WAXMAN. Okay.

Mr. STEARNS. Would the gentleman yield just for a second?

Mr. WAXMAN. I am afraid to yield to you because I have so little time, but I know you probably will get your own time in a minute.

Mr. Derrick, you were Enron's general counsel. Can you tell the committee where we would find the necessary documents to obtain the list of partners and investors?

Mr. DERRICK. Well, I don't think I have much to add to what I just said, Congressman, on that point.

Mr. WAXMAN. Okay. Mr. Rogers, you are the only lawyer testifying today who still works for Enron, and you also worked on aspects of the LJM transactions. Can you tell us where we can obtain a list of the partners and investors in LJM?

Mr. ROGERS. Actually, Congressman, I did not work on the LJM transactions, but I think part of the problem here is that LJM, despite Mr. Fastow's relationship to it, is not an Enron entity; it is a separate entity. And I think that is part of the problem is that Enron doesn't have access to the records of LJM and the investors in LJM. And I think part of the problem is the people that would have that information, I don't know if it is going to be very helpful to you, as Mr. Sefton said, would be Andy Fastow, Michael Kopper, who I understand was the individual to whom Mr. Fastow sold his interest, the law firm representing LJM, which I am sure they attorney/client privilege issues. But a lot of the information that you want on investors into these other entities, if they are not Enron subsidiaries or subsidiaries that Enron controls or has ownership interest in, I think that is part of the delay in getting this information. I am not sure Enron has that information.

Mr. WAXMAN. Well, let me ask this of anybody at the table, because you are all Vinson & Elkins lawyers. Does anybody have anything else to tell the committee where and how we can obtain a list of the partners and investors in all these Enron special entities? Anything more to add? Yes?

Mr. ASTIN. Congressman, the only thing I would add is that I have read news reports that indicate there is litigation I believe in the State of Delaware regarding LJM2 that might disclose the names of the partners.

Mr. WAXMAN. Let me ask each of you, if you would, to respond. Are you personally aware of the names of any of the investors in the Special Purpose Entities or other partnerships? And why don't we start with you, Mr. Sefton?

Mr. SEFTON. I am sorry, am I aware of——

Mr. WAXMAN. Are you personally aware of any of the names of the investors or partners in this Special Purpose Entities? Can you tell us any that you know of and some of the figures that are in those entities?

Mr. SEFTON. Well, I know that Enron has formed several different—many subsidiaries that I think would be classified as Special Purpose Entities, and they may have investors ranging from institutional investors, investment banks, pension funds.

Mr. WAXMAN. I am really asking now what are the categories what your personal knowledge is of the participants in these special entities?

Mr. SEFTON. I can't identify any, sitting here right now.

Mr. WAXMAN. Mr. Chairman, my time is—I would like to have this as a request for the witnesses to respond in writing of their personal knowledge of the names of any of the special entities and participants or investors in those special entities. And I will be pleased to hear——

Mr. GREENWOOD. We will make Mr. Waxman's request an official request from the committee. Did the witnesses understand Mr. Waxman's request? We are asking you to supply——

Mr. WAXMAN. Your personal information——

Mr. GREENWOOD. Reiterate your request, please.

Ms. ST. CLAIR. Which entities are——

Mr. WAXMAN. So whatever Special Purpose Entities you know about and whatever investors or partners in those entities that you know about, I would like you to submit to the committee in writing that information.

Mr. GREENWOOD. The time of the gentleman has expired. We will go to a second round now, and we will just take 5 minutes for questions for each of us for the second round, and I will begin.

Let me address some questions to you, Ms. St. Clair, and I would refer you to Tab 25. This is the mysterious document that surfaced in November of last year about the—that refers to the $6 million side agreement to the Jedi/Chewco revolving loan agreement, dated December 30, 1997. This was the reason that Chewco and Jedi had to be consolidated onto Enron's books and prior year financial statements revised back to 1997. If you look at the document, you will see on page 2 that there are initials next to the Enron signature line. Are those your initials, Ms. St. Clair?

Ms. ST. CLAIR. Yes, they are.

Mr. GREENWOOD. Okay. Did you draft this side agreement?

Ms. ST. CLAIR. I don't recall, but there is a footer on the second page that doesn't look like an Enron footer.

Mr. GREENWOOD. Say that again.

Ms. ST. CLAIR. At the bottom of the signature page to the left, it doesn't look like an Enron footer to——

Mr. GREENWOOD. So you don't think you drafted this document. Do you know who drafted it if it was not you?

Ms. ST. CLAIR. I don't recall.

Mr. GREENWOOD. Mr. Astin, have you looked at this document?

Mr. ASTIN. I haven't right now, but I have seen it before.

Mr. GREENWOOD. Okay. Do you know who drafted the document?

Mr. ASTIN. I am not certain, but our records indicate that it was likely drafted by Vinson & Elkins.

Mr. GREENWOOD. Okay. Ms. St. Clair, do you know why this amendment was made to the Jedi/Chewco revolving loan agreement in a separate document, given that it was dated the same day as the principal agreement it was amending?

Ms. ST. CLAIR. I don't know.

Mr. GREENWOOD. What do your initials signify? Why did you put your initials on that document?

Ms. ST. CLAIR. They signify that as the lawyer that was in charge of representing Enron's side in the Chewco transaction, that the document satisfied the legal criteria, that it was okay for the officer to sign from a legal perspective.

Mr. GREENWOOD. Okay. But you don't know why it was drafted in a separate document. I mean you looked at it and you decided that it was okay for the executive to sign. You had done your legal scrub of it——

Ms. ST. CLAIR. Right.

Mr. GREENWOOD. [continuing] but in so scrubbing, you didn't ascertain why it was a separate document.

Ms. ST. CLAIR. I don't recall now why it was a separate document; no, sir.

Mr. GREENWOOD. Do you recall any discussions in the fall of 1997 about this side agreement or the creation of reserve accounts to benefit Barclay's who was lending money to Big River and Little River, which in turn was providing the 3 percent outside equity in Chewco?

Ms. ST. CLAIR. At this time, I have no independent recollection of that, but as a result of reviewing my notes during that time period, there appears to be meetings where reserve accounts were discussed.

Mr. GREENWOOD. And your notes are those that we find in Tab 17 of the binder?

Ms. ST. CLAIR. That is correct.

Mr. GREENWOOD. Okay. As you read through these notes, they seem to reflect discussions regarding these reserve accounts and how they would be funded from distributions to Chewco to benefit the Big River/Little River lender, Barclay's. Now, you do acknowledge that this subject was discussed in the meetings at the time and that this side agreement with your initials on it didn't just come out of thin air.

Ms. ST. CLAIR. That is correct.

Mr. GREENWOOD. Okay. Who was at these meetings?

Ms. ST. CLAIR. I don't have——

Mr. GREENWOOD. Let me help you. Your notes reflect that Mr. Astin was in at least three of these meetings.

Ms. ST. CLAIR. That is correct.

Mr. GREENWOOD. Mr. Glisan, who handled the accounting aspects of this transaction for Enron, was in at least two.

Ms. ST. CLAIR. Correct.

Mr. GREENWOOD. Okay. Was it your understanding that such individuals, including Mr. Astin, Mr. Glisan, Mr. Brown and other Enron employees and V&E attorneys, were aware of these reserve accounts at the time of their creation back in 1997?

Ms. ST. CLAIR. I can't speak for Vinson & Elkins, Bill Brown and Ben Glisan, because they were—Ben was heading up the accounting team, and Bill was on the commercial team would have had the knowledge of the reserve accounts.

Mr. GREENWOOD. Who do you know that had—to your knowledge, who had knowledge?

Ms. ST. CLAIR. To the best of my knowledge, Ben Glisan and Bill Brown.

Mr. GREENWOOD. How about Kristina Mordaunt?

Ms. ST. CLAIR. At that time, I reported to her, and she was my supervisor on this deal. I don't recall whether she was present at any of the meetings, but I did report to her on this particular deal, but I was handling the day-to-day activities as the lawyer——

Mr. GREENWOOD. You told the committee in your interviews prior to today that you were aware that a key aspect of the Chewco deal was that there needed to be 3 percent outside equity in the deal. Weren't you at all concerned when you reviewed this side agreement, which in effect transferred $6 million from Enron Jedi to the purported outside equity holders, Big River and Little River? Weren't you concerned about that, that it would undo the 3 percent requirement?

Ms. ST. CLAIR. I don't recall that I was concerned. I would have looked to Ben Glisan who was interfacing with Arthur Andersen to make sure that it would pass all the accounting tests. And in looking at the side agreement now, I am not sure that it actually says that the accounts were funded, it just allocates a different distribution scheme to funds that Chewco may be receiving. As to how the reserve accounts worked themselves, we did not have access to those particular documents.

Mr. GREENWOOD. How about you, Mr. Astin, can you shed any light on this?

Mr. ASTIN. I would like very much to be helpful to you, Congressman, but I don't have any independent recollection of these meetings. I was in meetings at which the partnership allocations of the Chewco side of the transaction were discussed. I was primarily responsible for another aspect of the transaction, which was Jedi II and was devoting most of my attention to that. This was the first transaction involving this accounting issue on which I had worked, and I was not familiar with its significance in 1997.

Mr. GREENWOOD. You understood the 3 percent rule, right?

Mr. ASTIN. I understood, I believe, that the intention of the parties was to have 3 percent equity. I did not——

Mr. GREENWOOD. Did you understand why they would pick 3 percent?

Mr. ASTIN. My understanding coming into this transaction was primarily as a private equity and mergers and acquisitions lawyer. I thought that the principal purpose, and I still believe one of the principal purposes, of the leverage was to maximize the potential returns from the Jedi portfolio of assets since it was a mature portfolio of assets that was not expected to greatly increase in value so that for it to become an attractive equity investment by a third party, which was the original plan, it would require additional leverage in order to maximize the possibility of return on the investment.

Mr. GREENWOOD. Do you know why the side agreement was written to begin with, why it was a separate document, why it wasn't incorporated in the original document?

Mr. ASTIN. I have no memory of having seen it in 1997. I only—I mean we have internal files that indicate a copy was sent to me, but I was primarily working on another aspect of the transaction.

Mr. GREENWOOD. You weren't aware that Barclay's had insisted on this agreement.

Mr. ASTIN. No, I was not.

Mr. GREENWOOD. And how about you, Ms. St. Clair, were you aware of that?

Ms. ST. CLAIR. No, I was not.

Mr. GREENWOOD. My time has expired. The Chair recognizes the gentleman from Florida, Mr. Deutsch.

Mr. DEUTSCH. Thank you, Mr. Chairman. Mr. Derrick, if you could go to page 8 of the Vinson & Elkins report addressed to you, and on that page, under the title—I will read it to you if you can't get to it, but on the page, under the title, "Potential Bad Cosmetics," the report states, "Concern was recently expressed that the transactions involving Condor and White Wing and Raptor could be portrayed very poorly as subjected to a Wall Street Journal expose or class action lawsuit." What were your thoughts when you read that statement?

Mr. DERRICK. Well, my thoughts were of being concerned, but there was nothing that I know of that could have been done at this stage to have addressed that issue. It was something that if it came, when it came, we would simply have to address.

Mr. DEUTSCH. So it didn't surprise or shock you that type of activity——

Mr. DERRICK. No, as I expressed, it was a concern to me. The issue was given the concern, what at that point could the company do about it? It was something that would happen or wouldn't happen, and based on what happened we would have to address it.

Mr. DEUTSCH. Do you recall what Mr. Lay's reaction was?

Mr. DERRICK. I am sorry, I don't recall his reaction.

Mr. DEUTSCH. Mr. Dilg, these were your words, at least my understanding is that you participated in the letter. Even though it wasn't under your signature, it was under your supervision. What did those words mean to you?

Mr. DILG. We were conveying—concerns had been expressed to us during our interviews, and we wanted to make sure the company was aware of those concerns. Again, there wasn't—the company was taking action or had taken action at the time this letter was written to terminate the Raptor vehicles.

Mr. DEUTSCH. I mean is there a difference between the term "bad cosmetics" and "unethical behavior" or "illegal behavior?"

Mr. DILG. I definitely think so. I think we were trying to convey that there were aspects of these transactions that in hindsight could be portrayed very badly.

Mr. DEUTSCH. And, Mr. Derrick, would that be your opinion as well or a different take on it? You know, it is described as potential bad cosmetics.

Mr. DERRICK. Yes. Congressman, I did not take that to mean that there had been unethical conduct or illegal conduct but rather that it was simply what it was, that it could be portrayed in a very unflattering light, and normally litigation would follow that kind of publicity.

Mr. DEUTSCH. And Mr. Dilg, if you could try to, in your own words, describe the difference between bad cosmetics and unethical behavior?

Mr. DILG. I think unethical behavior, in my words, in going into the transaction, if people had an illegal motive or something of that nature not fully disclosed, the motives, et cetera. The bad cosmetics arose primarily because of the large losses that had been incurred on the assets that were hedged against the Raptor vehicles. That had nothing to do with the intent of the parties at the beginning of the transactions. It was a market factor that happened in the retail electric business as well as the broadband business, et cetera, that highlighted a lot of the cosmetic issues here. It was just the amount of loss that was involved.

Mr. DEUTSCH. Mr. Rogers, do you want to add anything to this?

Mr. ROGERS. Are you asking my opinion of the report or just the——

Mr. DEUTSCH. Well, I mean really in terms of this specific thing, because, again, someone reading this—you know, I mean I read the words exactly, and I think what we have just heard is it portrayed in the best possible light, and was that accurate? I mean saying that—even this report is saying that exposure of what occurred could subject an expose or class action lawsuit, and is this something that convinces you that there was unethical or, for that matter, illegal activity occurring?

Mr. ROGERS. I can't make a determination that there was unethical or illegal activity from that; no, sir.

Mr. DEUTSCH. I mean in hindsight, does anyone think that these activities or any of these partnership agreements were unethical? Do any of you? I mean in the light of hindsight, in light of what we know at this point.

Mr. DERRICK. Well, I think let me say first I am sure all of us would agree that while the investigation is still ongoing and not every side has been heard from, that everyone does deserve presumption of innocence. To the extent that it is finally determined that in fact there was wrongdoing here, then certainly I think we would agree there would have been unethical conduct.

Mr. DEUTSCH. Right. I mean but no one at this point, based on what we know, and particularly—again, I hate to keep focusing on Mr. Fastow, but, again, I mean in hindsight, looking at his activities as a general partner, my understanding is he was telling the board or the board was looking the other way or winking that he was not getting compensation. I mean it was clear he was getting compensation.

I think Mr. Waxman's line of questioning is we still don't know who else made money. We know for a fact that he made money and that tens of millions of dollars in terms of these outside partnerships, and yet with his fiduciary responsibility as the CFO of the organization and it appears as if misrepresenting to the board or the board looking the other way or sticking their heads in the sand at that issue.

Mr. GREENWOOD. Time of the gentleman has expired. The Chair recognizes the chairman of the full committee, Mr. Tauzin, for 5 minutes.

Chairman TAUZIN. Thank you, Mr. Chairman. We do know from Enron who some of those investors were. They reported to us in some cases. Ben Glisan, managing director and treasurer of Enron Corporation, was an investor in South Hampton Place. Kristina Mordaunt was an investor. She was managing director and general counsel of an Enron division. Kathy Lynn, vice president of an Enron division; Ann Yaeger, an officer employee of the company were investors.

We do know now that they invested rather sums. Kristina Mordaunt, $5,800; Ben Glisan, $5,800; Ann Yaeger, $2,900; Kathy Lynn, $2,300. As a return on their investments in 6 weeks, Kristina Mordaunt made $1 million and Ben Glisan made $1 million and Ann Yaeger and Kathy Lynn each made $500,000, approximately, on their investment. Any of you folks know that that was going on before you wrote your October 15 report to Mr. Derrick and to Mr. Lay? Mr. Dilg?

Mr. DILG. Chairman Tauzin, we were not aware of the investors in South Hampton at the time we wrote our report. I believe I became aware of that early in November.

Chairman TAUZIN. If you would have known that then, might you have written a different report?

Mr. DILG. Yes, sir.

Chairman TAUZIN. I would think so. And yet I asked you a while ago if you stood by your report, and you said you did. Everything was honkey dory and that we didn't need to have anybody outside look at this business.

Mr. DILG. Based on the facts we knew at the time, I stand by that submission.

Chairman TAUZIN. Under the facts you knew at the time, you stand by your report. Under the facts you know now, would you have advised Mr. Derrick and Mr. Lay differently?

Mr. DILG. I think if we had known of the South Hampton investors, that would have raised a serious concern. We were——

Chairman TAUZIN. Would you advise them then to get an outside counsel, an outside auditor to come look at things?

Mr. DILG. I am not sure on the auditor point, Chairman, but we would have definitely advised further investigation into——

Chairman TAUZIN. Let us talk about what you did know when you wrote that report. You did know, did you not, that Michael Kopper was running Chewco?

Mr. DILG. I did not. We did not look at Chewco.

Chairman TAUZIN. Now, wait a minute, wait a minute. You say in your report, and I am going to quote from it, that, “Based on our review of the LJM deal approval sheets and accompanying checklist, it appears the approval procedures were generally adhered to.” I am looking at one of them. It says Michael Kopper negotiating for LJM. It says that Ben Glisan is negotiating for Enron. You didn’t see this?

Mr. DILG. Could you refer me to which one you are looking at?

Chairman TAUZIN. I am looking at Raptor, Tab 20. While you are looking for that, I am going to quote Mr. Skilling to you. I was asking Mr. Skilling at a previous hearing with reference to Chewco, and I asked him then if he had informed Mr. Lay that Mr. Kopper was involved with Chewco and with LJM, and he said, “I don’t recall.” We got a lot of that. Then I asked him—he is not aware of what Ken knew, he said. But Mr. Kopper’s participation was well-known throughout the company.

And I started to go to Mr. Jaedicke, and he interrupted me. He said, “By the way,” this is Mr. Skilling talking, “it was known by Vinson & Elkins who would have had responsibility,” and I said, “I am sorry, I didn’t hear that. Say that again.” And he said, “His participation in Chewco was also known to Vinson & Elkins, to my knowledge. It is my understanding that Vinson & Elkins knew that he was involved. I believe that they would have identified, to the extent there was a conflict of interest, that a waiver needed to be received.”

I asked did Vinson & Elkins report to Mr. Lay or to you after they researched the issue following Ms. Watkins’ letter that Mr. Kopper might require such a waiver. So at least Mr. Skilling believed you knew. I am looking at an approval sheet you say that you reviewed in your investigations that shows Mr. Kopper is negotiating for LJM. Do you want to tell me now you didn’t know?

Mr. DILG. We did not look—in the investigation that Mr. Henderick and I undertook, we did not look at Chewco. I don’t believe this approval sheet——

Chairman TAUZIN. This is a Raptor sheet.

Mr. DILG. Yes. I don’t believe it relates to Chewco.

Chairman TAUZIN. Did you know that Kopper was working for Raptor and LJM?

Mr. DILG. We knew Mr. Kopper, based off of the approval sheet, was negotiating on behalf of LJM.

Chairman TAUZIN. Absolutely. In fact, when you flip the approval sheet over, there is a question, was the transaction done strictly at an arm’s length basis, yes or no? It says yes. You have got Kopper on one side negotiating for LJM, and you have got Glisan on the other side negotiating for Enron, and the documents says it is an arm’s length transaction. It goes on further to say, have all Enron employees’ involvement in the transaction, on behalf of LJM, been waived by the Enron Office of Chairman, in accordance with the Enron’s conflict of business affairs policy? It is checked off, “yes.” Can you tell us today whether in fact Mr. Kopper got a waiver?

Mr. DILG. For working on this transaction?

Chairman TAUZIN. For working on any transaction on the other side of Enron. Apparently Mr. Fastow got such a waiver for the conflict of interest rule somewhere, did he not?

Mr. DILG. Mr. Fastow got a waiver from the Office of the Chairman. It was approved by the full board, as I understand it from the board minutes.

Chairman TAUZIN. Right. And what is the procedure for that? The Office of the Chairman approves the waiver first, then the board approves it after, right?

Mr. DILG. I believe that was the procedure followed in terms of Mr. Fastow.

Chairman TAUZIN. Mr. Derrick, is that correct?

Mr. DERRICK. Yes. I wanted to clarify that. Under the Code of Conduct, actually there is no required approval for anyone by the board of directors. There is a——

Chairman TAUZIN. But there is by the Office of the Chairman.

Mr. DERRICK. By the Office of the—well——

Chairman TAUZIN. So the Office of the Chairman approved Mr. Fastow. Did the Office of the Chairman approve Mr. Kopper, Mr. Derrick?

Mr. DERRICK. Was that directed to me, Congressman? The answer——

Chairman TAUZIN. Did the Office of the Chairman ever approve a waiver for Mr. Kopper?

Mr. DERRICK. I am not personally aware of such an approval.

Chairman TAUZIN. So as counsel, you don't know, and you are the general counsel. You don't know whether Mr. Kopper, who is negotiating on LJM for LJM, against his own company, you don't know whether he got a waiver?

Mr. DERRICK. I don't because there is no requirement that waivers come through the Legal Department, Mr. Congressman.

Chairman TAUZIN. You signed the form, didn't you? Didn't Mr. Sefton sign it? I am sorry, Mr. Sefton, could you help me here, sir. You signed this form. Were you aware Mr. Kopper had or did not have a waiver?

Mr. SEFTON. My recollection is that Mr. Fastow advised me that he was taking care of the waivers for the LJM people.

Chairman TAUZIN. That is very nice. You can tell he took care of it. Did you personally assure yourself before you signed this document—you signed yes that the waiver was given. You signed yes it was an arm's length transaction. Did you take care to assure Mr. Kopper had a waiver?

Mr. SEFTON. I had no reason to believe that Mr. Fastow was not telling me the truth on that.

Chairman TAUZIN. So you, as counsel, just took his word?

Mr. SEFTON. I relied on his assurances.

Chairman TAUZIN. And you, Mr. Dilg, when you investigated this on behalf of the corporation for Mr. Derrick took the word of the folks who signed this document that everything was okay, even though you knew Kopper was—at that time you had to know—was working for LJM and for Enron at the same time.

Mr. DILG. We were given the board of directors' minutes that approved the participation by Mr. Fastow. They designated Mr. Buy and Mr. Causey to guard against the conflict of interest. There was a service——

Chairman TAUZIN. But what about Kopper? I am not asking Fastow.

Mr. DILG. Excuse me, there was a service agreement that provided for the services of certain employees of Enron that would be utilized on behalf of LJM. Mr. Kopper was listed in that service agreement. That service agreement was signed by Mr. Causey.

Chairman TAUZIN. But you see what is troublesome for me is that you are telling me if you would have known all these corporate executives were investing in and playing on the other side of the board, at the same time working in very responsible positions for the corporation and earning all these amazing amounts in 6 weeks, that you would have found that very troubling, you would have written a different report. Knowing what you know now, you might not stand by that report you wrote.

But what I am troubled by is that you did know that Mr. Kopper was involved. You had the approval sheets, you claimed you reviewed them. And according to you, this is a report you have given to Mr. Derrick and Mr. Lay who have just received a report saying that they are running a corporate corporation. They have just received a report—I will quote some of the things that Ms. Watkins reported again.

Jeff McMahon was highly vexed over it and he heard conflicts of LJM. He complained mightily to Jeff Skilling. Cliff Baxter, who, as we know, ended up committing suicide, complained mightily to Skilling and to all who would listen about the inappropriateness of the transactions with LJM. This was a report that you had in your hands that at least you were going to look at. You weren't going to look at the accounting, you were told not to do that, but you were going to look at the conflicts.

Mr. DILG. Yes, sir.

Chairman TAUZIN. And you had this report from Ms. Watkins, you have got these documents that show a very important officer in the corporation negotiating for the outside partnership and documents that say this is an arm's length transaction. You didn't look behind any of these documents in this so-called investigation to find out whether Ms. Watkins was telling Mr. Lay the truth?

Mr. DILG. The board had established procedures to guard against the conflict of interest that they recognized with Mr. Fastow's position in LJM. Those were to have the transactions signed off by Mr. Buy and Mr. Causey. There was a service agreement that we were provided that provided for Mr. Kopper to work on behalf of LJM. That agreement was signed by Mr. Causey.

Chairman TAUZIN. Now, we have to press again with this hearing because we are checking with some banks. Because according to Mr. McMahon, some of these banks were threatened or promised other business if they didn't invest in these partnerships. You knew about that, didn't you?

Mr. DILG. Yes, sir. Mr. McMahon raised that in his initial interview.

Chairman TAUZIN. Did you interview any one of these banks?

Mr. DILG. We did not.

Chairman TAUZIN. You didn't interview the banks. You didn't check on these transactions to see if Mr. Kopper had a proper waiver from conflict of interest. Wasn't it your job?

Mr. DILG. We were conducting a preliminary review to determine whether an additional investigation was necessary.

Chairman TAUZIN. Mr. Derrick, wasn't that your job? Wasn't it somebody's job? Mr Sefton, wasn't it one of your jobs to make sure that these people negotiating on the other side of the table from their own corporation had been properly cleared to do so? Whose job was it? According to Skilling, he is throwing the blame at you pretty heavily right here. He is saying,"It was their responsibility." He says, "I left the company. I don't know what they did after I left, but it was their responsibility to report to the board and Mr. Lay that this man needed a waiver. So don't blame me; blame Vinson & Elkins" is what he is saying. Should we blame Vinson & Elkins?

Mr. DILG. No, sir.

Chairman TAUZIN. Who should we look to? Who should Enron, who should Mr. Lay look to when he asked the question of, "Why weren't we told Mr. Kopper was in a conflict of interest position, that he wasn't negotiating at arm's length, that he never received a waiver to do this." Who should bear the responsibility for having, No. 1, known that and not done something about it, and No. 2, checked on it when Sherron Watkins went to the president of the corporation and said, "You have got a corrupt company; check into it"?

Mr. DERRICK. I think, initially, Congressman, the responsibility lies with, in this case, Mr. Kopper. Under our Code of Conduct, each employee is required to certify——

Chairman TAUZIN. You have got to be kidding me, Mr. Derrick. Any employee could go negotiate against a company and it was up to them to come and get a waiver? And you guys were signing these documents that said they had gotten waivers and you never checked to see if they did?

Mr. DERRICK. I am not saying that I have signed a document——

Chairman TAUZIN. I have got your Code of Conduct in front of me. You are not supposed to engage in any outside activity or enterprise which would interfere in any way with job performance. You don't think Mr. Kopper was engaging in enterprises that interfered with his performance? You don't think these employees who were investing $5,000 and reaping $1 million reward in 6 weeks were in a conflict of interest position?

Mr. DERRICK. Well, that is exactly my point. They were, and under our Code of Conduct, each of those individuals were required to approach the chairman and chief executive officer to seek an approval.

Chairman TAUZIN. Lawyers of the company had to know they were doing that. You admitted that to us. You have admitted to us that you knew Kopper was doing that. Whose job was it to tell them, "You are in violation of the Code of Ethics. You are fired." Or go to the president and say, "Get rid of these people. They didn't have the courtesy of complying with your Board of Ethics requirements—your Code of Ethics requirements."

Mr. DERRICK. Well, initially——

Chairman TAUZIN. Whose job was that?

Mr. DERRICK. Well, in my judgment, it was initially the employee's. To the extent that people in the company became aware that no conflict had been received, that was something that they should have reported. But there isn't a way that I know of for a company to, other than relying on the good faith of its employees, under a Code of Conduct, who are required to report conflicts of interest. That is where it all starts.

Chairman TAUZIN. But what is a requirement of a lawyer who is a counsel for the corporation who knows that an employee is violating the Code of Ethics?

Mr. DERRICK. Well, if——

Chairman TAUZIN. What is the requirement of a counsel?

Mr. DERRICK. If a lawyer knows that——

Chairman TAUZIN. Yes.

Mr. DERRICK. [continuing] as well as any other employee of the company, if they know that, they should have reported it.

Chairman TAUZIN. And you knew that Mr. Kopper was working for LJM and had not received a waiver.

Mr. DERRICK. I am sorry, Congressman, I wasn't working on these transactions. I wouldn't know Mr. Kopper if he walked in the conference room today.

Chairman TAUZIN. Mr. Sefton, did you know Mr. Kopper was working for LJM, and you don't think you had any responsibility to do anything except Mr. Fastow's word, and Mr. Fastow got his waiver, he is already working and making millions.

Mr. SEFTON. At the time that I received those assurances, I felt justified in relying upon them.

Chairman TAUZIN. Mr. Chairman, you know what we have? We have got the same kind of situation we had with Arthur Andersen when they said the lawyers let the accountants make the decisions about what their legal responsibilities were. I can't believe that the lawyers at a great American corporation would let the employees decide whether they could be in conflict of interest like this and make these investments and reap these benefits out of the very company that it was supposed to have a fiduciary responsibility for. These are major offices of your corporation. They are not workers at the bottom of the ladder; they are workers at the top of the ladder.

It is amazing to me that you guys could write a report to the chairman of the corporation after Ms. Watkins put herself way out on a limb to tell you all that this was going on, and you never bothered to talk to the banks, you never bothered to call in Mr. Kopper and say, "Did you get a waiver? Are you operating in conflict of interest? Are you operating in a way detrimental to the corporation when you owe your fiduciary obligation to the corporation?" It is amazing to me that you could issue that paper to Mr. Lay, which basically said, "Don't believe that lady; everything is fine. Everything is find. Don't hire any other outside lawyers. Look at what we did? For heaven's sake, don't hire any more accountants. Everything is okay. Now, just tell that lady we looked at it real carefully and everything is good." That is basically what you did.

Mr. DILG. Can I respond?

Chairman TAUZIN. Please respond. Yes, sir, please.

Mr. DILG. I think there are two things with regard to Mr. Kopper that are different. One, his investment in the Chewco matter, which was not raised by Ms. Watkins' letter and was not at all within the scope of our inquiry, as far as looking at Chewco. Mr. Kopper did negotiate on behalf of LJM and was reflected as doing so in the LJM approval sheets that were signed off on by the two people that the board had established to make sure that the deals were done on a basis that was favorable to Enron. There was a service agreement that was signed by Mr. Causey on June 30, 1999 that recognized Mr. Kopper's participation——

Chairman TAUZIN. But Causey and Buy are in the Office of the Chairman, you know that. They can't give waivers, you know that. You just testified, or Mr. Derrick did, that the Office of the Chairman was the only one that could give a waiver, not Causey and Buy. Is that right?

Mr. DILG. That is correct. We did not check on the waiver of the Code of Ethics issues. There was an agreement signed by the person that the board had designated to look after Enron's side on this.

Chairman TAUZIN. What do you think—and this is my final question, Mr. Chairman, I apologize—what do you think when you reviewed these approval sheets and you wrote a letter to Mr. Derrick, extensively to him, and to Mr. Lay, saying, "We checked the approval sheets, and everything looks okay"? What do you think when you saw a blank signature place for Mr. Skilling? Didn't that alert you that something is maybe amiss here?

Mr. DILG. We did note in our letter that the Office of the Chairman had not signed except on rare occasion. We wanted to bring that to their attention. The board minutes that we——

Chairman TAUZIN. Well, no, you said it differently. You said that in most instances there was no approval signature for the Office of the Chairman except for several significant transactions. And that sort of leaves the impression the only time he had to sign was for significant transactions. What was your understanding of the approval process? Did the Office of the Chairman have to approve these transactions?

Mr. DILG. The board minutes that we had that approved the LJM2 transaction and set up the approval process required Mr. Buy and Mr. Causey to approve matters on behalf of Enron. There was nothing in the board minutes that we had that required a signature by the Office of the Chairman.

Chairman TAUZIN. Mr. Jaedicke testified that his understanding of the controls was that approval was required of the Office of the Chairman, or at least a review was required. We got into whether or not approval and review, but at least review by the Office of the Chairman. You don't believe that is true?

Mr. DILG. I understand from the Powers report, which was the first time that I was aware of the information, that at a Finance Committee meeting in the fall of 2000, I believe, there was discussion of approval by the Office of the Chairman, and that was put in. Those minutes were not part of the minutes we were given in connection with our review. I think those minutes basically related to the formation of a new entity called LJM3 that didn't go forward. I am presuming that is why we didn't see them. We were not present at that meeting.

Chairman TAUZIN. But you did see a blank space.

Mr. DILG. We did, and we noted that in our report.

Chairman TAUZIN. What do you think? What do you think when you saw a blank space from the chief executive of the corporation on the approval forms?

Mr. DILG. We felt that it was worth noting in our report that those spaces had not been filled in.

Chairman TAUZIN. Wasn't it a red flag?

Mr. DILG. It was enough of a flag that we felt like it should be brought to Mr. Derrick's attention.

Chairman TAUZIN. But you never, never, never tried to talk to Mr. Skilling.

Mr. DILG. We did not try to talk to Mr. Skilling.

Chairman TAUZIN. Thank you, Mr. Chairman.

Mr. GREENWOOD. Thank you, Mr. Chairman. It is amazing how much inquiry you can squeeze into a 5-minute period.

The Chair recognizes the gentlelady from Colorado for 5 minutes.

Ms. DEGETTE. Thank you, Mr. Chairman. And Chairman Tauzin, when you were asking about the Code of Conduct, it occurred to me we have reached new heights now, because it is not just the fox guarding the hen house that we used to think about a week ago, now it has become clear it is the fox guarding the fox. I mean——

Chairman TAUZIN. The hen is guarding the fox.

Ms. DEGETTE. Yes, or something. You know, the exact same people who are the evildoers, who are committing these acts, are the ones that are supposed to go somehow to the chairman and say, "Oh, by the way, I have these conflicts of interest." It is unbelievable to me.

But I actually have a different line of questioning. What I want to talk about is Mr. Fastow's compensation, because as I read the Powers report and also some of the board committee minutes, it looks to me like the Compensation and Management Committee and also the Finance Committee told Enron that they should figure out what Mr. Fastow's compensation was from LJM1 and LJM2. Is that correct, Mr. Derrick? In your view, were you guys supposed to figure out how much Mr. Fastow was making?

Mr. DERRICK. I don't recall a specific instruction from the committee, Congresswoman. I think the compensation would come up in terms of what is disclosed in the proxy statement. I think what you may be referring to——

Ms. DEGETTE. But do you think that you should have found out how much Mr. Fastow was making?

Mr. DERRICK. Well, the teams that were working on the proxy disclosure issues did examine that question, and my understanding——

Ms. DEGETTE. Did you know how much Mr. Fastow was making?

Mr. DERRICK. Pardon me?

Ms. DEGETTE. Did you know how much Mr. Fastow was making from the LJM transactions?

Mr. DERRICK. I did not. I was——

Ms. DEGETTE. Did anybody at Enron, to your knowledge?

Mr. DERRICK. Not to my knowledge. My understanding is that the team that was working on it had concluded it was simply not practical to ascertain what the compensation was. But I will need to——

Ms. DEGETTE. Did anybody ever ask Mr. Fastow?

Mr. DERRICK. I can't speak to that.

Ms. DEGETTE. Who was running this team that was supposed to be finding it out?

Mr. DERRICK. Well, it would have been initially, I think, Mr. Mintz, in the Global Finance Group, and other people working with him.

Ms. DEGETTE. Okay. Do you know if Mr. Mintz tried to find out from Mr. Fastow what his compensation was?

Mr. DERRICK. I don't personally have knowledge of that.

Ms. DEGETTE. Mr. Rogers, do you think that management should have obtained Mr. Fastow's compensation while he was at LJM—or involved with LJM?

Mr. ROGERS. Yes, ma'am; it is my understanding they did try to find that out.

Ms. DEGETTE. And did you think they were supposed to find that out?

Mr. ROGERS. Yes.

Ms. DEGETTE. And in fact when you were interviewed on January 20 by Wilmer Cutler you talked to them about discussions that you had in a meeting in early 2001 whether anybody knew the amount of compensation that Mr. Fastow was receiving from the LJM transactions. Do you remember that meeting in early 2001?

Mr. ROGERS. I don't remember the date, but, yes, I remember asking that.

Ms. DEGETTE. Okay. And did you ask anybody to find that information out?

Mr. ROGERS. Yes.

Ms. DEGETTE. You were concerned about that issue, weren't you?

Mr. ROGERS. I knew it was a disclosure issue, yes.

Ms. DEGETTE. And is that why you were concerned about it?

Mr. ROGERS. Yes.

Ms. DEGETTE. Okay. And wasn't there a lot of conversation around Enron that Mr. Fastow might need to disclose this compensation from LJM on the 1999 and 2000 proxy statements?

Mr. ROGERS. Not a lot of conversation that I was a party to, but, yes, I understand it was discussed.

Ms. DEGETTE. Okay. But you were a party to conversations that that information had to be obtained.

Mr. ROGERS. Yes. I have read a lot of memos relating to that, yes.

Ms. DEGETTE. You have read a lot of memos relating to that?

Mr. ROGERS. Yes.

Ms. DEGETTE. Okay. And do we have those memos, do you know?

Mr. ROGERS. I believe you do.

Ms. DEGETTE. Okay.

Mr. ROGERS. I am confident you do.

Ms. DEGETTE. Did you ever try to get Mr. Fastow's compensation from LJM?

Mr. ROGERS. I didn't personally.

Ms. DEGETTE. Did you direct someone else to get that compensation?

Mr. ROGERS. I didn't direct someone, but someone undertook to do so, yes.

Ms. DEGETTE. Who did?

Mr. ROGERS. Mr. Mintz.

Ms. DEGETTE. Mr. Mintz. And do you know what Mr. Mintz did to try to get his compensation, to get Mr. Fastow's compensation from the LJM transactions?

Mr. ROGERS. It is my understanding that he met with Mr. Fastow, at least according to his memos, at some length.

Ms. DEGETTE. And as far as you know, Mr. Mintz was never successful in getting those compensation figures from Mr. Fastow, was he?

Mr. ROGERS. I don't know if he was or was not. What Mr. Mintz reported was that the compensation was not determinable after his conversations with——

Ms. DEGETTE. Did Mr. Mintz say why?

Mr. ROGERS. He makes references to it in his memo. I don't remember the exact reasons. I believe it had something to do with—well, first of all, a number of the transactions in that year had not closed, so it was not determinable. With one of the other transactions, there was an agreement between, as I understand it, between Mr. Fastow and LJM, which rendered whatever he had been paid something that was not a final number that could be adjusted.

Ms. DEGETTE. Well, okay, you didn't have the final numbers, but did you ever try to get a ballpark figure? Do you know if Mr. Mintz ever got a ballpark figure?

Mr. ROGERS. I don't know if he did or not.

Ms. DEGETTE. Didn't that concern you that Mr. Mintz was unable to get this information that was supposed to be on the financial statements?

Mr. ROGERS. I don't think it is on the financial statements.

Ms. DEGETTE. Okay.

Mr. ROGERS. It may be on the proxy statements. But Mr. Mintz is an outstanding lawyer. He undertook to get the information.

Ms. DEGETTE. He testified in front of us, so, yes, we all love him, but that is not my question.

Mr. ROGERS. Well, what he reported back to——

Ms. DEGETTE. My question is did he ever try to get at least a ballpark figure of what Mr. Fastow was making?

Mr. ROGERS. I wasn't a party to the conversation between Mr. Mintz and Mr. Fastow, but what Mr. Mintz reported back was the number was not determinable at that time.

Ms. DEGETTE. Okay. Have you ever gotten that figure, to this date?

Mr. ROGERS. I have not personally gotten the number. The only number I am aware of is the $30 million number that has been published.

Mr. GREENWOOD. Time of the gentlelady has expired.

Ms. DEGETTE. So that is the number that—I would ask unanimous consent for 1 additional minute.

Mr. GREENWOOD. Without objection. We are trying to be sensitive to the members' travel schedules.

Ms. DEGETTE. Thank you. I have one too, Mr. Chairman.

Mr. ROGERS. I am sorry, is there an open—is there a question?

Ms. DEGETTE. Yes. The question I was asking was that is the figure you read in the newspapers, the $30 million?

Mr. ROGERS. I believe that number first was reported in an 8K current report that Enron filed subsequent to the SEC investigation, in response to the SEC's questions. And my understanding, if my recollection is correct, that the members of the board spoke with Mr. Fastow.

Ms. DEGETTE. Okay. If you had known that $30 million at that time in 2001, would you have been concerned about the red flag that might raise as to these transactions?

Mr. ROGERS. If I had known at the time that——

Ms. DEGETTE. Yes.

Mr. ROGERS. [continuing] the number was $30 million?

Ms. DEGETTE. That was $30 million.

Mr. ROGERS. Absolutely.

Ms. DEGETTE. Do you know to this day how much the real number ever was?

Mr. ROGERS. I do not.

Ms. DEGETTE. Mr. Derrick, did you know at that time how much Mr. Fastow was making from the LJM transactions?

Mr. DERRICK. No. I had been told by the team that it was not practical to ascertain that because of these various open positions.

Ms. DEGETTE. And have you ever yet found out how much he made from those transactions?

Mr. DERRICK. The only thing I can add is, what Mr. Rogers referred to, was when the board elected or chose two of its members to sit down with Mr. Fastow and ask that question. And the number that has been referred to is, I believe, the number that Mr. Fastow told to those two members of the board.

Ms. DEGETTE. And that was in the Powers report?

Mr. DERRICK. I believe that is in the Powers report.

Ms. DEGETTE. Okay. And if you had known at least that $30 million at the time, would that have raised a red flag for you?

Mr. DERRICK. Yes, Congresswoman; it certainly would have.

Ms. DEGETTE. And to this day——

Mr. GREENWOOD. The time of the gentlelady——

Ms. DEGETTE. [continuing] do you have any idea how much Mr. Fastow made from LJM?

Mr. DERRICK. The only information I have is what I have just reported.

Ms. DEGETTE. Thank you.

Mr. GREENWOOD. The Chair recognizes the gentleman from Florida for 5 minutes.

Mr. STEARNS. Thank you, Mr. Chairman, and let me just say to the witnesses you came here voluntarily and we appreciate what you are doing, and we understand that you haven't had lunch and so we are very sensitive to that. But I think what we are all having trouble with is that people were making large sums of money and no one on this panel has any concern or doesn't stop to blow the whistle. It is like the three monkeys who see no evil, hear no evil and speak no evil. And you folks are unfortunately communicating that kind of sense to us that you would not have changed a thing and you did nothing wrong. I mean in retrospect, Mr. Derrick, do you think there has been any corporate malfeasance at all during this whole process?

Mr. DERRICK. Well, you say change nothing. In my opening testimony, I have said that had I been given the gift of clairvoyance, had I been able to foresee these events, I certainly would have done things differently. In fact, if it were within my power to go back and change anything, whatever it may be, that would have prevented us from being where we are now, certainly, Congressman, I would have done that.

But in terms of corporate malfeasance, I have no reason to believe that—when the board considered this, it honestly believed that it was taking decisions that it thought was not adverse to the best interest of Enron and put in place procedures that they honestly believed would protect those interests.

Mr. STEARNS. So today, Mr. Derrick, do you think there has been any corporate malfeasance, just yes or no?

Mr. DERRICK. Well, if the allegations that have been made at the end of the day prove to be true, then the answer is yes.

Mr. STEARNS. Mr. Dilg, do you think there has been corporate malfeasance based upon what you have seen?

Mr. DILG. We were very disheartened to see some of the things that came out in November. The participants in South Hampton was a great surprise to us.

Mr. STEARNS. So you see things today that would indicate, if true, it is corporate malfeasance.

Mr. DILG. The ownership of and interest in a company doing business with Enron without going through the proper Code of Conduct waivers, et cetera, raises grave concerns to me.

Mr. STEARNS. The question has come up of a $40 million that Mr. Fastow, the CFO, made. Mr. Derrick, you met with 10 members of our staff, one of those was on a telephone hookup. And per that discussion they had with you, you left a message with Lay and Skilling that it was not practical to determine Fastow's compensation but that it would be disclosed in the year 2002 and that you were not aware of Fastow's compensation at that point. But for the September 1 board meeting, you said you wrote a list of questions for the board to ask Mr. Fastow, and ultimately it was decided the chairman of the Executive Committee, John Duncan, and the Compensation Committee would sit down with Mr. Fastow outside the meeting, which they did, you said. At a board meeting after that, they reported that Fastow made $40 million. Is that true? Do you still stand by your statements to our staff?

Mr. DERRICK. With respect—yes, I do, with one exception. I believe I made it clear that as to the $40 million I can't be clear as to whether that was the amount. It may have been $30 million. But as to the other things you said, yes, I do, Congressman.

Mr. STEARNS. So you did not know that he made—let us say $40 million just for the discussions—that he made $40 million on these business transactions, and you did not know that before the September 1 board meeting. Is that true?

Mr. DERRICK. I am taking your word it is September 1, but, yes, that board meeting. Yes, that is correct.

Mr. STEARNS. Mr. Sefton, did you know that before September 1 board meeting that Mr. Fastow was making $40 million?

Mr. SEFTON. No. And was that September 1, 2001?

Mr. STEARNS. Yes, 2002.

Mr. SEFTON. 2002. I left Global Finance in 2000.

Mr. STEARNS. Okay. I have—it is Tab number 22 that Mr. Fastow signed. It is a proxy statement talking as of holdings of equity securities in the company. And on the last page, he talks about, in response to questions, he says—they are talking about his salary and his affiliates and his shares, and he said, “I suggest that you talk to Scott Sefton if you want to talk about my arrangements, my salary, and that Scott Sefton is preparing a draft of the disclosure relating to these transactions, which he will provide shortly.” Do you remember preparing a draft of disclosure on Mr. Fastow?

Mr. SEFTON. Yes.

Mr. STEARNS. And what did that disclosure say?

Mr. SEFTON. It was for the proxy for 2000.

Mr. STEARNS. And it did not talk at all about his salary and how much his compensation was.

Mr. SEFTON. The disclosure that I worked on was for the related party transactions.

Mr. STEARNS. Did you have an understanding of how much he made before you left the company?

Mr. SEFTON. No.

Mr. STEARNS. So all during the process you never understood it. You never knew how much he made.

Mr. SEFTON. No.

Mr. STEARNS. Mr. Rogers, did you?

Mr. ROGERS. No, sir.

Mr. STEARNS. And Mr. Dilg, do you?

Mr. DILG. I did not know until the results came back from the meetings with Mr. Duncan and the other board member.

Mr. STEARNS. Mr. Astin?

Mr. ASTIN. No, Congressman, not until the report that Mr. Rogers referred to, the 8K filing that first disclosed the number.

Mr. STEARNS. And Ms. St. Clair? okay. Thank you, Mr. Chairman.

Mr. GREENWOOD. Thank you. The Chair recognizes the gentleman from California for 5 minutes.

Mr. WAXMAN. Thank you very much, Mr. Chairman. One of the most disturbing facts to emerge from Congress’ investigation of the Enron collapse is the extent to which the company lobbied for and took advantage of inadequate regulation and oversight by legislators and regulators. If not for Enron’s political connections and power, the company’s true financial status might have been uncovered long ago. I would like to ask some questions about those political connections.

From 1989 to 2001, Enron’s PAC, Political Action Committee, and its employees and family members gave close to $6 million to Federal candidates and political parties. Press reports indicate that employees were, at the very least, strongly encouraged to make political contributions. One press report has cited a 2000 company memo that recommended employees give money to President Bush’s campaign. Are any of you aware of this particular memo?

Mr. DERRICK. It is certainly possible that I would have seen it at the time, Congressman. I don’t have specific recollection of it now.

Mr. WAXMAN. Okay. Any of the others. Mr. Sefton, are you aware of any memo asking employees to contribute?

Mr. SEFTON. I don't recall a memo relating to the Bush campaign, but the employees of the company were asked from time to time to consider contributions to, I think, a Political Action Committee that was set up by the company.

Mr. WAXMAN. And how were they asked, through a memo, through written communication?

Mr. SEFTON. Probably a memo or an e-mail.

Mr. WAXMAN. Anybody else recall seeing any memos or being aware of this information? Mr. Rogers?

Mr. ROGERS. Yes, sir. I don't recall any specific request to support a specific candidate. I do recall getting Political Action Committee materials. The company did—there was no obligation on any employee to join the PAC, but the company—all the employees were given the opportunity to, and I think the company did endorse being a member of the PAC. But there were no—nothing negative would happen to an employee if he did not join the PAC.

Mr. WAXMAN. Were any of them, when they were told they could voluntarily do this, given a suggested amount they ought to contribute?

Mr. ROGERS. Not to my recollection.

Mr. WAXMAN. Anybody else have a——

Mr. ROGERS. It is possible, I don't recall.

Mr. WAXMAN. Well, according to a press story, low-level employees were encouraged to give $500, and senior executives, at least $5,000. Do you know whether that would have been accurate?

Mr. ROGERS. I don't recall, but it would be very easy to find out.

Mr. WAXMAN. Did any of you, as lawyers for Enron, advise the company on campaign-related matters?

Mr. DERRICK. No, but we did have an employee who was charged, not as 100 percent of her job, but as part of her job was advising the PAC issue.

Mr. WAXMAN. Okay. And could you identify for the record, if not right now, who the employee had been——

Mr. DERRICK. Certainly; I will be happy to.

Mr. WAXMAN. And, Mr. Rogers, you say it would have been easy to find out if a memo had been sent out. How would we go about finding out that information?

Mr. ROGERS. I would guess the company would have records of the materials that it would send out with respect to the Enron PAC.

Mr. WAXMAN. The Washington Post reported that a letter was allegedly sent by Ken Lay to certain employees in the spring of 1999 asking for contributions to the Bush campaign. One recipient of the letter, according to the press report, said it was a rather menacing letter. Are any of you aware of this or other letters or memos from Ken Lay encouraging employees to contribute to the Bush campaign?

Mr. DERRICK. Congressman, I may have received a letter, not in Mr. Lay's capacity as the chairman of Enron, but in this private capacity. I know he was active for a number of candidates, one of whom was President Bush. And, certainly, I made a number of contributions to various candidates, and one of those would have been to Mr. Bush.

Mr. WAXMAN. And when you gave contributions to a number of candidates, were they at the request of Mr. Lay?

Mr. DERRICK. There would have been some of those, but it was my philosophy to try to support good candidates on both sides of the aisle. And only a small fraction of those would have been the result of any communication from Mr. Lay. But, again, it would have been in Mr. Lay's capacity, not as chairman of Enron but rather as a private citizen.

Mr. WAXMAN. Are you aware of any campaign contributions being reimbursed, like bonuses or other compensation intended, in effect, to reimburse employees for what they gave politically?

Mr. GREENWOOD. Last question, Mr. Waxman.

Mr. WAXMAN. I would like to have Mr. Rogers answer it was well.

Mr. DERRICK. I have no personal recollection of any such reimbursement.

Mr. WAXMAN. Mr. Rogers, are you aware of that?

Mr. ROGERS. Let me make sure I understand the question. Would you restate that, please?

Mr. WAXMAN. What I am trying to find out is whether you are aware of any additional compensation that was given to employees or executives to make up for the contributions they would have given to campaigns?

Mr. ROGERS. I am not aware of that.

Mr. WAXMAN. Are any of you aware of that?

Mr. GREENWOOD. Apparently not. The time of the gentleman has expired.

Mr. STEARNS. Mr. Chairman, just a point of information. I think in all fairness, if the question is going to be asked of the President, I think the gentleman from California should also ask it of President Clinton too, his same questions.

Mr. WAXMAN. I think that is reasonable. I want to know if any political campaigns.

Mr. GREENWOOD. I think the record has demonstrated that the Enron employees and Enron Political Action Committee, as well as Enron soft money, went generously to both sides of the aisle, this election cycle and previous election cycle.

The Chair thanks the gentlemen and lady for their testimony today. This committee has held 4 days of hearings on the collapse of Enron, and we have done that because this is the largest bankruptcy in the history of the country. We have done that because not only did 4,000 Enron employees, at least, lose their jobs, pensions lost, but teachers' funds, retirement funds across the country were lost, $70 billion. Funds invested by parents for their children's education lost because of investments in Enron. There has been a lot of human suffering as a result of this collapse, not the least of which, of course, is the tragic death of Mr. Baxter.

It has been interesting to this member that this collapse happened at a time when all of the commodities in which this company was trading were in high demand in the country. You had good supplies, you had great demand, all of the economic reasons for this company to succeed were in place. And yet it failed. The accountants have come in and told us that it didn't fail because of anything they have done, no one from the company's management has said it has failed because of anything that they have done wrong, and none of you have indicated today that the company because of anything that you have done wrong.

My final question for you, in retrospect and without the gift of clairvoyance, as you look back upon this failure, what happened? Who caused the failure of Enron. Mr. Derrick?

Mr. DERRICK. Well, there are brighter people than I who are looking at this issue. From my perspective, Congressman, it was a loss of confidence and panic selling. I believe—I am not a businessman, I am not a financial person, but certainly it was my sense that the company still had enormous opportunities. There was, as some have said, a run on the bank——

Mr. GREENWOOD. It wasn't loss in confidence that you could sell natural gas and electricity and—it wasn't like automobiles were made and people lost confidence in the ability to sell buggy whips, was it? It was loss of confidence in the management, was it not?

Mr. DERRICK. I can't speak to that. I can't say that you are wrong on that. I don't know. But experiencing from the inside, it was simply a panic sale of our shares based on what seemed to be a loss of confidence, and I think had the company had some opportunity to have had a circuit breaker in place, that it might have saved many, many people from the tragedy that they have undergone.

Mr. GREENWOOD. Well, it would be my final observation—first, without objection, I would like to put into the record the documents to which we have referred today and identified as, "O&I Financial Collapse of Enron, March 14, 2002."

My only comment in closing would be that once again the commentary from the witnesses is that the company failed because of loss of confidence of the investors, which sounds an awful lot to me like blaming the victims, the people who lost the money failed because they failed to have confidence in the company itself.

This hearing is adjourned.

[Whereupon, at 3 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

# O&I – Financial Collapse of Enron
# March 14, 2002

| Tab# | Document | Date |
|---|---|---|
| 1 | Stuart Zisman's memo | September 1, 2000 |
| 2 | Scott Sefton's memo | June 19, 2000 |
| 3 | Bob Baird's email to Scott Sefton, and Rex Rogers about LJM2 Private Placement Memo | October 4, 1999 |
| 4 | Carl Jordan's memo to Sharon Butcher about managing employee situation | August 24, 2001 |
| 5 | Mintz's memo on LJM3 Private Placement Memo | December 7, 2000 |
| 6 | Mintz's agenda for LJM Legal Review | March 7, 2001 |
| 7 | Mintz's memo on LJM Approval Process | March 8, 2001 |
| 8 | Mintz's memo on Related Party Disclosures | April 6, 2001 |
| 9 | Mintz's memo on proposed sale of Enron Wind to LJM | April 16, 2001 |
| 10 | Mintz's agenda for LJM Update | May 7, 2001 |
| 11 | Mintz's agenda for LJM Legal Review | May 22, 2001 |
| 12 | Mintz's memo on approval for transactions with LJM | May 22, 2001 |
| 13 | Mintz's memo on LJM Proxy Disclosures (2002) | June 4, 2001 |
| 14 | Sherron Watkins' letter | August 2001 |
| 15 | Vinson and Elkins' letter to Jim Derrick about Preliminary Investigation | October 15, 2001 |
| 16 | Enron Document Retention Order | October 25, 2001 |
| 17 | Carol St. Clair's handwritten notes | November 1997 |
| 18 | Scott Sefton's notes | |
| 19 | Services agreements (4) | April 4, 2000; July 17, 2000; December 20, 2000; |
| 20 | LJM Approval Sheets | |
| 21 | LJM2 Private Placement Memo | October 13, 1999 |
| 22 | Fastow's 2000 Proxy Statement | |
| 23 | Bauer Memo | November 2, 2001 |
| 24 | Legal Times Article on V&E | February 11, 2002 |
| 25 | Side Agreement - Chewco | |
| 26 | "The Enron Wars" – *Vanity Fair* Article | April 2002 |
| 27 | Vinson & Elkins Interview Memoranda | Aug., Sept., Oct. 2001 |

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Natural Gas
Electricity and
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**DRAFT**

| | | | |
|---|---|---|---|
| **TO:** | Mark Haedicke<br>Julia Murray | | |
| **FROM:** | Stuart Zisman | **DEPARTMENT:** | ENA Legal |
| **SUBJECT:** | **PROJECT RAPTOR** | **DATE:** | September 1, 2000 |

Enron Corp., through its wholly-owned subsidiary, Harrier I, L.L.C. ("Harrier"), recently entered into a Master Derivatives Agreement with Talon I, L.L.C. ("Talon") along with a variety of other related documents in order to establish a risk management program for hedging the volatility of certain assets (the "Raptor Structure").

ENA was asked to spearhead the efforts to: (i) incorporate certain assets/securities into the Raptor Structure and (ii) establish a road map for future use of the Raptor Structure. In doing so, several issues have been raised as possible areas of concern. They are as follows:

1. Overall book and manipulation (**Legal Risk Level = 4**);
2. Breach of confidentiality obligations (**Legal Risk Level = 3.5**);
3. Insider trading (**Legal Risk Level = 3**); and
4. Liability as a "tipper" (**Legal Risk Level = 3**).

1. **Overall Book Manipulation**. The Raptor Structure is designed to reduce earnings volatility resulting from the rules of fair value accounting. Our original understanding of this transaction was that all types of assets/securities would be introduced into this structure (including both those that are viewed favorably and those that are viewed as being poor investments). As it turns out, we have discovered that a majority of the investments being introduced into the Raptor Structure are bad ones. This is disconcerting for two reasons: (1) it might lead one to believe that the financial books at Enron are being manipulated in order to eliminate the drag on earnings that would otherwise occur under fair value accounting, and (2) it increases the likelihood of a claim by the Talon investors (i.e. LJM), because of the weak nature of the assets being put into this structure, and the resulting losses that are likely to be incurred by Talon under the Raptor derivative transactions.

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2. <u>Breach of Confidentiality Obligations</u>. In nominating derivative transactions for inclusion in the Raptor Structure, Harrier is required to provide information to Talon regarding the assets/securities being hedged. The provision of such information would (in numerous cases) constitute a violation of our confidentiality obligations (for obvious reasons, this issue is significantly more problematic when dealing with assets/securities of private (as opposed to public) companies). Our review of the assets/securities of the private companies which have been identified as Raptor hedge candidates has revealed that strict confidentiality obligations are virtually ubiquitous. There are, however, the following noteworthy mitigants to the confidentiality issue: (i) in most instances, the first and only level of contemplated disclosure would be to Andy Fastow and/or Michael Kopper as authorized signatories of Talon (while disclosure to these parties is arguably a violation of most confidentiality obligations that might apply, an argument could be made that Andy/Michael are reviewing the confidential information in their capacity as officers of Enron); and (ii) there are confidentiality agreements between Harrier and Talon that forbid further disclosure by Talon thereby reducing the potential damages arising from the initial "breach" by Enron. Despite the mitigants listed above, there are circumstances under which confidential information can/must be disclosed by Talon to others (one potential scenario (which becomes increasing likely in the event that many of the hedged assets perform poorly) involves the insistence, by the LJM investors that certain information be revealed in connection with Talon's derivative transactions).

3. <u>Insider Trading</u>. To the extent that the security underlying any derivatives transaction is publicly traded, we are obligated to disclose to Talon any material inside information in our possession in order to avoid claims by Talon of fraud or material misrepresentation. While we intend to secure a written agreement from Talon to not use such information for any purpose other than evaluation of the related Raptor transaction we cannot be absolutely certain that Talon will not use the information to trade the underlying securities. If Talon ever used material inside information (provided by Harrier) in violation of the securities laws, Enron would likely be incriminated and become liable for significant damages and penalties (not to mention the resulting public relations nightmare).

4. <u>Liability as a "Tipper"</u>. A concern related to insider trading is the potential use by Talon of material inside information learned from Harrier to tip others thereby potentially making Enron liable for such violations. In order to safeguard against this, we intend to obtain written assurances from Talon that any information provided to it shall not be used for any other purpose other than to consider the proposed derivative transaction and further that no such information shall be provided to any other party in order to avoid any tipping liability. Notwithstanding the existence of these assurances, some risk remains.

cc: John Lavorato
Mark Frevert
Dave Delainey
Joe Deffner

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ENRON

# Interoffice Memorandum

To: Distribution

From: Scott Sefton

Department: EGF Legal

Subject: LJM Approval Sheet

Date: June 19, 2000

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I just wanted to remind everyone that there is a special Enron approval process for transactions between Enron and LJM.

A copy of the approval form is attached. This form should be completed for all transactions between Enron and LJM and should be completed prior to the closing of the deal.

In my experience, the questions in Section 4 on page 2 of the form have been particularly difficult for the commercial person to complete. In order to facilitate the approval process, I've completed these questions on the attached form. I will confirm that these items are properly completed when I sign the form.

Please contact me if you have any questions.

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**Baird, Bob**

| | |
|---|---|
| **From:** | Baird, Bob |
| **Sent:** | Monday, October 04, 1999 6:52 AM |
| **To:** | 'Sefton, Scott'; Rogers, Rex (Enron) |
| **Cc:** | Astin, Ronald T. |
| **Subject:** | LJM2 |

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**CONFIDENTIAL/ATTORNEY-CLIENT PRIVILEGE**

Scott: Welcome back!

Rex Rogers asked that I look over the draft of the private placement memorandum for LJM2 Co-Investment, L.P. Here are my principal comments:

1. Obviously Andy, Michael and Ben will have a conflict of interest, but the Enron Board of Directors may waive this conflict and may want to put in place procedures to approve transactions involving them or LJM2 that involve conflicts. In order to make an intelligent waiver, however, the Enron board needs to know what financial interests the principals have in LJM2 and what financial commitment they have made to it. I would think the investors in LJM2 would want to know that as well. But the document does not disclose those interests or amounts they will invest. It discloses the earnout the general partner has, and it discloses that the principals control the general partner, but it does not say who owns the equity interests in the general partner, what amounts they will invest and what amounts are entitled to under what circumstances. This point is particularly important because of the fact that the Designated Percentage in a given project that JEDI II invests in can vary from 50% to 75%; presumably if the principals have control over Enron's decisions and also have a financial interest in the excluded portion of any investment (under (u) of the definition of Excluded Investment in the JEDI II partnership agreement), then they will have an incentive to minimize Enron's investment so that LJM2 can take a larger percentage. Also, it would be important to know what kind of investment they are making in LJM2, because if they are in effect getting a free ride (or ~~a bargain)~~ because of their earnout or small financial commitment, that will tend to give them an incentive to make sure JEDI II makes more investments (so they have more exposure to the upside).

2. I assume that the principals and the board realize that all transactions involving over $60,000 between Enron and LJM2 will probably need to be disclosed as "certain transactions" with management in Enron's proxy statement.

3. Section 6.03(c)(ii) of the JEDI II partnership agreement says that "During the Commitment Period, neither Enron nor any of its Affiliates may organize a new limited partnership or other investment entity the purpose of which is to invest in Qualified Investments, until the date on which 80% of the aggregate Commitments have been invested or committed for investment in Qualified Investments pursuant to binding contractual agreements." I would think that LJM2 arguably violates this commitment unless it is made clear that, with respect to any investment it makes other than an investment in amounts in excess of the Designated Percentage of an investment that Enron makes (i.e. investments not sourced at Enron), such investment cannot be a Qualified Investment. I would not think that Enron would be comfortable merely taking the position that Enron did not organize this fund, particularly because its CFO is the main principal, and I assume that the Board's rationale for approving this (and waiving the conflicts of interest and letting the principals spend some of their time on this) is that it benefits Enron. See especially the statements under "Dual Role Advantages" on page 7. Also on page 7 it says that LJM1 has substantially similar objectives to LJM2; if LJM1 was organized to invest in Qualified Investments there may already be a breach of Enron's commitment in Section 6.03(c)(ii).

4. There are many statements in the document that absolutely must be changed, because Enron's business is described in a way that paints it as an investment portfolio manager or as a company whose assets consist of an investment portfolio. It is critical that Enron not advertise itself as an investment adviser because (a) with respect to certain activities it has relied (and will continue to rely) on the fewer than 15 clients exemption in the Investment Advisers Act, which requires that the party relying on the exemption must not "hold himself out generally to the public as an investment adviser" and (b) the definition of an investment company under the Investment Company Act of 1940 is a company engaged in the business of investing, reinvesting and trading in securities; and among other things Enron has received an important exemptive order from the SEC which it can rely on only if it does not hold itself out as being in the business of investing, reinvesting and trading in securities. So references to Enron's merchant investment portfolio (e.g. page 6 under "Preferred Access"), assets under management (e.g. page 8 under Rationale) and other such references need to be changed. Also, it is a bad idea to describe Enron as being in the investment syndication business (e.g. page 9 at the top), because many of Enron's investments involve securities, and if Enron is in the investment syndication business it must register as a broker-dealer.

5. I question whether it is true that Enron will manage and operate the Investments that JEDI II makes. There are many places in the draft where this is stated (e.g. page 24, bottom), but I thought that many of the JEDI II investments would be minority investments.

6. There is no mention whether LJM2 will register as a commodity pool operator, although the draft says it will employ rigorous risk management techniques. This is really more LJM2's problem than it is Enron's, although if LJM2 runs regulatory risk it is possible that Enron will take some heat.



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7. There are several places where the draft says that this has been fully reviewed and approved by Enron's board of directors and office of chairman; has that been done? The draft says that Rick Causey will review the activities of LJM2. Is that the only control that Enron will placed on LJM2 in terms of reviewing and approving conflicts of interest? Andy would get more protection if there were some review and approval process at the board level or at a more senior executive level.

8. One question is whether Enron's indemnity (which covers persons serving at the request of Enron on other companies' boards, etc.) will cover Andy, Ben and Michael's activities with LJM2, and also whether Enron's insurance will cover it. It seems to me that this should be clarified and agreed to in advance. The description in the private placement memorandum indicates that perhaps they are serving at Enron's request. If Enron objects to its indemnity and insurance extending to their activities with LJM2, it could insist on an agreement that they not seek indemnity or insurance, or if it wants the indemnity and insurance to extend to LJM2 it could specifically clarify that they do.

9. The draft private placement memorandum says nothing about transfer pricing between Enron and LJM2. Will LJM2 invest alongside Enron on the same, more favorable or less favorable terms? Shouldn't this be addressed in the private placement memorandum? Shouldn't Enron's board get a commitment from the principals that LJM2 will not get more favorable treatment than Enron?

10. The private placement memo makes it look like Enron is sponsoring this fund. I would think that it would be advisable to put in a statement that although Enron's board has given the principals permission to set up and run this fund, it is not an Enron sponsored fund, Enron has not made any commitment to it and Investors must, as a condition to investing, enter into an agreement acknowledging those facts, stating that they are relying solely on the fund and not Enron and agreeing that they will not seek recourse against Enron in the event their investment does not perform as promised.

11. The private placement memo should point out that the principals could resign or be dismissed from Enron at any time (subject, of course, to rights they may have under employment agreements). I don't think that their service with LJM2 is tied to their service with Enron.

12. I have some other nits that I can go over with you, but those are the main points.

CONFIDENTIAL

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**Dilg, Joe**

**From:** Jordan, Carl
**Sent:** Friday, August 24, 2001 7:02 PM
**To:** Butcher, Sharon (Enron)
**Subject:** Confidential Employee Matter

ATTORNEY CLIENT PRIVILEGED COMMUNICATION

Sharon:
Per your request, the following are some bullet thoughts on how to manage the situation with the employee who made the sensitive report.

1. I agree that it is a positive that she has requested reassignment to another department. Assuming a suitable position can be found, I recommend documenting in memo form that the transfer is being effected per her request. This would be worded to convey that the company has considered and decided to accomodate her request for reassignment. See comments below re additional items to be addressed in the memo.
2. I suggest that the memo also name a designated company officer for her to contact in the unlikely future event that she believes she is being retaliated against for having made the report. Case law suggests that she then will have the burden of reporting any perceived retaliation and allowing the company a reasonable opportunity to correct it before quitting and asserting a constructive discharge. (Note: If there is any chance that the decision might be made in the future to discharge the employee for making the report -e.g., if the company concludes that the allegations were not made in good faith- then this assurance probably should not be given, at least until later when (if) the company is satisfied that the employee was not acting in bad faith or otherwise improperly.)
3. The memo should contain language that conveys that the other terms of her employment -specifically, its at-will status- remains unchanged. This is to avoid any future claim that the understandings surrounding the transfer constitute a contractual obligation of some sort.
4. The new position, as we discussed, should have responsibilities and compensation comparable to her current one, to avoid any claim of constructive discharge.
5. As we discussed, to the extent practicable, the fact that she made the report should be treated as confidential.
6. The individual or individuals who are implicated by her allegations should be advised to treat the matter confidentially and to use discretion regarding any comments to or about the complaining employee. They should be advised that she is not to be treated adversely in any way for having expressed her concerns.
7. You indicated that the officer in charge of the area to which the employee may be reassigned would probably need to be advised of the circumstances. I suggest he be advised at the same time that it is important that she not be treated adversely or differently because she made the report. And that the circumstances of the transfer are confidential and should not be shared with others.

You also asked that I include in this communication a summary of the possible risks associated with discharging (or constructively discharging) employees who report allegations of improper accounting practices:

1. Texas law does not currently protect corporate whistleblowers. The supreme court has twice declined to create a cause of action for whistleblowers who are discharged; however, there were special factors present in both cases that weighed against the plaintiffs and the court implied that it might reach a different conclusion under other circumstances.
2. Regardless of the whistleblower issue, there is often a risk of a Sabine Pilot claim (i.e., allegation of discharge for refusing to participate in an illegal act). Whistleblower cases in Texas commonly are pled or repled as Sabine Pilot claims - it is often an easy leap for the plaintiff to make if she had any involvement in or duties relating to the alleged improper conduct. For example, some cases say that if an employee's duties involve recording accounting data that she knows to be misleading onto records that are eventually relied on by others in preparing reports to be submitted to a federal agency (e.g., SEC, IRS, etc.), then the employee can be subject to criminal prosecution even tho she did not originate the misleading data and does not prepare the actual document submitted to the government. Under such circumstances, if the employee alleges that she was discharged for refusing to record (or continuing the practice of recording) the allegedly misleading data, then she has stated a claim under the Sabine Pilot doctrine.
3. As we discussed, there are a myriad of problems associated with Sabine Pilot claims, regardless of their merits, that involve allegations of illegal accounting or related practices. One is that the company's accounting practices and books and records are fair game during discovery - the opposition typically will request production of volumes of sensitive material. Another problem is that because accounting practices often involve judgments in gray areas, rather than non-judgmental applications of black-letter rules, there are often genuine disputes over whether a company's practice or a specific report was materially misleading or complied with some statutory or regulatory requirement. Third, these are typically jury cases - that means they are decided by lay persons when the legal compliance issues are often confusing even to the lawyers and

experts. Fourth, because of the above factors, they are very expensive and time consuming to litigate.
4. In addition to the risk of a wrongful discharge claim, there is the risk that the discharged employee will seek to convince some government oversight agency (e.g., IRS, SEC, etc.) that the corporation has engaged in materially misleading reporting or is otherwise non-compliant. As with wrongful discharge claims, this can create problems even tho the allegations have no merit whatsoever.

These are, of course, very general comments. I will be happy to discuss them in greater detail at your convenience.

W. Carl Jordan
Vinson & Elkins L.L.P.
1001 Fannin
2300 First City Tower
Houston, Texas 77002
(713) 758-2258
(713) 615-5334-fax

**Interoffice Memorandum**

**Confidential Communications**
**Attorney-Client Privilege**

To: Rick Buy
Rick Causey

From: Jordan Mintz Jordan

Department: Enron Global Finance - Legal

Subject: **Private Placement Memorandum for "LJM3"**

Date: December 7, 2000

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As you know, LJM has recently circulated a PPM regarding the formation of a new private equity fund, "LJM3 Co-Investment, L.P." (I believe they are planning to close in two weeks.) For the most part, its contents closely mimic that used for LJM2, but in many instances pare down its discussion of Enron. The recurring reference to the "linkage" between Enron and LJM, however, continues to be substantial. To that end and in light of Enron now having a "history" with LJM (albeit only a year or so), I thought it would be instructive to summarize some of the provisions of LJM3 that are relevant for Enron's purposes. (We also are reviewing the related draft LJM3 limited partnership agreement.)

In particular, I offer for your review and consideration:

(1) Discussion of Investment Opportunity: This section describes why LJM3 is an attractive investment opportunity highlighting the following:
- Access to Significant [Enron] Proprietary Deal Flow;
- Enron's Capabilities to Analyze and Structure Investments and Operate Assets;
- The Ability to Evaluate Investments with Full Knowledge of the Assets [Due to the Principals' Insider Status]; and
- Speed and Knowledge Advantage of LJM3.

(2) Investment Strategy: This section describes how LJM3 plans to capitalize on its aforementioned advantages highlighting the following:
- Invests with Enron; and
- Invests in Assets/Businesses where Enron retains an ongoing economic interest thus ensuring that LJM3 has access to Enron's significant resources to manage assets on an ongoing basis.

(3) Dual Role Advantages: This section highlights the benefits investors should realize due to the dual roles played by Andy Fastow and Michael Kopper, thereby facilitating LJM3's access to Enron dealflow.

VEL 00522

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(4) Discussion of Conflict of Interest: Describes the steps Enron has taken to ensure that conflict-of-interest issues are appropriately addressed, including the review roles of Enron's Chief Accounting and Risk Officers, as well as that of the Enron Board's Finance and Audit Committees. The PPM further notes that "Enron's Office of the Chairman has waived certain provisions of Enron's employee code of conduct to permit the Principals to form and operate the Partnership and Enron's Board of Directors has ratified that waiver as it applies to Mr. Fastow". (It is my understanding from Rex Rogers that this description is not wholly accurate and we are considering providing modified language for inclusion in the PPM Supplement.)

One additional item worthy of mention regarding LJM3 is my understanding that a targeted investor is CalPERs.

There are a number of additional important issues involving LJM that we are currently addressing (with the assistance of Rex Rogers and Ron Astin). Such issues primarily relate to (i) our internal review of the processes and deal review/substantiation efforts regarding Enron/LJM transactions and (ii) proxy disclosure issues, including scope of information and mitigation alternatives.

I will keep you advised regarding material developments; in turn, please do not hesitate to contact me with any questions or comments you may have. I may be reached at x 37897.

cc: Rex Rogers
Ryan Siurek
Ron Astin (Vinson & Elkins)

VEL 00523

6

LJM LEGAL REVIEW
(Confidential)

Participants: Jim Derrick
Rex Rogers
Jordan Mintz
Ron Astin

A. Overview

LJM1
LJM2

1. A "Who, What, Where" of LJM
2. 1999 Activity
3. 2000 Activity

B. Enron Board Involvement

1. Directives
2. Review Process
3. February 2001 Audit and Finance Committee Reviews

C. Legal Consideration

1. Financial Statement Disclosures
2. Proxy Disclosures
3. Memo regarding Suggestions for Improvement to Policies/Controls for Transacting with LJM in 2001

3/7/01

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To: Rick Buy
Rick Causey
From: Jordan Mintz

Department: Enron Global Finance–Leg

Subject: **LJM Approval Process – Transaction Substantiation**

Date: March 8, 2001

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With the year-end and recent Board meetings behind us, and our now being in the midst of proxy season, I thought it might be timely to memorialize my observations and summarize my recommendations for refining our compliance with the procedures approved by Enron's Board of Directors (the "Board") with respect to the Company's transacting with LJM. Briefly stated, it is my view that the Company needs to improve both the *process* it follows in executing such transactions and implement improved procedures regarding *written substantiation* supporting and memorializing the Enron/LJM transactions; at the same time, it is also my view worthwhile improvements can be accomplished without significant disruption to commercial efforts.

More specifically, my recommendations focus on two areas: the first is the need for the Company to implement a more active and systematic effort in pursuing non-LJM sales alternatives before approaching LJM, and then to create more extensive written documentation substantiating such efforts; the second is to modify the LJM Approval Checklist so as to impose a more rigorous testing of the fairness and benefits realized by Enron in transacting with LJM -- and balancing such benefits against perception and shareholder relations issues such transactions may present.

To that end, what follows below is: relevant background regarding the Board's approval for transacting with LJM; my "due diligence" findings relating to the Company's compliance with such approval; and recommendations for improvement to be effective for the 2001 year.

**Overview**

As you know, the sensitivities surrounding Enron's transacting with LJM primarily stem from three areas: whether such transactions are being conducted at arms-length in such a clear and convincing fashion that they will be respected from a GAAP earnings perspective; whether the benefits realized by Enron from such transactions are sufficiently "compelling" from an investor's perspective to negate perceptions, however unwarranted, of an "interested" dealing; and whether such transactions are in the best interests of the Company and, thus far, consistent with the Board's carrying out its fiduciary duties and in compliance with the Company's Code of Ethics. In order to address these three critical and often-overlapping concerns, the Board has previously approved the following procedures and controls:

(1) Enron and LJM are not obligated to one another to transact;

(2) Enron's Chief Accounting and Risk Officers are to review and approve the terms all transactions Enron or an affiliate enters into with LJM;

VEL 010

(3) The Board's Audit and Compliance Committee shall annually review all transactions completed that year and make any recommendations they deemed appropriate; and

(4) The Board is to determine, also annually, that Andrew Fastow's controlling position at LJM and his involvement as a counterparty to Enron does not adversely effect the best interests of the Company.

Additionally, although not explicitly provided for by the Board, the Finance Committee also annually reviews all Enron/LJM transactions, but may review on an *ad hoc* basis, as needed.

To supplement the Board's mandated procedures, Enron and LJM also agreed to an additional control precluding Mr. Fastow (and Michael Kopper, also a senior level professional at both Enron and LJM) from negotiating on behalf of Enron in transactions with LJM.

The Company subsequently adopted a written "LJM Approval Sheet" to generally describe the business nature of any Enron/LJM transaction, including the deal terms and anticipated economics to Enron. This Approval Sheet is supplemented with an "Issues Checklist", which captures the procedures to be followed in executing transactions with LJM; in this manner, Enron can test whether it is complying with the Board's directions. (Such Approvals are to be reviewed and executed by certain members of Enron's Senior Management, including Jeff Skilling.) For example, the Checklist provides for the following determinations to be made:

(1) In addition to LJM, identifying other sales options that were considered and rejected, including sales to Condor, JEDI II, and third parties; identifying other banks/offers that were received with respect to the transaction;

(2) Whether the transaction with LJM will be the most beneficial alternative to Enron; identifying the related benefits – cash flow, earnings;

(3) Determining whether the transaction involves a "Qualified Investment" so that it was required to be offered to JEDI II;

(4) Whether the transaction was negotiated at arm's-length; did any advisors conclude that the transaction was *not* fair to Enron;

(5) Whether the transaction had to be disclosed in the Proxy and whether it yielded any monetary benefit to an Enron employee; and

(6) Whether LJM's participation in the transaction has been reviewed by Enron Office of the Chairman ("OTC")? Has it been reviewed and approved by Enron's Chief Accounting and Risk Officers?

And finally, the Checklist asks whether Enron's Board's Audit Committee reviewed all Enron/LJM transactions within the past 12 months.

**Findings**

The procedures followed by Enron in transacting with LJM, including the manner in which they have been substantiated, should be improved and can be, I believe, with minimum disruption to commercial efforts. I also believe that the adoption of certain of these recommendations will yield material benefits with respect to accounting substantiation and further documentation of the Board's carrying out of its fiduciary duties and business judgment.

The more significant areas for improvement are as follows:

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(1) Enron does not consistently seek to negotiate with third parties before it transacts with LJM. No policy exists specifically requiring evaluation and pursuit of third party alternatives before transacting with LJM. Because no existing policy requires the prior evaluation of third party alternatives and, given the fluid nature of the Company's commercial activities, too often Enron finds itself facing a time deadline that makes it difficult (*in fact* often impossible, as a practical matter) to transact with a third party, thus potentially: (a) reducing the benefits Enron realizes from the LJM transaction by eroding Enron's bargaining position; (b) clouding the objective evidence of such benefits (due to a lack of comparable alternatives) and, perhaps; (c) undermining the arm's-length nature of the transaction (due to a lack of both comparable and practical alternatives);

(2) Enron does not always adequately substantiate in writing the procedures it follows with respect to transacting with LJM. For example, some of the questions in the Checklist do not capture the "full picture" of information that would be instructive in demonstrating compliance with Enron's Board. For example:

(a) The Checklist does not require an explanation as to *why* the particular transaction would be the most beneficial alternative for Enron -- only that it is. Requiring an answer to the question of *why* the transaction is beneficial would have the added advantage of requiring that the question be directly addressed by the commercial personnel charged with its execution;

(b) The Checklist does not provide for a detailed explanation/substantiation of sales efforts prior to transacting with LJM (thereby negating a contemporaneous record that could be useful in fashioning appropriate disclosures regarding those transactions required to be disclosed);

(c) The Checklist does not require an explanation as to *how* Enron determined that the transaction was conducted at arm's-length -- only if it was not (which presents the same difficulties as (b));

(d) The Checklist provides for pre-determined, rather than a more "realtime" OTC determination that transacting with LJM does not adversely affect Enron; and

(e) The Checklist does not provide any level of detail regarding the Chief Accounting and Risk's Officer's review and approval; I believe, for the Board's Audit and Finance Committee's benefit, this additional information -- when coupled with formal Board presentations -- would provide additional enhancement to the Board's decision-making as to having all relevant facts before it.

(3) Inherent employee conflicts exist that can contribute to a perception that Enron and LJM *cannot* transact at arm's-length; and

(4) Enron's transactions with LJM create potential conflicts with CalPERS, and perhaps other future "investment parties" with whom Enron may have a relationship.

Particular suggestions for improvements follow. These recommendations for a more "formal" approach for transacting with LJM, however, should not replace or supercede any "commonsense" alternatives that may better allow for flexibility in any commercial/financial transaction and, perhaps, a better balancing of competing interests.

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**Recommendations**

Adoption of the suggestions that follow should enhance those procedures already in place and being followed for purposes of substantiating Enron's compliance with the Board's directives and, in particular, "completing the Company's files" with respect to responding to audit reviews and preparation of proxy and footnote disclosures. In particular:

(1) Additional education of business units regarding the role to be played by LJM as an alternative counterparty after efforts with "traditional", third party counterparties are exhausted and the Company's expectation that such third parties will be explored before resort to LJM. Further written *substantiation* of such efforts;

(2) Amendments to the Checklist to ensure further written substantiation of *why* this particular transaction with LJM was the *most beneficial* vis-à-vis alternatives, *how* such determination is *substantiated*, and substantiation that the transaction was conducted at arm's-length;

(3) Better contemporaneous involvement by the OTC regarding review and approval of Enron's transacting with LJM, *i.e.* sign-off by Jeff Skilling on a more regular basis;

(4) Mitigation of personnel conflicts by physical separation of all fulltime LJM employees from Global Finance representatives; and

(5) Coordination of LJM Approvals, review, and substantiation documents through an internal group made up of representatives of EGF Commercial, Legal (custodian of the documents), Accounting, and Commercial Support.

Items (2) (4) and (5) above are already being addressed. We can work through the individual business unit CFOs to progress item (1) and, with your concurrence, I can discuss item (3) with Jeff.

Please let me know your thoughts about these recommendations and whether you take exception to my working towards their implementation. Of course, feel free to contact me with any questions you may have.

Thank you for your time.

Cc: Jim Derrick
Rex Rogers
Rob Walls
Ron Astin (Vinson & Elkins)

VEL 0110

Bcc: Ron Baker
Rodney Faldyn
Ben Glisan
George McKean
Gordon McKillop
Ryan Siurek

**Interoffice Memorandum**

**Confidential Communications**
**Attorney-Client Privilege**

**8**

To: Andy Fastow

From: Jordan Mintz

Department: Enron Global Finance-Legal

Subject: **Related-Party Proxy Disclosures**

Date: April 6, 2001

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You will recall that in preparing the LJM related-party disclosure for this year's (2000) Proxy, we did not disclose financial information regarding your interest as the ultimate general partner/managing member in either LJM1 or LJM 2. The purpose of this memorandum is to explain our reasons for concluding such a disclosure was not required in either 1999 or 2000 and to explain why such rationale(s) may not be applicable in future filings.

**Discussion**

The Proxy Rules require -- among other things -- a description of the related party's (i.e. LJM's) interest in transactions entered into with the registrant (i.e. Enron), the nature of such interest, and -- "where practicable" -- the amount of such person's interest in the transaction(s). It is this last piece of information relating to your financial stake that we have not explicitly disclosed because the Legal Department, in consultation with our outside counsel, has concluded disclosure was not mandated. In both the 1999 and 2000 Proxies we have generally provided as follows: "The general partner is entitled to receive a percentage of the profits of the partnership in excess of the general partner's proportion of the total capital contributed to LJM1/LJM2, depending upon the performance of the investments made by LJM1/LJM2." Thus, it is clear that, at a minimum, there is public disclosure that you, as the general partner in these two investment vehicles, are entitled to receive some level of carried interest.

Our rational for not disclosing any additional financial information related to your general partner interests varies as between 1999 and 2000 and, in particular, with respect to the RhythmsNet transaction, as follows:

(1) 1999: The "where practicable" language in the Proxy Disclosure Rules gave us the basis for not providing additional financial information in 1999. More specifically, the majority of the transactions entered into in 1999 between Enron and LJM1/LJM2 -- and specifically the RhythmsNet hedge -- were "open" transactions during the 1999 fiscal year and had not yet settled or liquidated in a fashion that it would be "practicable" to determine what you earned in your general partner capacity. The "open transaction" basis applied to both the RhythmsNet transaction and the newly-executed LJM2-related acquisitions and hedges for 1999.

(2) 2000: We determined it was not practicable to quantify your interest in LJM2 in the most recent Proxy, again, based on the existence of multiple open and

> unmatured transactions making it impracticable to compute. The rationale for not making any additional disclosures relating to the settlement of the RhythmsNet transaction, however, is somewhat different. In particular, the RhythmsNet transaction settled in 2000 pursuant to terms allowed for under the original agreement. At settlement of RhythmsNet it may have been practicable to determine your financial interest. However, no further disclosure was otherwise required of the RhythmsNet transaction in 2000 because settlement occurred under conditions permitted in the original agreement. Thus, there was no new transaction involving LJM1 and Enron in the year 2000 required to be disclosed in this year's proxy; accordingly, we have concluded that there was no requirement to disclose any financial information related to what you may have earned in that transaction – notwithstanding that it was now more practicable to do so.

The decision not to disclose in this instance was a close call; arguably, the more conservative approach would have been to disclose the amount of your interest. Given other pertinent (and competing) issues that you and I have discussed at great length, we decided against doing so. It was, perhaps, fortuitous that the RhythmsNet transaction extended over two proxy filing years and the specific facts of the particular case allowed us to conclude that a disclosable transaction occurred only in the year in which financial disclosure was impracticable. Thus, we have relied on two different arguments for avoiding financial disclosure for you as the LJM1 general partner in both 1999 and then 2000. If, however, the RhythmsNet transaction began and concluded in the same year, it would have been more difficult to avoid making some additional level of financial disclosure.

**Going Forward**

This disclosure issue will continue to be a challenge as transactions entered into between Enron and LJM2 settle and, as such, it becomes "practicable" to quantify and, therefore, be required to disclose the amount of your financial interest. To that end, we need to continue to be cognizant of this issue as the year progresses and continue to consider some of the safe-harbors provided under the SEC rules from having to disclose related party transactions – including the (1) competitive bid and (2) reduction of general partner control alternatives we have previously discussed. I, of course, will continue to examine other alternatives, as well.

After you have had a chance to review this summary, I am available to discuss any questions or comments you may have.

Cc: Jim Derrick
Rex Rogers
Ron Astin (Vinson & Elkins)

**Interoffice Memorandum**

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**Confidential Communications**
**Attorney-Client Privilege**

ENRON

CONFIDENTIAL

To: Cliff Baxter
Mark Metts
Rick Causey

From: Jordan Mintz

Department: Enron Global Finance - Legal

Subject: **Proposed Sale of Enron Wind to LJM – Disclosure Issues**

Date: April 16, 2001

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This memorandum addresses the disclosure issues (i.e. proxy and financial statements) implicated by a proposed sale by Enron of its ownership in Enron Wind to LJM ("Proposal"). In particular, it summarizes a safe-harbor under the SEC Rules which would avoid any proxy disclosure relating to the Proposal; however, it should also be noted that it is unlikely that compliance with such safe-harbor would also provide us with a basis for not disclosing such transaction for financial statement purposes (i.e. 10Q/10K).

Briefly stated, no disclosure is required in the annual proxy for transactions engaged in by a registrant (i.e. Enron) and a related party (i.e. LJM) if done pursuant to a "competitive bid" process. Although there is scant guidance in this area, it is my judgment that a process like the following would satisfy the definition of a competitive bid:

- A preprinted, unsigned form contract omitting the name of the counterparty and the pricing provisions would be delivered to several active, viable counterparties, including, for example, LJM;

- Each proposed counterparty would be instructed to fill-in pricing and sign the proposed agreement, and indicate any other changes it would propose to make to the preprinted agreement. Each proposed counterparty would be advised that changes to the preprinted agreement would be taken into account by Enron in selecting a winning counterparty; and

- All responses would be due back to Enron at a preset time, delivered to a contact within Enron, remote from the executive officer whose entity may be bidding on the proposal. At the appropriate time, all envelopes would be opened at the same time and the winning counterparty selected from the proposed counterparties responding.

As you know, the foregoing is a process similar to that used by investment banking firms when attempting to sell companies, and it is generally considered competitive by those in the industry. Of course, we could tweak the process to be responsive to our view of appropriate industry standards. Stating the obvious, for this process to pass muster, we would need to ensure that is it monitored carefully to ensure "true competition".

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If the process results in an LJM winning bid, no proxy disclosure would be required. Nevertheless, it appears that the accounting rules would require disclosure independently of the analysis just described.

It may well be that financial statement disclosure – without proxy disclosure -- could appear "too cute" and we may decide to proceed with the proxy disclosure in any event. In that instance, we would be required to provide a description of the Proposal, the related party's (i.e. LJM's) interest in the Proposal, the nature of the interest of the related party, the amount of the transaction and, "where practicable", the amount such related party may earn in the transaction. In addition, if the Proposal were not viewed as a "sale in the ordinary course" of Enron's business, we would also need to provide the sales price. Although such information can be provided in a fairly "punchy and pithy" fashion, we would obviously be revealing sensitive information.

I am available to discuss any questions or comment you may have; I may be reached at x 37897.

Cc: Rodney Faldyn
Rex Rogers

VEL 00533

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LJM UPDATE
(May 7, 2001)

1. Closed Transactions (2001)
   - Raptor Restructuring

2. Pending Transactions
   - Cuiaba Repurchase (End of May)
   - Merlin CLO (By May 15)

3. Due Diligence
   - Enron Wind
   - Generation (CA executed)
   - [illegible]

4. Other Items
   - Disclosure
   - Approval Sheet
   - Skilling's Signature
   - Board's/OTC Determination Regarding "No Adverse Effect"
   - Mike Miller

Default [illegible]?

No [illegible]

Don Miller

5/15 T/C w/ [illegible]

① [illegible] -- [illegible]
② [illegible]
③ Raptor: [illegible] -- [illegible]
S.A. [illegible] -- [illegible]
④ Default [illegible] -- [illegible]

VEL 00537

II

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**LJM LEGAL REVIEW**
(May 22, 2001)

Participants: Jim Derrick
Rob Walls
Rex Rogers
Jordan Mintz

A. Developments since March 7th Legal Review Meeting

1. Proxy/10-K Disclosures
2. Enron Wind
3. Overlapping Employee Duties/Services Agreements Review
4. Deal Approval Changes
5. Investor Relations Feedback
6. Meetings with Causey/Buy

B. Meetings with ASF; Current Proposals

1. Restructure of LJM ownership to avoid disclosure
2. "Fresh look" at Enron/LJM relationship

Meeting
(1) Why is Andy staying in? Pay value to [illegible]?
(2) Ugly. Disclosures being made: lengthy/[illegible]
(3) Corporate Governance issue regarding

Interoffice
Memorandum

Confidential Communications

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To: Jeff Skilling

From: Jordan Mintz Jordan

Department: Enron Global Finance - Legal

Subject: **Company Approvals for Transactions with LJM**

Date: May 22, 2001

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One of the internal procedures we have in place for monitoring Enron's transactions with LJM for arm's-length dealings and "fairness" is an internal approval sheet (similar to the DASH). Such approval sheet, which summarizes (1) the nature of the transactions and its terms, (2) other options considered by Enron, and (3) disclosure obligations, if any, by the Company, is signed by Global Finance Legal, Accounting, and RAC. Accounting and RAC, particularly, require the signatures of Rick Causey and Rick Buy. Such approval sheet also provides for your signature.

All required sign-offs for the 2000 transactions have been recently completed. In discussing our arranging for your signature with Rick Causey and Rick Buy, it was decided to provide you with all finalized approvals in aggregate--rather than in a piecemeal fashion—and we are now ready to do so.

To that end, I will arrange to get on your schedule to assist you in this regard; alternatively, I can send such approval sheets to you as a package and you can then sign at your convenience. In the interim, please let me know if you have any questions or comments. I may be reached at x37897.

Thanks for your time.

Cc: Rick Buy
Rick Causey

VEL 00534

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**Interoffice Memorandum**

**Confidential Communications**
**Attorney-Client Privilege**

ENRON

To: Andy Fastow

From: Jordan Mintz

Department: Enron Global Finance-Legal

Subject: **LJM Proxy Disclosures (2002)**

Date: June 4, 2001

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What follows below is a summary of the key steps to be taken so as to minimize any related-party and proxy disclosure Enron would be required to make in 2002 with respect to transactions executed with LJM 1 and 2 (collectively, the "LJM Entities") during 2001. Such steps are being taken in order to be responsive to certain commercial changes occurring at Enron. In that regard, it is intended that such approach would (i) cause the LJM Entities to cease to be related persons whose transactions with Enron are required to be disclosed for financial statement footnote purposes, and (ii) liquidate your interest in the LJM Entities in a fashion that minimizes the extent to which such interest must be described (except to note its disposition) in the proxy statement for next year's annual meeting.

**Proposal**

As you may recall, this year Enron and LJM2 have executed two transactions--one relating to the restructuring of Raptor and the other with respect to the repurchase of the Merlin CLO equity. The steps listed below are premised on all other pending transactions between Enron affiliates and the LJM Entities being frozen prior to such steps being implemented. (Raptor will continue to be disclosed in the 10-Q and year-end 10-K, and it is also likely the CLO equity repurchase will need to be disclosed in the second quarter 10-Q and year-end 10-K). However, if your interest in the LJM Entities is eliminated without recognizing value attributable to 2001 transactions, we do not anticipate that any material disclosure would be required in the 2002 proxy statement for the annual meeting, other than noting the unwind of your interest in LJM, assuming all of the following steps are taken:

(1) No "value", i.e. distributions, has been taken out of LJM by you this year and the purchase price paid by Michael Kopper does not reflect any amount attributable to 2001 transactions between Enron and the LJM Entities;

(2) The purchase of your entire interest in the LJM Entities by Michael Kopper will not be financed by you (or any person whose interest would be attributable to you for reporting purposes, such as family members) or Enron; and

(3) Michael will no longer be an employee of Enron or retain any material contractual relationship with the Company going forward.

In this manner, any proxy disclosure in 2002 is, again, likely to be limited to a notification of your termination of your interest in LJM, while -- with respect to the 10-Q/10-K -- earlier transactions will continue to be disclosed until they settle.

After you have had a chance to review this summary, please contact me with any questions/comments you may have. We should also discuss coordination and implementation matters

Cc: Rick Buy
Jim Derrick
Rob Walls
Rick Causey
Rex Rogers
Ron Astin (Vinson & Elkins)

EC 000024322

Respect Integrity Communication Excellence

14

Dear Mr. Lay:

Has Enron become a risky place to work? For those of us who didn't get rich over the last few years, can we afford to stay?

Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.

The spotlight will be on us, the market just can't accept that Skilling is leaving his dream job. I think that the valuation issues can be fixed and reported with other goodwill write-downs to occur in 2002. How do we fix the Raptor and Condor deals? They unwind in 2002 and 2003, we will have to pony up Enron stock and that won't go unnoticed.

To the layman on the street, it will look like we recognized funds flow of $800 mm from merchant asset sales in 1999 by selling to a vehicle (Condor) that we capitalized with a promise of Enron stock in later years. Is that really funds flow or is it cash from equity issuance?

We have recognized over $550 million of fair value gains on stocks via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm, The New Power Co by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.

I am incredibly nervous that we will implode in a wave of accounting scandals. My 8 years of Enron work history will be worth nothing on my resume, the business world will consider the past successes as nothing but an elaborate accounting hoax. Skilling is resigning now for 'personal reasons' but I think he wasn't having fun, looked down the road and knew this stuff was unfixable and would rather abandon ship now than resign in shame in 2 years.

Is there a way our accounting guru's can unwind these deals now? I have thought and thought about how to do this, but I keep bumping into one big problem – we booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay back it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse. We are under too much scrutiny and there are probably one or two disgruntled 'redeployed' employees who know enough about the 'funny' accounting to get us in trouble.

What do we do? I know this question cannot be addressed in the all employee meeting, but can you give some assurances that you and Causey will sit down and take a good hard objective look at what is going to happen to Condor and Raptor in 2002 and 2003?

Summary of alleged issues:

**Raptor**

Entity was capitalized with LJM equity. That equity is at risk; however, the investment was completely offset by a cash fee paid to LJM. If the Raptor entities go bankrupt LJM is not affected, there is no commitment to contribute more equity.

The majority of the capitalization of the Raptor entities is some form of Enron N/P, restricted stock and stock rights.

Enron entered into several equity derivative transactions with the Raptor entities locking in our values for various equity investments we hold.

As disclosed, in 2000, we recognized $500 million of revenue from the equity derivatives offset by market value changes in the underlying securities.

This year, with the value of our stock declining, the underlying capitalization of the Raptor entities is declining and Credit is pushing for reserves against our MTM positions.

To avoid such a write-down or reserve in Q1 2001, we 'enhanced' the capital structure of the Raptor vehicles, committing more ENE shares.

My understanding of the Q3 problem is that we must 'enhance' the vehicles by $250 million.

I realize that we have had a lot of smart people looking at this and a lot of accountants including AA&Co. have blessed the accounting treatment. None of that will protect Enron if these transactions are ever disclosed in the bright light of day. (Please review the late 90's problems of Waste Management – where AA paid $130+ mm in litigation re. questionable accounting practices).

**The overriding basic principle of accounting is that if you explain the 'accounting treatment' to a man on the street, would you influence his investing decisions? Would he sell or buy the stock based on a thorough understanding of the facts? If so, you best present it correctly and/or change the accounting.**

My concern is that the footnotes don't adequately explain the transactions. If adequately explained, the investor would know that the "Entities" described in our related party footnote are thinly capitalized, the equity holders have no skin in the game, and all the value in the entities comes from the underlying value of the derivatives (unfortunately in this case, a big loss) AND Enron stock and N/P. Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transactions with us at the same prices or without substantial premiums from Enron. In other words, the $500 million in revenue in 2000 would have been much lower. How much lower?

Raptor looks to be a big bet, if the underlying stocks did well, then no one would be the wiser. If Enron stock did well, the stock issuance to these entities would decline and the transactions would be less noticeable. All has gone against us. The stocks, most notably Hanover, The New Power Co., and Avici are underwater to great or lesser degrees

I firmly believe that executive management of the company must have a clear and precise knowledge of these transactions and they must have the transactions reviewed by objective experts in the fields of securities law and accounting. I believe Ken Lay deserves the right to judge for himself what he believes the probabilities of discovery to be and the estimated damages to the company from those discoveries and decide one of two courses of action:

1. The probability of discovery is low enough and the estimated damage too great; therefore we find a way to quietly and quickly reverse, unwind, write down these positions/transactions.
2. The probability of discovery is too great, the estimated damage to the company too great; therefore, we must quantify, develop damage containment plans and disclose

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

Summary of Raptor oddities:

1. The accounting treatment looks questionable

   a. Enron booked a $500 mm gain from equity derivatives from a related party
   b. That related party is thinly capitalized, with no party at risk except Enron
   c. It appears Enron has supported an income statement gain by a contribution of its own shares.

   One basic question: The related party entity has lost $500 mm in its equity derivative transactions with Enron. Who bears that loss? I can't find an equity or debt holder that bears that loss. Find out who will lose this money. Who will pay for this loss at the related party entity?

   If it's Enron, from our shares, then I think we do not have a fact pattern that would look good to the SEC or investors.

2. The equity derivative transactions do not appear to be at arms length

   a. Enron hedged New Power, Hanover, and Avici with the related party at what now appears to be the peak of the market. New Power and Avici have fallen away significantly since. The related party was unable to lay off this risk. This fact pattern is once again very negative for Enron.
   b. I don't think any other unrelated company would have entered into these transactions at these prices. What else is going on here? What was the compensation to the related party to induce it to enter into such transactions?

3. There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly. This alone is cause for concern.

   a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. He complained mightily to Jeff Skilling and laid out 5 steps he thought should be taken if he was to remain as Treasurer. 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets and never addressed the 5 steps with him.
   b. Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.
   c. I have heard one manager level employee from the principle investments group say "I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company." The principle investments group hedged a large number of their investments with Raptor. These people know and see a lot. Many similar comments are made when you ask about these deals. Employees quote our CFO as saying that he has a handshake deal with Skilling that LJM will never lose money.

E 68551

4. Can the General Counsel of Enron audit the deal trail and the money trail between Enron and LJM/Raptor and its principals? Can he look at LJM? At Raptor? If the CFO says no, isn't that a problem?

Condor and Raptor work:

-

1. Postpone decision on filling office of the chair, if the current decision includes CFO and/or CAO.

2. Involve Jim Derrick and Rex Rogers to hire a law firm to investigate the Condor and Raptor transactions to give Enron attorney client privilege on the work product. (Can't use V&E due to conflict – they provided some true sale opinions on some of the deals).

3. Law firm to hire one of the big 6, but not Arthur Andersen or PricewaterhouseCoopers due to their conflicts of interest: AA&Co (Enron); PWC (LJM).

4. Investigate the transactions, our accounting treatment and our future commitments to these vehicles in the form of stock, N/P, etc..
For instance: In Q3 we have a $250 mm problem with Raptor 3 (NPW) if we don't 'enhance' the capital structure of Raptor 3 to commit more ENE shares.
By the way: in Q1 we enhanced the Raptor 3 deal, committing more ENE shares to avoid a write down.

5. Develop clean up plan:

   a. Best case: Clean up quietly if possible.

   b. Worst case: Quantify, develop PR and IR campaigns, customer assurance plans (don't want to go the way of Salomon's trading shop), legal actions, severance actions, disclosure.

6. Personnel to quiz confidentially to determine if I'm all wet:
   a. Jeff McMahon
   b. Mark Koenig
   c. Rick Buy
   d. Greg Whalley

To put the accounting treatment in perspective I offer the following:

1. We've contributed contingent Enron equity to the Raptor entities. Since it's contingent, we have the consideration given and received at zero. We do, as Causey points out, include the shares in our fully diluted computations of shares outstanding if the current economics of the deal imply that Enron will have to issue the shares in the future. This impacts 2002 – 2004 EPS projections only.

2. We lost value in several equity investments in 2000. $500 million of lost value These were fair value investments, we wrote them down. However, we also booked gains from our price risk management transactions with Raptor, recording a corresponding PRM account receivable from the Raptor entities. That's a $500 million related party transaction – it's 20% of 2000 IBIT, 51% of NI pre tax, 33% of NI after tax.

3. Credit reviews the underlying capitalization of Raptor, reviews the contingent shares and determines whether the Raptor entities will have enough capital to pay Enron its $500 million when the equity derivatives expire.

4. The Raptor entities are technically bankrupt; the value of the contingent Enron shares equals or is just below the PRM account payable that Raptor owes Enron. Raptor's inception to date income statement is a $500 million loss.

5. Where are the equity and debt investors that lost out? LJM is whole on a cash on cash basis. Where did the $500 million in value come from? It came from Enron shares. Why haven't we booked the transaction as $500 million in a promise of shares to the Raptor entity and $500 million of value in our "Economic Interests" in these entities? Then we would have a write down of our value in the Raptor entities. We have not booked the latter, because we do not have to yet. Technically, we can wait and face the music in 2002 – 2004.

6. The related party footnote tries to explain these transactions. Don't you think that several interested companies, be they stock analysts, journalists, hedge fund managers, etc., are busy trying to discover the reason Skilling left? Don't you think their smartest people are pouring over that footnote disclosure right now? I can just hear the discussions – "It looks like they booked a $500 million gain from this related party company and I think, from all the undecipherable ½ page on Enron's contingent contributions to this related party entity, I think the related party entity is capitalized with Enron stock." ….. "No, no, no, you must have it all wrong, it can't be that, that's just too bad, too fraudulent, surely AA&Co wouldn't let them get away with that?" ….. "Go back to the drawing board, it's got to be something else. But find it!" …… "Hey, just in case you might be right, try and find some insiders or 'redeployed' former employees to validate your theory."

[redacted] P.32

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# Vinson & Elkins


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October 15, 2001

**Privileged and Confidential:
Attorney-Client Communication
and Attorney Work Product**

Mr. James V. Derrick, Jr.
Executive Vice President and General Counsel
Enron Corp.
1400 Smith Street
Houston, Texas 77002

Re: Preliminary Investigation of Allegations of an Anonymous Employee

Dear Jim:

You requested that Vinson & Elkins L.L.P. ("V&E") conduct an investigation into certain allegations initially made on an anonymous basis by an employee of Enron Corp. ("Enron"). Those allegations question the propriety of Enron's accounting treatment and public disclosures for certain deconsolidated entities known as Condor or Whitewing and certain transactions with a related party, LJM, and particularly transactions with LJM known as Raptor vehicles. The anonymous employee later identified herself as Sherron Watkins, who met with Kenneth L. Lay, Chairman and Chief Executive Officer of Enron, for approximately one hour to express her concerns and provided him with materials to supplement her initial anonymous letter. This letter constitutes our report with respect to our investigation and sets forth the scope of our review, the activities undertaken, the identification of primary concerns, and our analysis and conclusions with respect to those concerns.

## I. Scope of Undertaking

In general, the scope of V&E's undertaking was to review the allegations raised by Ms. Watkins' anonymous letter and supplemental materials and to conduct an investigation to determine whether the facts she has raised warrant further independent legal or accounting review.

By way of background, some of the supplemental materials provided by Ms. Watkins proposed a series of steps for addressing the problems she perceived, which included retention of independent legal counsel to conduct a wide-spread investigation, and the engagement of independent auditors, apparently for the purpose of analyzing transactions in detail and opining as to the propriety of the accounting treatment employed by Enron and its auditors Arthur Andersen

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L.L.P. ("AA"). In preliminary discussions with you, it was decided that our initial approach would not involve the second guessing of the accounting advice and treatment provided by AA, that there would be no detailed analysis of each and every transaction and that there would be no full scale discovery style inquiry. Instead, the inquiry would be confined to a determination whether the anonymous letter and supplemental materials raised new factual information that would warrant a broader investigation.

2. **Activities Undertaken**

Our preliminary investigation included the review of selected documents provided to us by Enron and from our internal sources, interviews with key Enron and AA personnel and discussions with V&E attorneys who are familiar with legal issues addressed by Enron in connection with the subject transactions. The focus, of course, was to identify background information, disclosures and personal views with respect to the Condor/Whitewing and Raptor vehicles and Enron's relationship with LJM.

Documents reviewed in this process included excerpts of meetings of Enron's Board of Directors, including minutes of meetings of the Audit and Finance Committees of the Board, various public filings of Enron (annual reports, 10-K's, 10-Q's), documents relating to Enron's transactions with LJM, including Deal Approval Sheets and Investment Summaries, and various miscellaneous materials in the nature of presentations and memoranda. The focus of our document review was to determine whether the requisite approval of the transactions referenced in the anonymous letter had been obtained from Enron's Board and its committees, the nature of the disclosures made with respect to the transactions and relationships questioned by the anonymous letter and supplemental materials and to provide general background information.

Interviews were also conducted with various Enron personnel based either on their connection with the transactions involving Condor/Whitewing, LJM and Raptor, or because they were identified in materials provided by Ms. Watkins as persons who might share her concerns. Those persons interviewed were: Andrew S. Fastow, Executive Vice President and Chief Financial Officer; Richard B. Causey, Executive Vice President and Chief Accounting Officer; Richard B. Buy, Executive Vice President and Chief Risk Officer; Greg Whalley, President and Chief Operating Officer (formerly Chairman of Enron Wholesale); Jeffrey McMahon, President and Chief Executive Officer, Enron Industrial Markets (formerly Treasurer of Enron); Jordan H. Mintz, Vice President and General Counsel of Enron Global Finance; Mark E. Koenig, Executive Vice President, Investor Relations; Paula H. Rieker, Managing Director, Investor Relations; and Sherron Watkins, the author of the anonymous letter and supplemental materials.

Interviews were also conducted with David B. Duncan and Debra A. Cash, both partners with AA assigned to the Enron audit engagement.

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In addition to the foregoing formal interviews, discussions were likewise held with Rex Rogers, Vice President and Assistant General Counsel of Enron, and Ronald T. Astin of V&E regarding general background information and the identification of specific issues relating to the matters raised by the anonymous letter and supplemental materials.

After completing interviews with all of the foregoing individuals, supplemental interviews were conducted with Andrew S. Fastow and Richard B. Causey of Enron and David B. Duncan and Debra A. Cash of AA to confirm certain information learned in the overall interview process.

As we initially discussed, we limited our interviews (with the exception of the AA partners mentioned above) to individuals still employed with Enron. Therefore, we did not interview individuals no longer with Enron mentioned in the anonymous letter or supplemental materials or any third party related to LJM.

3. **Identification of Primary Concerns**

Our preliminary investigation revealed four primary areas of concern expressed by Ms. Watkins' anonymous letter and supplemental materials. Accordingly, our document review and interview process focused on those areas of concern and whether the facts raised by Ms. Watkins' anonymous letter and supplemental materials presented any new information as to those matters that may warrant further independent investigation. Those areas of primary concern are as follows:

a. the apparent conflict of interests by Mr. Fastow's ownership in LJM;

b. the accounting treatment accorded the Condor and Raptor structures in Enron's financial statements;

c. the adequacy of public disclosures of the Condor and Raptor transactions; and

d. the potential impact on Enron's financial statements as a result of the Condor/Whitewing and Raptor vehicles because of the decline in value of the merchant investments placed in those vehicles as well as the decline in the market price of Enron common stock.

Our findings and conclusions with respect to each of these areas of concern are set forth separately below.

4. **Conflict of Interest**

Mr. Fastow actually organized two separate investment partnerships. The first, LJM-Cayman L.P. ("LJM1"), was launched in June, 1999. The LJM concept appears to have been fully discussed with the Office of the Chairman and was presented to and approved by Enron's Board of Directors at a special meeting on June 28, 1999. That approval included the Board's waiver of Enron's code of ethics to permit Mr. Fastow to act as the general partner of LJM1. The primary purpose for the organization of LJM1 was to establish a non-Enron entity with which Enron could enter into a swap transaction to hedge its investment in Rhythms NetCommunications. It was likewise recognized that LJM might negotiate to purchase additional assets in Enron's merchant portfolio. LJM raised $16 million in outside equity, invested in a Raptor vehicle that entered into a swap for Rhythms NetCommunications and also purchased a sufficient portion of Enron's equity in the Cuiaba power plant in Brazil to allow Enron to deconsolidate that project.

The second investment partnership – LJM2 Co-Investment, L.P. ("LJM2") – was organized in October, 1999.[1] At an October 11, 1999 meeting of the Finance Committee of the Board of Directors, Enron's activities with LJM1 were reviewed and the proposal for transacting business with LJM2 was discussed and approved. The Board of Directors, at its meeting on October 12, 1999, waived Enron's code of ethics to permit Mr. Fastow to serve as general partner of LJM2 and established guidelines for Enron's transaction of business with LJM2. Those included: (i) no obligation to do transactions between Enron and LJM2; (ii) the Chief Accounting and Risk Officers would review, and where appropriate, approve transactions with LJM2; (iii) there would be an annual review by the Board's Audit Committee of completed transactions or recommendations, as appropriate; and (iv) there would be an annual review as to the application of the Company's code of ethics to assure that such transactions would not adversely affect the best interests of the Company.

The LJM2 partnership raised $349 million in equity from investors ranging from commercial and investment banks, insurance companies, public and private pension funds and high net worth individuals. LJM2 has engaged in approximately 21 separate transactions with Enron.

Pursuant to the Board's guidelines, special procedures were adopted and utilized for the transaction of business with LJM. Those procedures included the preparation of a special LJM2 Deal Approval Sheet ("DASH") that would be prepared for every Enron/LJM2 transaction generally describing the nature of the commercial transaction and the relevant economics. Approval was also required by a variety of senior level commercial, technical and commercial support professionals. DASH was supplemented by an LJM approval process checklist testing for compliance with Board directives for transactions with LJM2, including questions addressing the following:

- alternative sales options and counter-parties,

[1] The initial LJM partnership was then referred to as "LJM1." LJM1 and LJM2 will be referred to jointly as "LJM" unless there is a particular reason to distinguish between the two investment partnerships.

- dete mination that the transaction was conducted at arm's length.
- disclosure obligations. and
- review of the transaction by Enron's Office of the Chairman. Chief Accounting Officer and Chief Risk Officer.

As part of these procedures, it also appeared that several additional controls were adhered to. These included LJM senior management professionals never negotiating on behalf of Enron; Enron professionals negotiating with LJM reporting to senior Enron professionals other than Mr. Fastow; Enron Global Finance commercial, legal and accounting monitoring of compliance with procedures and controls for regular updates for Chief Accounting and Risk Officers, and internal and outside counsel regularly consulted regarding disclosure obligations and review of any such disclosures.

Based on our review of the LJM Deal Approval Sheets and accompanying checklist, it appears that the approval procedures were generally adhered to. Transactions were uniformly approved by legal, technical and commercial professionals as well as the Chief Accounting and Risk Officers. In most instances, there was no approval signature for the Office of the Chairman except for several significant transactions. It also appeared that the LJM transactions were reviewed by the Audit Committee on an annual basis. At the February 7, 2000 meeting of the Audit Committee, all LJM transactions occurring prior to that date were reviewed. A review of all the LJM transactions during the following year was made at the February 12, 2001 meetings of both the Audit and Finance Committees.

Based on our interviews with various Enron representatives, and notwithstanding the foregoing guidelines and procedures that were adopted, concerns were expressed about the awkwardness in LJM's operating within Enron and two potential conflicts of interest. The awkwardness arose from the fact that LJM's professionals – primarily individuals reporting to Mr. Fastow and Michael Koppers – were also Enron employees who officed in Enron space and worked among Enron employees. Transactions were negotiated between Enron employees acting from Enron and other Enron employees acting for LJM. Within Enron, there appeared to be an air of secrecy regarding the LJM partnerships and suspicion that those Enron employees acting for LJM were receiving special or additional compensation. Although there was a Services Agreement between Enron and LJM pursuant to which LJM compensated Enron for the services of Enron personnel and use of Enron's facilities, this fact did not quell the awkwardness of the Enron employees "wearing two hats." Much of this awkwardness should be eliminated on a going-forward basis, however, by reason of Mr. Fastow's sale of his ownership interest in LJM effective July 31, 2001 to Mr. Koppers (who resigned from Enron prior to the transaction) and the complete separation of LJM's employees and facilities from Enron.

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The first area of potential conflict of interest voiced by several individuals was the risk that undue pressure may be placed on Enron professionals who were negotiating with LJM because those individuals would ultimately have their performance evaluated for compensation purposes by Mr. Fastow in his capacity as Chief Financial Officer. In particular, Jeffrey McMahon stated that while he was Treasurer of Enron he discussed this conflict directly with Mr. Fastow and Jeffrey Skilling, and that the conflict was not resolved prior to his acceptance of a new position within Enron. Mr. McMahon stated, however, that he was aware of no transaction where Enron suffered economic harm as a result of this potential conflict.

The second potential conflict of interest identified by several individuals was that investors in LJM may have perceived that their investment was required to establish or maintain other business relationships with Enron. Although no investors in LJM were interviewed, both Mr. Fastow and Mr. McMahon stated unequivocally that they told potential investors that there was no tie-in between LJM investment and Enron business. Moreover, Mr. Fastow stated that Merrill Lynch was paid a fee for marketing LJM2 partnership interests and that a number of investors, such as private and public pension funds and high net worth individuals, had no business relationship with Enron.

In summary, none of the individuals interviewed could identify any transaction between Enron and LJM that was not reasonable from Enron's standpoint or that was contrary to Enron's best interests. Conversely, the individuals interviewed were virtually uniform in stating that LJM provided a convenient alternative equity partner with flexibility that permitted Enron to close transactions that otherwise could not have been accomplished. Moreover, both the awkwardness and potential for conflict of interest should be eliminated on a going-forward basis as a result of Mr. Fastow's divestment of his ownership interest in the LJM partnerships.

5. **Accounting Issues**

As stated at the outset, the decision was made early in our preliminary investigation not to engage an independent accounting firm to second guess the accounting advice and audit treatment provided by AA. Based on interviews with representatives of AA and Mr. Causey, all material facts of the Condor/Whitewing and Raptor vehicles, as well as other transactions involving LJM, appeared to have been disclosed to and reviewed by AA. In this regard, AA reviewed the LJM solicitation materials and partnership agreement to assure that certain safeguards were provided that would permit LJM to be a source of third party equity in transactions conducted with Enron. AA likewise reviewed specific transactions between Enron and LJM to assure that LJM had sufficient equity in the transaction to justify the accounting and audit principles being applied.

The relationship between Enron and AA was an open one and, according to Mr. Causey, Enron consults AA early and often on accounting and audit issues as they arise. AA concurs with this statement, but points out that in certain of its accounting and audit treatment, it must rely on

Enron's statement of the business purpose for specific transactions and Enron's valuation of assets placed in the Condor/Whitewing and Raptor structures.

Enron and AA representatives both acknowledge that the accounting treatment on the Condor/Whitewing and Raptor transactions is creative and aggressive but no one has reason to believe that it is inappropriate from a technical standpoint. In this regard, AA consulted with its senior technical experts in its Chicago office regarding the technical accounting treatment on the Condor/Whitewing and Raptor transactions, and the AA partners on the Enron account consulted with AA's senior practice committee in Houston on other aspects of the transactions. Enron may also take comfort from AA's audit opinion and report to the Audit Committee which implicitly approves the transactions involving Condor/Whitewing and Raptor structures in the context of the approval of Enron's financial statements.

Following our initial interview with AA representatives you agreed with us that it was desirable and appropriate to provide them with Ms. Watkins' anonymous letter and supplemental materials so that AA could comment directly on specific allegations contained in those materials. AA identified two allegations in particular that, if accurate, would affect their accounting and audit treatment. Those allegations were, in effect: (i) There was a handshake deal between Mr. Skilling and Mr. Fastow that LJM would never lose money on any transaction with Enron; and (ii) LJM received a cash fee in the Raptor transactions that completely recouped its investment and profit.

Mr. Fastow adamantly denies any agreement with Mr. Skilling or anyone else that LJM would never lose money in transactions with Enron, and he recognized that such an agreement would defeat the accounting treatment that was the very objective for the formation of LJM. Mr. Causey is unaware of any such agreement and has seen no evidence of it.

Both Mr. Fastow and Mr. Causey acknowledge that LJM was to receive a cash fee for its management of the Raptor vehicles in an amount not to exceed $250,000.00 annually for each company, for a total of $1,000,000.00 for the four entities. AA was aware of Enron's payment of these fees as well as other organizational costs of the Raptor entities, but these fees fall far short of recouping LJM's investment in the Raptor entities. Both Mr. Fastow and Mr. Causey were quick to point out, however, that in each Raptor vehicle the first transaction was a "put" of Enron shares which was settled favorably to LJM prior to maturity, and as a result thereof, distributions were made to LJM in amounts equal to or greater than its initial investment in those Raptor vehicles. AA is aware of these transactions and is comfortable that, by reason of the applicable special purpose entity accounting rules, the transactions do not undermine LJM's equity investment in the Raptor vehicles.

When questioned about her basis for these two allegations in her anonymous letter and supplemental materials, Ms. Watkins acknowledged that she had no personal, first hand knowledge of either allegation. Both were based solely on rumors that she heard during the two months she was working in Enron Global Finance, and she was uncertain about any details of the alleged cash fee allegation. Notwithstanding the lack of any solid basis for the allegations, we think it is likely that AA will seek some kind of assurance from Enron and perhaps from Messrs. Fastow and Causey that no such agreement or cash fee payment occurred.

6. **Adequacy of Disclosures**

Notwithstanding the expression of concern in Ms. Watkins' anonymous letter and supporting materials regarding the adequacy of Enron's disclosures as to the Condor/Whitewing and Raptor vehicles (which, to a large extent, reflect her opinion), AA is comfortable with the disclosure in the footnotes to the financials describing the Condor/Whitewing and Raptor structures and other relationships and transactions with LJM. AA points out that the transactions involving Condor/Whitewing are disclosed in aggregate terms in the unconsolidated equity affiliates footnote and that the transactions with LJM, including the Raptor transactions, are disclosed in aggregate terms in the related party transactions footnote to the financials.

The concern with adequacy of disclosures is that one can always argue in hindsight that disclosures contained in proxy solicitations, management's discussion and analysis and financial footnotes could be more detailed. In this regard, it is our understanding that Enron's practice is to provide its financial statements and disclosure materials to V&E with a relatively short time frame within which to respond with comments.

7. **Potential Bad Cosmetics**

Concern was frequently expressed that the transactions involving Condor/Whitewing and Raptor could be portrayed very poorly if subjected to a Wall Street Journal exposé or class action lawsuit. Factors pointed to in support of these concerns included (i) the use of Enron stock to provide equity necessary to do transactions with Condor/Whitewing and Raptor; (ii) recognizing earnings through derivative transactions with Raptor when it could be argued that there was no true "third party" involved in those transactions; (iii) because both merchant investment value and Enron stock have fallen, the Raptor entities may not be able to satisfy their obligations to Enron, thus raising the question "Who ultimately bears this loss?"; (iv) the apparent conflict of interest issue raises questions as to the valuation of assets sold to or that were the subject of transactions with Raptor and the timing of those transactions, (generally at a point when the valuation was at a historical high point).

8. **Conclusions**

Based on the findings and conclusions set forth with respect to each of the four areas of primary concern discussed above, the facts disclosed through our preliminary investigation do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors.

Our preliminary investigation, however, leaves us with concern that, because of the bad cosmetics involving the LJM entities and Raptor transactions, coupled with the poor performance of the merchant investment assets placed in those vehicles and the decline in the value of Enron stock, there is a serious risk of adverse publicity and litigation. It also appears that because of the inquiries and issues raised by Ms. Watkins, AA will want additional assurances that Enron had no agreement with LJM that LJM would not lose money on transactions with Enron and that Enron paid no fees to LJM in excess of those previously disclosed to AA. Finally, we believe that some response should be provided to Ms. Watkins to assure her that her concerns were thoroughly reviewed, analyzed, and although found not to raise new or undisclosed information, were given serious consideration.

We have previously reported verbally to Mr. Lay and you regarding our investigation and conclusions and, at your request, have reported the same information to Robert K. Jaedicke, in his capacity of Chairman of the Audit Committee of Enron's Board of Directors. At Dr. Jaedicke's request, we gave a verbal summary of our review and conclusions to the full Audit Committee. Should you desire to discuss any aspect of this written report or any other details regarding our review of this matter, please do not hesitate to contact us at your convenience.

Very truly yours,

VINSON & ELKINS L.L.P.

By: Max Hendrick III
Max Hendrick, III

c: Joseph C. Dilg
Houston 666623.1

**Edison, Andrew**

| | |
|---|---|
| **From:** | Enron Announcements/Corp/Enron@ENRON on behalf of Jim Derrick@ENRON |
| **ent:** | Thursday, October 25, 2001 11:55 PM |
| **o:** | All Enron Worldwide@ENRON |
| **Subject:** | Important Announcement Regarding Document Preservation |

As you know, Enron, its directors, and certain current and former officers are defendants in litigation in Federal and State court involving the LJM partnerships.

Enron has employed counsel and they will represent Enron and its interests in the litigation.

Under the Private Securities Litigation Reform Act, we are required to preserve documents that might be used in the litigation.

Accordingly, our normal document destruction policies are suspended immediately and shall remain suspended until further notice.

Please retain all documents (which include handwritten notes, recordings, e-mails, and any other method of information recording) that in any way relate to the Company's related party transactions with LJM 1 and LJM 2, including, but not limited to, the formation of these partnerships, any transactions or discussions with the partnerships or its agents, and Enron's accounting for these transactions.

You should know that this document preservation requirement is a requirement of Federal law and you could be individually liable for civil and criminal penalties if you fail to follow these instructions.

You should know that Enron will defend these lawsuits vigorously. In the meantime, you should not discuss matters related to the lawsuits with anyone other than the appropriate persons at Enron and its counsel.

If you have any questions, please contact Jim Derrick at 713-853-5550.

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11/11/97 Bill Hayes

- Guaranty Agreement - letter from Enron Corp.

Richard McGee - Phillips * X3515 *

+ Inland - OK
+ Vastar -
- JEDI Hydrocarbon Instruments II L.P.

- Aspect Resources, LLC

11/12/97

Mary Wallace - K&Ellis

Bill Brown
- Jedi I liquidation
- Partnership agreement - JEDI I.
V&E 12/31 * Jedi / Chewco Revolver
- Barclays / Nations Loans to Big River / Little River
- Mutual - SONR #2.
- voting Enron stock - when does this occur?
J:E&O dialogue * - Subordinated Loan from ___ & Chewco - Enron Guarant
- Tax Indemnity Enron or Jedi

INT00700975

EC2 000000010

BT MASTERBRAND. CHEWCO BTM00276

Question:
- settlements of Board Mtg. Can Enron be indemnify SOS others?

11/19/97
Bill Brown
Shirley Hudler

Reserve Account - cash to be used by Big River LLC and Little River LLC lenders'

- Chewco pays Enron guaranty fee of 315 basis points

- Chewco pays Sub Debt - LIBOR + 100

- Cash goes into Reserve Account to fund interest payments on Big River / Little River

* Chewco Cash - 30% of this goes to Reserve Account + enough to service interest
→ cap - 1/2 of premium.
5,500,000

- What happens to cash that is in Reserve Account?

Open - ~~do you count 70/0 to Chewco?~~

Jedi distributions - preferred distribution
- first 7% goes to Chewco
- then 50/50 until [illegible]
- then 60/40 Enron/Chewco

- Chewco level - creation of Reserve Account
- current interest payments
- first 3% of cash to Chewco goes 3% to Account

- Chewco pays interest to Sub Debt - Cohort 1
- Chewco pays guaranty fee - 315
- Chewco pays 35 basis points into Reserve Account.

- build up for "principal" payments

Chewco Waterfall
- Management Fee - G&A
- Jedi/Chewco Interest

Libor + 400
- Sub Debt Interest
- Guaranty Fee
- Reserve Account

- prin on Jedi/Chewco
- prin on Sub Debt
- Distribution - 30 HR 3;

Mike Edsall   Rusty Hubbard
Mike Kopper   Ron Astin
Bill Brown
Shelley Farber

- Income/Loss allocations   - Jordan + Jeff Udane to talk

- Coda - will not cause a recognition of income to Chewco

- Jordan + V&E sign off on this.

- K&E - Don Rocap - tax person K&E
- Chicago

- 7% cash priority distribution - needs to be tax modeled.
~~Chew~~

- Reserve Account – pledged to Big River / Little River Funding.

* upfront Enron fee – $10M.
– 3.5 basis pts. per year.

- Chewco LP Distributions – 3% of all Chewco distributions go to Reserve Account

① pay operating expenses (management fee)
② pay reserve (3%). About $5-6M
③ interest on Jedi
④ interest on 3rd Debt
⑤ princ. on Jedi
⑥ princ. on sub debt.

→ What happens to excess monies in Reserve Accounts? After SONR #1 and SONR #2 get their return, monies go back to Enron ~~Corp~~. (90%)

→ 90% of Chewco distributions go to Enron as a ~~mgmt~~ fee.

* Sale Potential Transactions

- Coda
- Taurus
- Enron Puts

~~*~~ Sale of Put Options - do we need Chase consent?
- settled 1/2.

- Article V - allocations
- should profits and losses allocations follow distributions?

~~**~~ - 3.03 (a) - GP transfers
- consent reqs
- affiliates OK.

- Tax Indemnity - form & purpose

6.01 (a) (xi) – should GP have this right?
– delete.

* 6.02 – greater of \$24 or what is in there.
– add [illegible]

* 6.03 (b) –

6.03 (d) – delete?

Open

10.02 (a) –

---

\$180 — \$7
\$93 — 50
50

12/3/97

- Sonr #2 and Jodi's GP — exceptional bonus payments
- restate amendments to SONR #1 and SONR #2 of allocation + distribution provisions

- Coda Sale — $142 — 127 - reduce ~~[illegible]~~ + outstanding debt
- 31 - distribution Jodi
- 3 - working capital

- $31 M — prepay Sub Debt and/or Fund Principal Reserve Account ?

Side Letter

Reserve Accounts — who will own these accounts?
— probably BR and CR
— 3% of lease distribution goes into "Principal" Reserve Account until you reach a caps.

— What happens to $ in Reserve Accounts after BR/CR debt is gone?
⇒ repay Sub Debt / ~~repay~~ Chewco Loan ??
⇒ how do BR and CR agree to this

* order of priority for $ in Reserve Accounts
⇒ BR/CR Lender
→ Chewco Revolver prepayment
⇒ Prepay Sub. Debt *

* Management Fee — needs to cover "operating" expenses at JEDI #1 ~~at~~ JEDI #2

INT00701381

EC2 000000018

02/05/2002 16:06 FAX 202 663 6363 WCP 021

142

072-5028

11/25/97

Golden Mintz
John Lynch
Bill Arrow
Steve Cohen

SOAR #1 LLC — should be an L.P.

12/4/97

Mike Howell
Green Group

Golden Mintz — needs to see and comment on tax model.

— send to Don Rockamp

BR/LR. Reserve Accounts — interest / principal

→ Subordinated debt interest
→ Guaranty Fee
→ BR/LR interest reserve — yield on BR's investments

Libor + 400

— Sub Debt Financing Cost

#5444* — Can Chewco — guaranty interest?
No.

— distributions from CODA — prepay sub debt / prepay Reserve Account.

Take the place of the 3% principal reserve account.

INT00701034

02/05/2002 16:58 FAX 202 663 6363 WCP 023

Ben Gibson — can Chewco pledge its P.I. to Jedi

— Chewco needs a documentation trail re note payments, funding etc...

foot note
~~word~~/RADR

Cadr/Tames — side letter
— use of proceeds

JOEL EPHROSS

3.02(6) — Bills needs to review model
What is the impact of setting it at a higher number

7.02 — open

INT00701035

EC2 000000021

9.12 — Open — discuss what we need to see

9.13 — open

Enron Performance Fee

1) 99% SONR #2, 1% SONR #1, until SONR #2 receives return

2) 99% SONR #1, 1% SONR #2 until SONR #1

3) SONR #1 returns (17%) cap and the remainder goes to JEDI G.P.

12/9/97 Jordan Ly
Ben Glenn Steve Shelley
Michael Kopper Ann Y. John L.
Bill Brown Mark S.

Agenda
1) Waterfall
2) Basis Allocation
3) Tax Indemnity
4) Bonus Payout II

202-879-5200
312-861-2200
407-827-6369 — Jay Walters

Waterfall Discussion

1) Barclays (Skadden)

- ChevroCard — full release / interest on LT Debt / interest/principal & Debt

repay LT + Sub Debt.

- BR Note/LR Note — no distributions from Chevron & SWR until all debt is paid (Chevron Revolver, Sub Debt, BR note, LR note)

- once reserves are filled up, excess $ go to prepay sub debt + sr. debt.

- Chewco Revolver -

§2.07 - Waterfall
a management fees
b costs, fees...
c interest on Notes
d Subordinated Debt Interest
Guaranty Fee
Reserve Account

-1% of aggregate Chewco distribution - distributable to Chewco + desirable
-distributable to BR
re BR reserve account

-Permitted Expenses
- 1% distribution
- 7 + 400

*212-412-7585 - George McKean Barclays

INT00701041

EC2 000000024

148

B. Basis Allocation

Δ $15M between inside + outside basis. Step up basis election & $975M.
– make §754 election

* Jedi Partnership freeze – need a special allocation re gain/income on post 6/30 assets.

C. Enron Performance Bonus

– Enron affiliate – would have an interest in either (Enron or SONR entities)

– allocate income to Enron affiliate, not SONR affiliates

– create another class of SONR members for Enron affiliate.

E. T4 Indemnity

- read & try to avoid "gross-up"
-

- Chevron - put in NPI.
- Subordinated Debt -

* 12/19/97 - proposed closing date. *

- Post 6/30 Asset - create special allocation in John Greener

Reserve Accounts

Closing Date $5M - Coda/Taurus proceeds

skim - (fund interest)

* 1-390 - distributions ÷ principal reserve accounts

INT00701043

EC2 00000(

WCP 029

150

12/10/97
Ben Glisan
Bill Brown
Mark Spradling

IRR – How is it calculated?

– Chewco Partnership Agreement

Jedi Funds to Chewco

BR/LR Reserve Account – there – 1%

Chewco Sub Debt

Jedi Debt

Big River/[illegible]

Little River

SONR #2

INT00701044

EC2 000000027

151

12/11/97
Ron Astin
Jeremy Blachman

JEDI II

(1) – issues? Andy + Jeremy
(2) – credit facility – Patrick Lewis – term sheet
– bridge
Mark S.
Trina Chandler – term – < year
– $300-400 M
– few covenants, reps, warranties
–

(3) Transfer of Jedi I & Jedi II
– timing – credit facility date?
– what about Jedi II issuing a note to Jedi I?

(4) GP – JEDI II

Not internal

GP LP

02/05/2002 19:01 FAX 202 663 6363 WCP 031

152

JEDI I.

(1) Amended + Restated Partnership Agreement

(2) Chewco / Jedi Revolver

(3) $250M Sub Debt.

(4) Amendment of Chase Revolver

(5) Creation of Reserve Account

- preferred distribution stream out of JEDI to Chewco

- "Performance Bonus Mechanism" — Chewco / GP

- benefits Big River / Little River Lenders

(6) Tax Indemnity

18

— Rex

- ① Bd meetings next week
  - Andy will describe LJM2 and his involvement in the pship
  - will ask the Bd to waive the conduct of bus. affairs policy on this and will explain the process we proposes be used ~~to~~ in this regard

② Process is

~~(1) Bd~~

① Rick Causey to review and approve transactions between LJM2 and Enron as they are done
   - details on how this is done will need to be worked out

② Annually, the audit committee will review these transactions, ~~and make any recommendations they~~ determine whether they agree that the transactions are fair and proper and make any recommendations they deem appropriate

③ Also, certain transactions, at Andy's option, can be presented to the Bd or a committee thereof either for approval (prior to completion or ratification (after completion)

EC 000024298

(3) Based on Andy's disclosures to the Bd and his proposed process, Andy will ask the Bd to ~~approve~~ waive the conduct of bus. affairs policy

(4) Proxy disclosure
- no compensation disclosure triggered by this
- any transaction where ~~Enron~~ LJM acquireds or sells an asset to Enron ! greater than $60,000, will need to be disclosed
- any co-investments with Enron greater than $60,000 will need to be disclosed
- any disposition of a co-investment in conjunction with Enron will need to be disclosed

EC 000024299

(5) we're still looking at the D!O insurance and indemnity issues - it may be quite easy to pick Andy up here without any sig. cost to Enron

(6) corp. opp. issue - still looking at that -- in practice it shouldn't be a big issue because this issue won't arise when buying or sell.. with Enron or doing co-investments

with Enron - bulk of activity if not all.
- would only arise when LJM2 buys an asset from a third party

EC 000024300

LJM Issues

- ~~Bo~~ Conduct of Bus Affairs
  Waiver

- LJM2 PPM disclosures
- people who got involved – Ferrick,
  V&E, Rogers
- corp. governance

- Andy's discharge of his
  fid. duties

- conflict of interest

- Proxy disclosure
  - Certain Transactions
  - Compensation Disc.

- Conflict with other Enron
  contracts – JEDI II
  (1) neither Enron nor affiliate can organize a fund to invest in Qual. Investments until 80% of JEDI II cap. invested
  (2) certain inv. must be offer to JEDI II
- indemnity and insurance
- procedural safeguards

(1) [illegible] Enron [illegible]
[illegible] and [illegible]

(2) [illegible] 98 to 97 [illegible]
[illegible]
[illegible]

- compound annual growth rate has increased by — % over the past — years

(3) disclosure of [illegible]
[illegible] → ok

EC 000024302

(4) [illegible] wants to get more [illegible]
on the conflict resolution process
- what exactly does Causey do?
Bob thinks the Board [illegible]
see [illegible]
[illegible]
- should we work something up
on this?

- LJM thinks the procedures Enron has done are ok

(5) fiduciary duty issue that Bob is [illegible]
- [illegible]
- [illegible]
[illegible]
- way to make sure [illegible]
[illegible]
[illegible]
to approve the transaction
- Bob and I [illegible] company [illegible]
[illegible] - I believe that the board's

- Causey process
- audit comm. will review once a year
- Andy not involved in the deals - bus. units do these as seller
- Rick

approval of the [illegible] process [illegible]
sufficient - Bob [illegible] [illegible] [illegible]
may need to approve [illegible] [illegible] [illegible]
Bob is still looking at this
- we do need to make sure that
a majority of the indep. directors approve
the deal on Tuesday

(5) Bob has asked for more disclosure on
the financial interest that the Principals
have in LJM 2
- I told him to think about this
done some more because I believe that
with the recent changes about
ownership of GP and Manager,
this is covered



(7) JEDI II restrictions
(1) neither Enron nor its affiliates [illegible] [illegible]
a fund to invest in Qualified Investments
until 80% of JEDI II capital has been
invested
- can we say that LJM 2 will only
invest in Qualified Investments [illegible]
[illegible] [illegible] [illegible] [illegible] JEDI II has
passed on the investment?

- other restrictions
(2) Certain kinds of investments must be offered to
JEDI II - this simply needs to be [illegible]

- Is Causey signing off on the [illegible]?
- disclosure issues on [illegible] Party Transaction Comp. in Proxy
- email to Rex re revising Bd minutes to delete reference to managing partner
- review of investor presentation
- need to get Kopper / Glisan covered on Conduct of Bus. Affairs booklet
- where do we stand on Enron's possible investment in LJM2? thru [illegible]
- get disclosure vote from KIE
- Kristina situation
- indemnity and insurance for Andy
- review of investor presentation
- firm up on Causey's role / process
- KIE issue - commodity port - [illegible]
- [illegible] approval - what kind of approval will we get

① Proxy disclosure
② deal approval process

③ being ready for the board

- make sure the minutes work well
  - work with Rebecca & Rex on this

- call Jim & tell him an update

- Code of Conduct reqs. that Andy
  - withdraw from LJM if Chairm. wants him to do so

- Disc. - he ~~may~~ doesn't want to assume Enron is making an investment

- fin. comm. may need to be authorised to authorise the transactions

- duty of care / duty of loyalty

- procedural checks
  1. bd. approval shifts the burden
  2. deals must be fair

- TF Martha Stuart
  - needs all comments ASAP
    (H) 202 965 4910
    (W) 202 879 5224
  - wants me to leave

- TF Marth St.
  - CF call
    9:30 CST on Monday morning
    888 380 9636 - call in #
    code 720145 -
  - wants any comments
- TF Shana Jones
  - needs my fax #
    44 171 316 5473
  - has faxed the comments to Martha
  - wants a voicemail
    (H) 512 257 1251
    W 512 495 8692
- TF Martha Stuart
  201 368 9026 - call in # for
  CF call on Monday
  - wants my phone & fax #

X – schedule etc.
– PPM
  X – markup in
  X – exit strategy
  X – fair value accounting
    – confirm certain #s in PPM

– Proxy disclosure note

– 212 341 7777 [redacted] Printers

– 212 449 1958 Martha #

– Mike Edsall office
202 879 5028

- 29.9.99 CF Fastow

- LJM1 deal -
  - we had the forward contracts out there to buy shares of stock
  - price had gone up
  - normally not a big benefit to buying your shares back

- LJM1 & 2 are two diff deals

- two things lead to LJM1

  (1) forward contracts to purchase Enron stock
    - price was below market
    - buying shares back would have increased equity
    - but we would have had to borrow money which would cause problem

    - have the Rythms stock position - huge volatality

    - we wanted to hedge the Rythams stock position but couldn't do it in the market

- take the $200 m of Enron value & use it to hedge the Rythms stock

- LJM does a derivative which is secured by the Enron stock

- needed to not be an affiliate

(1) forward contacts
(2) purchase contracts

- Andy is a GP
- raised $15 million from two banks
- any excess could be used to invest in Enron assets

- we need to sell our merchant assets into these funds to gen cash flow
- LJM bought equity in Condor

- LJM will be used to by these assets

- LJM 2 - no forward contacts here
  - just a fund to acquire Enron assets

(1) - Ene bd must waive the code of conduct for Andy
  - Oct 11 Bd meeting

EC 000024310

(2) Skilling wants Enron to invest in LJM 2

- CalPERS would like to invest in LJM2 through JEDI 2

- if Enron were to invest in LJM2 Andy wants to make sure he doesn't ~~to~~ report his mgt. fee
  - so possibly

- will disclose in Related Transactions

- if Enron invests through JEDI, could any other comp. need to be reported in the

  - GP has a carried interest if fund earns more than 8%

- if Enron doesn't invest, what disclosure would we need to make on compensation

- need to be able to say no disclosure in comp.

(*) - would we need to make any related party disc. ~~til~~ until Enron invests

- Related Party disc.
- Comp.
- what happens if Enron invests in LJM through JEDI
  - should be RPT
  - if Andy waives mgt fee, is it not comp
  - if Andy waives mgt fee but keeps his carried interest, is this comp.
- wants to clear code of conduct issue, not the investment in LJM 2
- Glen Hess is a secs. lawyer at K&E
- PPM needs to go out on Friday or Monday
- wants to get Kristina involved
① Code of conduct waiver & related disc. issues

- People and process
    - Jim D., Rex R and V&E
    - full involvement by all from beginning to end

- Conduct of Bus. Affairs Policy
    - all 3 cleared by Chairman of B and CEO
    - ~~Andy's 2 involvement~~
    - Bd unanimously approved the clearance based on ① disclosure of Andy's interest in LJM2 and ② procedural safeguards put in place

- Procedural Safeguards
    - Rick Causey reviews all deals ~~between~~ involving Enron and LJM 2 before deal closes
    - Audit Committee - annual review
    - Seller of assets will be a bus. unit, not part of the org. reporting to Andy, and these internal negotiations are truly arms length
    - Fairness opinions?
    - Fin. Comm. review optional?

- Rick
- Buy

checklist

- Proxy disclosure
  - Certain Transactions - buy or sell asse- worth $60,000 or more - sale of co-investment to 3rd p.
  - Compensation

- PPM
  - although Enron is not resp. for the info. in the PPM, we did check the Enron info to make sure it was accurate
  - made it clear that Enron is not offering the secs, ~~and~~ is not guaranteeing the secs. and is not resp. for the PPM
  - added a section on ~~forward 2too~~ incorp. of Enron's 34 Act filings

- Conflict with other Enron Contracts
  - JEDI II issues

- Corp. Opp. issues

- indemnity & insurance

11/8/99 CF Michael Kopper

- due dil. meeting on Th : Fri.
  - disc. issues
  - procedural safeguards
  - bd. disclosures
  - reviewed conflict of interest
  - disclosures
  - conflicts issue resolved
    - Rick Causey
    - Audit Comm.
  - unanimous bd app.
  - disc.
    - related party trans.
- Wed. afternoon
  - might need to have Bob available

- people involved and process I went through on legal side
  - Jim Derrick
  - Rex Rogers
  - Outside counsel

- waiver of the Conduct of Bus. ~~Affairs~~ requirement and general disclosure of Andy's involvement
  - Oct. 11 at a Fin. Comm. Mtg. and a full Bd meeting
    - one director (Ronnie Chan) was absent
  - Andy described LJM2 and his involvement in the pship and the process to be used to approve deals between LJM2 and Enron
  - based on Andy's presentation and after a discussion by the bd, it was unanimously approved
- Proxy disclosure
  - Certain Transactions
  - Compensation
- Conflict with other Enron contacts
  - JEDI II
- PPM
  - work to confirm accurate
  - wanted to ~~avoid~~ ~~certain~~ make clear

EC 000024316

- Procedural Safeguards
  - Causey
  - Audit Comm.
  - Fin. Comm ?
  - Seller focus on making sure it gets a good deal

- corp. opp. issue

- fiduciary duty issue

- indemnity / insurance

19

## SERVICES AGREEMENT

This Services Agreement (this "Agreement") is made and entered into as of the 4th day of April, 2000, between Enron Corp., an Oregon corporation ("Enron"), and LJM2 Capital Management, L.P., a Cayman Island company ("LJM2"). Enron and LJM2 may hereinafter be referred to individually as a "Party" or collectively as the "Parties".

## RECITALS:

WHEREAS, Enron and LJM2 desire by their execution of this Agreement to evidence their understanding concerning the provision of certain services by Enron to LJM2;

NOW, THEREFORE, for and in consideration of the mutual promises and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties hereto hereby agree as follows:

1. Services. Enron agrees to provide and LJM2 agrees to purchase, subject to the terms and conditions set forth herein, services for account set-up and closure, payments, collections, and investment execution, and any other cash management service mutually agreed by the Parties (collectively, the "Services").

2. Term. This Agreement shall become effective and Enron shall make the Services available to LJM2 pursuant to the terms of this Agreement for the period commencing on March 21,2000, and shall terminate upon 30 days written notice by either party; provided, however, that LJM2 shall remain responsible for all out-of-pocket costs and expenses incurred by Enron pursuant to agreements entered into by Enron for the benefit of LJM2 that could not be terminated prior to the date of termination of this Agreement.

3. Payment. LJM2, as compensation for the performance of the Services, agrees to the fee schedule as outlined in Attachment A. Invoices shall be submitted quarterly and are due 30 days from invoice date.

4. Information from LJM2 ____________. Any information necessary for Enron or any third party to perform any Services shall be submitted by LJM2 in a manner mutually agreed upon by the Parties. Should LJM2's failure to supply such information render Enron's or any third party's performance of any Services unreasonably difficult, Enron or any third party, upon reasonable notice to LJM2, may refuse to perform such Services until such information is supplied.

5. Sole Beneficiaries. LJM2 acknowledges that the Services shall be provided only with respect to the business of LJM2 and its subsidiaries or affiliates. LJM2 will not request performance of any Services for the benefit of any entity other than LJM2 and its subsidiaries or affiliates. LJM2 represents and agrees that it will use the Services only in accordance with all applicable federal, state and local laws and regulations and communications and common carrier tariffs, and in accordance with the reasonable conditions, rules, regulations and specifications which may be set forth in any manuals, materials, documents, or instructions in existence on the effective date of this Agreement and furnished by Enron to LJM2. Enron reserves the right to take all actions, including termination of any particular Services, that Enron reasonably believes to be necessary to assure compliance with applicable laws, regulations and tariffs.

6. Scope of Undertaking. Enron's duties and responsibilities in connection with this Agreement shall be purely ministerial and shall be limited to those expressly set forth in this Agreement. Enron is not a principal, participant or beneficiary in any transaction underlying this agreement and shall have no duty to inquire beyond the terms and provisions hereof. Enron may rely on, and shall not be liable for acting or refraining from acting in accordance with any written notice, instruction or request furnished to it hereunder or pursuant hereto and believed by it to have been signed or presented by the proper party. It is hereby expressly agreed and stipulated by the parties that Enron shall not be required to exercise any

discretion hereunder and shall have no investment or management responsibility and, accordingly, shall have no duty to, or liability for its failure to, provide investment recommendations or investment advice to LJM2. It is the intention of the parties hereto that Enron shall never be required to use, advance or risk its own funds or otherwise incur financial liability in the performance of any of its duties or the exercise of any of its rights an powers hereunder.

7. LIMITED WARRANTY: LIMITATION OF LIABILITY. ALL PRODUCTS OBTAINED FOR LJM2 ARE AS IS, WHERE IS, WITH ALL FAULTS, OTHER THAN FAULTS DUE TO THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF ENRON. NEITHER ENRON, ANY ENRON AFFILIATE NOR ANY THIRD PARTY PERFORMING ANY SERVICES HEREUNDER MAKE ANY WARRANTIES OR REPRESENTATIONS WHATSOEVER, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE WITH RESPECT TO THE SERVICES RENDERED OR PRODUCTS OBTAINED FOR LJM2. NOTWITHSTANDING THE FOREGOING, TO THE EXTENT A WARRANTY PROVIDED BY A THIRD PARTY MANUFACTURER OR PROVIDER OF GOODS OR SERVICES TO ENRON CAN BE PASSED ON TO LJM2, NOTHING HEREIN IS INTENDED TO LIMIT AND LJM2 SHALL HAVE THE RIGHT TO THE BENEFITS (SUBJECT TO THE TERMS AND CONDITIONS THEREOF) OF ALL SUCH THIRD PARTY WARRANTIES.

IN NO EVENT SHALL EITHER ENRON OR LJM2 BE LIABLE TO THE OTHER PARTY OR ANY OTHER PERSON FOR ANY INDIRECT, SPECIAL OR CONSEQUENTIAL DAMAGES RESULTING FROM ANY ERROR IN THE PERFORMANCE OF SERVICES OR FROM THE BREACH OF THIS AGREEMENT, REGARDLESS OF SUCH PARTY'S OR ANY THIRD PARTY'S FAULT. TO THE EXTENT ANY THIRD PARTY HAS LIMITED ITS LIABILITY TO EITHER ENRON OR LJM2 FOR SERVICES UNDER AN OUTSOURCING OR OTHER AGREEMENT, THE OTHER PARTY AGREES TO BE BOUND BY SUCH LIMITATION OF LIABILITY FOR ANY PRODUCT OR SERVICE PROVIDED TO ENRON OR LJM2 BY SUCH THIRD PARTY UNDER SUCH AGREEMENT.

8. Force Majeure. Enron shall have no obligation to perform the Services if its failure to do so is caused by or results from any act of God, governmental action, natural disaster, strike, failure of essential equipment or any other cause or circumstance beyond the control of Enron. Enron agrees that upon restoring service following any failure of any equipment necessary for Enron to provide any Services, Enron will allow LJM2 to have equal priority, in accordance with prior practice, with respect to access to the restored service. At its election, Enron may cause one or more of its subsidiaries, affiliates or third party contractors to provide the Services; however, such action shall not release Enron from its obligations under this Agreement.

9. Severability In the event any portion of this Agreement shall be found by a court of competent jurisdiction to be unenforceable, that portion of the Agreement will be null and void and the remainder of the Agreement will be binding on the Parties as if the unenforceable provisions had never been contained herein.

10. Assignment. This Agreement shall not be assignable by either of the Parties hereto without prior written consent of the other.

11. Entire Agreement; Amendment. This Agreement constitutes the entire agreement of the Parties relating to the performance of the Services and all prior or contemporaneous written or oral

Confidential Treatment Requested

agreements are merged herein. This Agreement may not be amended or otherwise modified except by a writing signed by both Parties.

12. Choice of Law. This Agreement shall be governed by the laws of the State of Texas, without regard to any conflict-of-law rule or principle that might refer the construction or interpretation of this Agreement to the laws of another state

13. Notice. Any notice, request, instruction, correspondence or other document to be given hereunder by either Party to the other (herein collectively called "Notice") shall be in writing and delivered personally or mailed, postage prepaid, or by facsimile or telegram, as follows

| | |
|---|---|
| If to Enron. | Enron Corp.<br>Attn: Mary Perkins<br>1400 Smith Street<br>Houston, TX 77002 |
| If to LJM2: | LJM2 Capital Management, L.P.<br>333 Clay St. – Suite 1203<br>Houston, TX 77002 |

Notice given by personal delivery or mail shall be effective upon actual receipt by the Party to whom addressed. Notice given by facsimile or telegram shall be effective upon actual receipt if received during the recipient's normal business hours, or at the beginning of the recipients next business day after receipt if not received during the recipient's normal business hours. Any Party may change any address to which Notice is to be given to it by giving Notice as provided above of such change of address.

14. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument

IN WITNESS WHEREOF, the Parties hereto have caused this Services Agreement to be signed on their behalf by their duly authorized officers or individuals.

LJM2 Capital Management, L.P.
By: [signature]

Name:
Title:

Enron Corp.
By: Mary Perkins CCA

Name: Mary Perkins
Title: Asst. Treasurer

Confidential Treatment Requested

**Attachment A**

Schedule of Fees:

| | |
|---|---|
| Account Opening | |
| New York Accounts | $50 |
| Other locations | Subject to Mutual Agreement |
| | |
| Account Closure | |
| New York Accounts | $25 |
| Other locations | Subject to Mutual Agreement |
| | |
| Direct Bank Charges Including but not limited to Transaction Fees, Account Maintenance, Reconcilement Services, Auto Sweep Investments, Overdraft fees, and other administrative services. | Reimbursement of fees from third party service provider |
| | |
| Wire Transfers-Manual Execution | |
| Regular | $ 5.00 |
| Priority | $15.00 |
| | |
| Investment Execution & Administration | $2,000 per month |
| | |

Fees are subject to change with 60 days prior written notice.

# SERVICES AGREEMENT

This Services Agreement (this "Agreement") is made and entered into as of the 4th day of April, 2000, between Enron Corp., an Oregon corporation ("Enron"), and LJM Management, L.P., a Cayman Island company ("LJM"). Enron and LJM may hereinafter be referred to individually as a "Party" or collectively as the "Parties".

## RECITALS:

WHEREAS, Enron and LJM desire by their execution of this Agreement to evidence their understanding concerning the provision of certain services by Enron to LJM;

NOW, THEREFORE, for and in consideration of the mutual promises and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties hereto hereby agree as follows:

1. Services. Enron agrees to provide and LJM agrees to purchase, subject to the terms and conditions set forth herein, services for account set-up and closure, payments, collections, and investment execution, and any other cash management service mutually agreed by the Parties (collectively, the "Services").

2. Term. This Agreement shall become effective and Enron shall make the Services available to LJM pursuant to the terms of this Agreement for the period commencing on June 28, 1999, and shall terminate upon 30 days written notice by either party; provided, however, that LJM shall remain responsible for all out-of-pocket costs and expenses incurred by Enron pursuant to agreements entered into by Enron for the benefit of LJM that could not be terminated prior to the date of termination of this Agreement.

3. Payment. LJM, as compensation for the performance of the Services, agrees to the fee schedule as outlined in Attachment A. Invoices shall be submitted quarterly and are due 30 days from invoice date.

4. Information from LJM____________. Any information necessary for Enron or any third party to perform any Services shall be submitted by LJM in a manner mutually agreed upon by the Parties. Should LJM's failure to supply such information render Enron's or any third party's performance of any Services unreasonably difficult, Enron or any third party, upon reasonable notice to LJM, may refuse to perform such Services until such information is supplied.

5. Sole Beneficiaries. LJM acknowledges that the Services shall be provided only with respect to the business of LJM and its subsidiaries or affiliates. LJM will not request performance of any Services for the benefit of any entity other than LJM and its subsidiaries or affiliates. LJM represents and agrees that it will use the Services only in accordance with all applicable federal, state and local laws and regulations and communications and common carrier tariffs, and in accordance with the reasonable conditions, rules, regulations and specifications which may be set forth in any manuals, materials, documents, or instructions in existence on the effective date of this Agreement and furnished by Enron to LJM. Enron reserves the right to take all actions, including termination of any particular Services, that Enron reasonably believes to be necessary to assure compliance with applicable laws, regulations and tariffs.

6. Scope of Undertaking. Enron's duties and responsibilities in connection with this Agreement shall be purely ministerial and shall be limited to those expressly set forth in this Agreement. Enron is not a principal, participant or beneficiary in any transaction underlying this agreement and shall have no duty to inquire beyond the terms and provisions hereof. Enron may rely on, and shall not be liable for acting or refraining from acting in accordance with any written notice, instruction or request furnished to it hereunder or pursuant hereto and believed by it to have been signed or presented by the proper party. It is hereby expressly agreed and stipulated by the parties that Enron shall not be required to exercise any

discretion hereunder and shall have no investment or management responsibility and, accordingly, shall have no duty to, or liability for its failure to, provide investment recommendations or investment advice to LJM. It is the intention of the parties hereto that Enron shall never be required to use, advance or risk its own funds or otherwise incur financial liability in the performance of any of its duties or the exercise of any of its rights an powers hereunder.

7. LIMITED WARRANTY; LIMITATION OF LIABILITY. ALL PRODUCTS OBTAINED FOR LJM ARE AS IS, WHERE IS, WITH ALL FAULTS, OTHER THAN FAULTS DUE TO THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF ENRON. NEITHER ENRON, ANY ENRON AFFILIATE NOR ANY THIRD PARTY PERFORMING ANY SERVICES HEREUNDER MAKE ANY WARRANTIES OR REPRESENTATIONS WHATSOEVER, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE WITH RESPECT TO THE SERVICES RENDERED OR PRODUCTS OBTAINED FOR LJM. NOTWITHSTANDING THE FOREGOING, TO THE EXTENT A WARRANTY PROVIDED BY A THIRD PARTY MANUFACTURER OR PROVIDER OF GOODS OR SERVICES TO ENRON CAN BE PASSED ON TO LJM, NOTHING HEREIN IS INTENDED TO LIMIT AND LJM SHALL HAVE THE RIGHT TO THE BENEFITS (SUBJECT TO THE TERMS AND CONDITIONS THEREOF) OF ALL SUCH THIRD PARTY WARRANTIES.

IN NO EVENT SHALL EITHER ENRON OR LJM BE LIABLE TO THE OTHER PARTY OR ANY OTHER PERSON FOR ANY INDIRECT, SPECIAL OR CONSEQUENTIAL DAMAGES RESULTING FROM ANY ERROR IN THE PERFORMANCE OF SERVICES OR FROM THE BREACH OF THIS AGREEMENT, REGARDLESS OF SUCH PARTY'S OR ANY THIRD PARTY'S FAULT. TO THE EXTENT ANY THIRD PARTY HAS LIMITED ITS LIABILITY TO EITHER ENRON OR LJM FOR SERVICES UNDER AN OUTSOURCING OR OTHER AGREEMENT, THE OTHER PARTY AGREES TO BE BOUND BY SUCH LIMITATION OF LIABILITY FOR ANY PRODUCT OR SERVICE PROVIDED TO ENRON OR LJM BY SUCH THIRD PARTY UNDER SUCH AGREEMENT.

8. Force Majeure. Enron shall have no obligation to perform the Services if its failure to do so is caused by or results from any act of God, governmental action, natural disaster, strike, failure of essential equipment or any other cause or circumstance beyond the control of Enron. Enron agrees that upon restoring service following any failure of any equipment necessary for Enron to provide any Services, Enron will allow LJM to have equal priority, in accordance with prior practice, with respect to access to the restored service. At its election, Enron may cause one or more of its subsidiaries, affiliates or third party contractors to provide the Services; however, such action shall not release Enron from its obligations under this Agreement.

9. Severability. In the event any portion of this Agreement shall be found by a court of competent jurisdiction to be unenforceable, that portion of the Agreement will be null and void and the remainder of the Agreement will be binding on the Parties as if the unenforceable provisions had never been contained herein.

10. Assignment. This Agreement shall not be assignable by either of the Parties hereto without prior written consent of the other.

11. Entire Agreement; Amendment. This Agreement constitutes the entire agreement of the Parties relating to the performance of the Services and all prior or contemporaneous written or oral

agreements are merged herein. This Agreement may not be amended or otherwise modified except by a writing signed by both Parties.

12. Choice of Law. This Agreement shall be governed by the laws of the State of Texas, without regard to any conflict-of-law rule or principle that might refer the construction or interpretation of this Agreement to the laws of another state

13. Notice. Any notice, request, instruction, correspondence or other document to be given hereunder by either Party to the other (herein collectively called "Notice") shall be in writing and delivered personally or mailed, postage prepaid, or by facsimile or telegram, as follows:

| | |
|---|---|
| If to Enron: | Enron Corp.<br>Attn: Mary Perkins<br>1400 Smith Street<br>Houston, TX 77002 |
| If to LJM: | LJM Management, L.P.<br>333 Clay St. - Suite 1203<br>Houston, TX 77002 |

Notice given by personal delivery or mail shall be effective upon actual receipt by the Party to whom addressed. Notice given by facsimile or telegram shall be effective upon actual receipt if received during the recipient's normal business hours, or at the beginning of the recipients next business day after receipt if not received during the recipient's normal business hours. Any Party may change any address to which Notice is to be given to it by giving Notice as provided above of such change of address.

14. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Parties hereto have caused this Services Agreement to be signed on their behalf by their duly authorized officers or individuals.

LJM Management, L.P.
By: [signature]

Name:
Title:

Enron Corp.
By: [signature] cck

Name: Mary Perkins
Title: Asst. Treasurer

Confidential Treatment Requested

**Attachment A**

Schedule of Fees:

| | |
|---|---|
| Account Opening | |
| New York Accounts | $50 |
| Other locations | Subject to Mutual Agreement |
| | |
| Account Closure | |
| New York Accounts | $25 |
| Other locations | Subject to Mutual Agreement |
| | |
| Direct Bank Charges Including but not limited to Transaction Fees, Account Maintenance, Reconcilement Services, Auto Sweep Investments, Overdraft fees, and other administrative services. | Reimbursement of fees from third party service provider |
| | |
| Wire Transfers-Manual Execution | |
| Regular | $ 5.00 |
| Priority | $15.00 |
| | |
| Investment Execution & Administration | $2,000 per month |
| | |

Fees are subject to change with 60 days prior written notice.

## SERVICES AGREEMENT

THIS SERVICES AGREEMENT (this "*Agreement*"), dated as of July 17, 2000, but effective for all purposes as of June 30, 1999, by and between (i) LJM Management, L.P., a Delaware limited partnership ("*LJM1 Management*"), and LJM2 Capital Management, L.P., a Delaware limited partnership ("*LJM2 Management*"), and (ii) Enron Corp., an Oregon corporation ("*Enron*").

W I T N E S S E T H:

WHEREAS, LJM1 Management provides certain management services to LJM Cayman, L.P. ("*LJM1*") pursuant to that certain Management Agreement dated June 30, 1999 by and among LJM1 Management, LJM Partners, L.P. (as general partner of LJM1), and LJM1; and

WHEREAS, LJM2 Management provides certain management services to LJM2 Co-Investment, L.P. ("*LJM2*") as contemplated by the Third Amended and Restated Agreement of Limited Partnership of LJM2, dated as of April 5, 2000 (as the same has been amended by that certain Amendment effective as of June 30, 2000); and

WHEREAS, LJM1 Management and LJM2 Management shall collectively be referred to herein as "LJM Management" and LJM1 and LJM2 shall collectively be referred to herein as the "Partnership"; and

WHEREAS, LJM Management desires to utilize certain employees and other support services from Enron or its subsidiaries as needed in order to provide various services to the Partnership and Enron agrees, subject to the terms and conditions hereof, to make available to LJM Management such employees and other support services during the term of this Agreement.

NOW, THEREFORE, the parties hereby agree as follows:

1. *Enron Employees.* (a) During the term of this Agreement, Enron shall make or cause to be made available to LJM Management employees of Enron or its subsidiaries as requested by LJM Management and approved by Enron (employees so provided are referred to herein as "*Enron Employees*") to provide administrative assistance to LJM Management in rendering management services to the Partnership, provided that (i) Enron reserves the right at all times to refuse to make available any person (or to discontinue the availability of any person) for any reason and (ii) LJM Management reserves the right at all times to cease using the services of any such person for any reason. LJM Management has requested, and Enron has approved, that the Enron Employees set forth on Annex A shall be made available to LJM Management in accordance with the terms and conditions set forth in Annex A. Enron Employees (i) shall remain regular, full-time employees of Enron (or such subsidiary), (ii) shall be treated as regular, full-time employees of Enron (or such subsidiary) under all compensation and benefit plans and (iii) shall not be deemed to be employees of LJM Management. Enron (or such subsidiary) shall be responsible for all withholding taxes associated with the employment of such persons.

(b) In order to facilitate the training and development of Enron's employees, LJM Management will make rotations available to the Associates and Analysts of Enron (and its subsidiaries). Enron (and such subsidiaries) will be under no obligation to use any of such available rotations. If Enron (or a subsidiary) does use any of such rotations, the Enron Employees participating in the rotation program (i) shall remain regular, full-time employees of Enron (or such subsidiary), (ii) shall be treated as regular, full-time employees of Enron (or such subsidiary) under all compensation and benefit plans and (iii) shall not be deemed to be employees of LJM Management. Enron (or such subsidiary) shall be responsible for all withholding taxes and other employer taxes or contributions as required by applicable law associated with the employment of such persons.

2. *Administrative Support.* During the term of this Agreement, LJM Management personnel and Enron Employees providing services to LJM Management may (subject to paragraph 3 below) utilize facilities, services and vendor accounts of Enron and its subsidiaries (such as postage, courier services, photocopying, facsimile, telephone, limousine services and the like) to provide administrative support to LJM Management ("*Support Services*").

3. *Compensation.* (a) LJM Management shall compensate Enron for the use of Enron Employees based on the cost to Enron and its subsidiaries for such Enron Employee and the amount of time that such Enron Employee spends providing services to LJM Management. For each Enron Employee made available to LJM Management, Enron and LJM Management shall agree, with reasonable promptness after such Enron Employee is first made available to LJM Management, upon a "per diem" rate or other reasonable cost allocation based upon the annual cost to Enron and its subsidiaries for such Enron Employee, including Base Compensation and Benefits, but excluding office space, administrative support and other allocated "overhead" costs (the "*Employee Cost*"). The Employee Cost for each Enron Employee shall be adjusted annually (or more frequently as Enron deems necessary) to reflect any changes in the Employee Cost for such Enron Employee. LJM Management and Enron have agreed that (i) Annex A hereto sets forth the types of compensation to be paid by LJM Management for the Enron Employees identified in Annex A and (ii) with respect to the Enron Employees participating in the rotation program described in paragraph 1(b) hereof, Enron (or such subsidiary) shall pay all compensation (including, but not limited to, base salary, cash bonus, long-term incentive compensation and benefits) related to such persons.

(b) If an Enron Employee ceases providing services to LJM Management for any reason, then LJM Management's obligation to compensate Enron for the use of such Enron Employee shall cease immediately and any reimbursable items such as cash bonuses shall be prorated in a manner to be agreed by the parties hereto.

(c) LJM Management shall also be responsible for reimbursing Enron for the cost to Enron and its subsidiaries for Support Services provided to LJM Management (the method for determining same to be agreed upon by LJM Management and Enron).

(d) The parties hereto acknowledge that some activities of LJM Management will also be for the benefit of Enron (such as a business trip with both LJM Management and Enron appointments) and agree to allocate the costs related thereto between Enron and LJM Management in a manner that is agreed upon by the parties hereto.

(e) For purposes of this Agreement, the following terms shall have the following meanings:

(i) "Benefits" means, for each employee, any benefits that Enron provides or may provide from time to time, including, without limitation, bonuses, long-term incentive compensation, qualified retirement benefits and health and welfare benefits, including, without limitation, severance and Enron's contribution if any to its employees pension and other retirement benefit plans, in accordance with the plan documents governing such benefit.

(ii) "Base Compensation" means, for each emnloyee, all amounts paid by Enron to its employees by way of salary, incentives, premiums and any other paid supplements as they may be increased from time to time by Enron, excluding Benefits.

4. *Accounting and Payment.* (a) LJM Management shall account for and maintain records of the amount of time actually expended by Enron Employees (other than those listed on Annex A and those participating in the rotation program described in paragraph 1(b) hereof) on LJM Management matters and the amount of Support Services utilized by LJM Management personnel and Enron Employees in providing services to LJM Management, which records shall be made available to Enron at its request. LJM Management shall remit payments to Enron semi-annually in arrears on each July 1 and each January 1 during the term of this Agreement (and at the termination of this Agreement), for amounts owing under paragraph 3 hereof for such prior semi-annual period, along with an accounting showing, in reasonable detail, LJM Management's calculation of the amount to be paid. Enron shall have the right to contest such accounting.

(b) Enron's accounting group will perform a quarterly (or, at Enron's option, more frequent) audit to ensure that Enron is being fully and properly compensated for all Enron Employees and Support Services that are being provided to LJM Management hereunder.

5. *Termination.* This Agreement shall be in effect for a term of one year, and shall automatically renew for additional one-year terms unless any party gives notice of its desire to terminate not later than sixty (60) days prior to the end of the applicable one-year term.

6. *Notices.* All notices, demands and other communications to be given and delivered under or by reason of provisions under this Agreement shall be in writing and shall be deemed to have been given when personally delivered, sent by express overnight courier service, or mailed by first class mail, return receipt requested, to the addresses set forth below.

LJM Management:

333 Clay Street
Suite 1203
Houston, TX 77002
Attention: Andrew S. Fastow

Enron:

1400 Smith Street
Houston, TX 77002-7361
Attention: Richard Causey

7. *Amendments; Waivers.* This Agreement may be amended only by an agreement in writing executed by the parties hereto. No waiver of any provision nor consent to any exception to the terms of this Agreement shall be effective unless in writing and signed by the party to be bound, and then only to the specific purpose, extent and instance so provided.

8. *Counterparts.* This Agreement and any other agreement (or document) delivered pursuant hereto may be executed in one or more counterparts. All of such counterparts shall constitute one and the same agreement and shall become effective when one or more counterparts of this Agreement have been signed by each party and delivered to the other party.

9. *Governing Law; Arbitration.* All questions concerning the construction, validity and interpretation of this Agreement shall be governed by the internal law, and not the law of conflicts, of the State of Texas. The parties hereto agree to submit to arbitration in the City of Houston, Texas any dispute arising out of this Agreement under the Commercial Arbitration Rules of the American Arbitration Association. The parties agree that any such dispute shall be submitted to three arbitrators selected from the panel of arbitrators of the American Arbitration Association. The parties further agree that they will faithfully observe this Agreement and such Rules, that they will abide by and perform any award rendered by the arbitrators and that a judgment of a court having jurisdiction may be entered upon the award.

10. *Severability.* If any provision of this Agreement is held invalid by any court, governmental agency or regulatory body, the other provisions to the extent permitted by law shall remain in full force and effect.

11. *Consequential Damages.* **IN NO EVENT SHALL ANY PARTY HERETO BE LIABLE FOR ANY LOST OR PROSPECTIVE PROFITS OR ANY OTHER SPECIAL, PUNITIVE, EXEMPLARY, CONSEQUENTIAL, INCIDENTAL OR INDIRECT LOSSES OR DAMAGES (IN TORT, CONTRACT OR OTHERWISE) UNDER OR IN RESPECT OF**

**THIS AGREEMENT OR FOR ANY FAILURE OF PERFORMANCE RELATED HERETO HOWSOEVER CAUSED, WHETHER OR NOT ARISING FROM A PARTY'S SOLE, JOINT OR CONCURRENT NEGLIGENCE.**

12. *No Authority to Bind.* Unless otherwise authorized by LJM Management, nothing in this Agreement shall convey authority on Enron to bind, or attempt to bind, LJM Management to any contract or the performance of any obligation, and Enron shall not represent to third parties that Enron has any right to enter into any binding obligation on LJM Management's behalf. Unless otherwise authorized by Enron, nothing in this Agreement shall convey authority on LJM Management to bind, or attempt to bind, Enron to any contract or the performance of any obligation, and LJM Management shall not represent to third parties that LJM Management has any right to enter into any binding obligation on Enron's behalf.

**[END OF PAGE]**
**[SIGNATURE PAGE FOLLOWS]**

IN WITNESS WHEREOF, each of the parties hereto has caused this Agreement to be executed as of the date first above written.

LJM MANAGEMENT, L.P.

By: LJM Management, LLC,
its General Partner

By: ______________________
Andrew S. Fastow
Member

LJM2 CAPITAL MANAGEMENT, L.P.

By: LJM2 Capital Management, LLC,
its General Partner

By: ______________________
Andrew S. Fastow
Managing Member

ENRON CORP.

By: ______________________ SMS
Richard A. Causey
Executive Vice President and
Chief Accounting Officer



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Confidential Treatment
Requested

ANNEX A

1. Michael Kopper: LJM Management will pay all of Michael Kopper's cash bonus (relating to the fiscal year 2000 and thereafter). Enron will continue to pay all other typical compensation including, but not limited to, base salary, long-term incentive compensation, and benefits.

2. Kathy Lynn: LJM Management will pay all of Kathy Lynn's base salary (effective January 1, 2000) and cash bonus (relating to the fiscal year 2000 and thereafter). Enron will continue to pay all other typical compensation including, but not limited to, long-term incentive compensation and benefits.

3. Anne Yaeger: LJM Management will pay one-half of Anne Yaeger's base salary (effective January 1, 2000) and one-half of Anne Yaeger's cash bonus (relating to the fiscal year 2000 and thereafter). Enron will continue to pay one-half of Anne Yaeger's base salary and cash bonus and 100% of all other typical compensation including, but not limited to, long-term incentive compensation and benefits.

4. Amy Flores: LJM Management will pay all of Amy Flores' base salary (effective January 1, 2000) and cash bonus (relating to the fiscal year 2000 and thereafter). Enron will continue to pay all other typical compensation including, but not limited to, long-term incentive compensation and benefits.

**EXECUTION COPY**

ADMINISTRATIVE SERVICES AGREEMENT

THIS ADMINISTRATIVE SERVICES AGREEMENT (the "*Agreement*") is effective as of the 20th day of December, 2000 (the "*Effective Date*") by and between ENRON BROADBAND SERVICES, INC., an Oregon corporation (the "*Servicer*"), and BACKBONE TRUST II, a Delaware business trust (the "*Trust*"). Capitalized terms used but not otherwise defined herein shall have the meaning set forth in the Backbone II Trust Agreement dated December 20, 2000 (the "*Trust Agreement*").

RECITALS:

**WHEREAS**, the Trust intends to utilize, from time to time, certain resources of the Servicer or its affiliates to assist the Trust in connection with the Trust's business; and

**WHEREAS**, the Servicer and the Trust desire by their execution of this Agreement to evidence their understanding concerning the use of such resources.

**THEREFORE**, in consideration of the premises, covenants, conditions and agreements, contained herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. **Term**. The term of this Agreement shall be from the Effective Date and continue in effect until the earliest to occur of (i) the date on which this Agreement is terminated by the Servicer, (ii) the date of the termination of the Trust as set forth in the Backbone Trust II Agreement or (iii) at the Trust's sole discretion, upon an Event of Default under (a) the Backbone Trust I Term Loan Credit Agreement dated December 20, 2000 among Backbone Trust I, as Borrower, the Banks parties thereto, ABN AMRO Bank N.V., as Administrative Agent, Sole Lead Arranger and Bookrunner, Fleet National Bank, as Syndication Agent, and Fleet Securities, Inc., as Co-Arranger, or (b) the Backbone II Credit Agreement. Each party shall continue thereafter to be responsible for any obligations incurred or occurring prior to such termination.

2. **Services**. During the term hereof, the Servicer agrees to provide certain assistance to the Trust for its general corporate services, such assistance to include tax and accounting services, cash management services, preparation of notices of borrowings, continuations and conversions and other relevant notices, and maintenance and safekeeping of books and records (the "*Services*") in accordance with the terms of this Agreement. The Servicer shall devote so much of its time and effort as is reasonably necessary to perform its obligations under this Agreement. In exchange for the provision of the Services by the Servicer, the Trust shall pay to the Servicer an up-front management fee in the amount of $7,500 on the Effective Date

3. **Standard of Care**. The Servicer shall perform the Services with the same degree of reasonable diligence and care as a typical provider of such Services to a third party.

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4. **Limitation of Remedies**. Neither party nor any of their affiliates shall have the right to recover indirect, special, consequential, or punitive damages or loss of profits that may result from any action or inaction of the other party or from the breach of this Agreement, regardless of the fault of such party or any third party fault.

5. **Assignment; Delegation**. No party shall have the right to assign its rights or obligations under this Agreement without the written consent of the other party, which consent will not be unreasonably withheld. However, the Servicer shall have the right to delegate the performance of the Services under this Agreement to its Affiliates. In such case, such Affiliates shall be deemed bound by this Agreement as the "*Servicer*." For purposes of this Section 5, "*Affiliate*" means any entity that, directly or indirectly, is in control of, is controlled by, or is under common control with, Enron Corp. For purposes of this definition, "*control*" means the power, directly or indirectly, either to (a) vote 10% or more of the securities having ordinary voting power for the election of directors (or persons performing similar functions) of an entity or (b) direct or cause the direction of the management and policies of an entity, whether by contract or otherwise.

6. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties relating to the performance of the Services. All prior or contemporaneous written or oral agreements are merged herein.

7. **Choice of Law**. This Agreement shall be subject to and governed by the laws of the State of New York.

8. **Amendment or Modification**. This Agreement may be amended or modified from time to time only by a written instrument signed by the parties hereto.

9. **Notices**. Any written notice, request, instruction, correspondence, or other document to be given hereunder by either party to the other (herein, collectively called "*Notice*") shall be delivered personally or mailed, postage prepaid, as follows:

| | |
|---|---|
| If to Servicer: | Enron Broadband Services, Inc.<br>1400 Smith Street<br>Houston, Texas 77002<br>Attention: Contract Administration<br>Fax No.: (713) 345-5686 |
| If to Trust: | Backbone Trust I<br>c/o Wilmington Trust Company<br>Rodney Square North<br>1100 North Market Street<br>Wilmington, Delaware 19890-0001<br>Attention: Corporate Trust Administration<br>Fax No.: (302) 651-8882 |

Notice given by personal delivery or mail shall be effective upon the actual receipt by the person to whom addressed. Any party may change any address to which Notice is to be given to it by giving Notice as provided above of such change of address.

11. **Further Assurances**. In connection with this Agreement and all transactions contemplated by this Agreement, each signatory party hereto agrees to execute and deliver such additional documents and instruments as may be necessary or appropriate to effectuate, carry out and perform all of the terms, provisions, and conditions of this Agreement.

12. **Limitation of Trustee Liability**. It is expressly understood and agreed by the parties hereto that (a) this Agreement is executed and delivered by Wilmington Trust Company, not individually or personally, but solely as trustee, in the exercise of the powers and authority conferred and vested in it, (b) each of the representations, undertakings and agreements herein made on the part of the Trust is made and intended not as personal representations, undertakings and agreements by Wilmington Trust Company but is made and intended for the purpose of binding only the Trust, (c) nothing herein contained shall be construed as creating any liability on Wilmington Trust Company, individually or personally, to perform any covenant either expressed or implied contained herein, all such liability, if any, being expressly waived by the parties hereto and by any person claiming by, through or under the parties hereto, and (d) under no circumstances shall Wilmington Trust Company be personally liable for the payment of any indebtedness or expenses of the Trust or be liable for the breach of failure of any obligation, representation, warranty or covenant made or undertaken by the Trust under this Agreement.

**[Remainder of page left intentionally blank]**

**IN WITNESS WHEREOF,** the parties hereto have caused this Agreement to be signed on their behalf by their duly authorized officers.

**ENRON BROADBAND SERVICES, INC.**

By: Scott Pudee
Name: Scott Pudeng
Title: Agent & Attorney in Fact

km

Signature Page for Administrative Services Agreement – Backbone Trust III

**BACKBONE TRUST II**

By: WILMINGTON TRUST COMPANY,
not in its individual capacity but solely as
Owner Trustee under the Trust Agreement

By: ______________________
Authorized Signatory

(Signature Page for Administrative Services Agreement – Backbone Trust II)

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# LJM2 APPROVAL SHEET

" · Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or , J Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

## GENERAL

Deal name: Pluto

Date Approval Sheet completed: December 28, 1999

Enron person completing this form: Chris Loehr

Expected closing date: December 29, 1999

Business Unit: Enron North America

Business Unit Originator: Brian Redmond

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☑ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:________________________.

Person(s) negotiating for Enron: Joe Deffner, Greg Caudell, Kathy Lynn

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Andrews & Kurth

Legal counsel for LJM: Kirkland & Ellis (Mike Edsal)

## DEAL DESCRIPTION

LJM2 will purchase from Enron North America a 90% equity interest in MEGS, L.L.C. for $743,040. LJM2 will also purchase ENA debt at MEGS, L.L.C. with $23.2 million principal amount and 14.15% coupon for $25,570,569.78. The premium paid on the debt ... :s LJM2's market view that 9.9% is an appropriate return for the blended Burlington/Mariner credit risk.

## ECONOMICS

LJM2 will purchase the equity with the expectation of receiving a 25% IRR on its investment. LJM2 and ENA will enter into a marketing agreement under which ENA agrees to use its reasonable best efforts to sell the equity on LJM2's behalf and under which ENA receives 90% of any gains exceeding LJM2's 25% return. Due to the significant premium, LJM2's debt investment will yield approximately 9.9%. ENA has agreed to bear syndication risk on the debt piece.

## DASH

Attached. The only material changes in the attached DASH are the now executed contracts that were contemplated when the DASH was done. MEGS, Mariner, and Burlington entered into a gathering agreement stipulating the contractual cashflows. MEGS and Mariner entered into an operating agreement under which Mariner and Burlington cover all operating expenses pro rata. The gathering system has been tested and is currently operational.

L[illegible]PP[illegible]VAL SHEET
Pa[illegible]

**ISSUES CHECKLIST**

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

      ☑Condor ☑JEDI II ☐Third Party ☐Direct Sale. Please explain: A sale to Condor would not allow Enron to book earnings. JEDI II would have required CalPERS' consent since the transaction is not a Qualified Investment. Due to the small size of the equity piece and due to JEDI II's unwillingness to present CalPERS' a transaction with more Mariner credit exposure, JEDI II declined.

   b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain: __________.

   c. Were any other bids/offers received in connection with this transaction? ☑Yes ☐No. Please explain: The debt was marketed to several banks, including Bank of America. Bank of America was unwilling to accept further Mariner credit exposure and declined.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes. ☑No. If yes, please explain how this issue was resolved: __________.

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: __________.

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☑Earnings

      ☑Other: Funds flow of approximately $24 million.

   b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain: __________.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain: __________.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: __________.

   d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

   e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

   f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. (The Audit Committee has not held a meeting since LJM2's formation.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

LJM APPROVAL SHEET
Page 3

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| iness Unit | Brian Redmond | [signature] | 12-23-99 |
| Business Unit Legal | [illegible] | [signature] | 12-23-99 |
| Enron Corp. Legal | Rex Rogers | [signature] | 12-29-99 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 12-29-99 |
| RAC | Rick Buy | [signature] | 12-28-99 |
| Accounting | Rick Causey | Richard A. Causey | 12-28-99 |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# ENRON INVESTMENT SUMMARY

DEAL NAME: Pluto
Originated: Enron North America
Expected Closing Date: 12/29/99
Expected Funding Date: 12/29/99

Date Completed: December 29, 1999
Investment Analyst: Chris Loehr
Investment Type: Debt and Equity

**APPROVAL AMOUNT REQUESTED**
Capital Commitment $ 26.3 MM

**DEAL DESCRIPTION**
Purchase $23,174,400 face value of MEGS, L.L.C. ("MEGS") debt from ENA, which based on market prices and required liquidity premiums, has a value of $25,570,569.78 and will yield 9.9%. Purchase 90% of the equity in MEGS from ENA for $743,040 which is expected to yield 25%. MEGS is a special purpose entity that purchased an offshore gathering system from Mariner Energy and Burlington Resources and is entitled to contractual cashflows under a gathering agreement with the same.

**TRANSACTION SUMMARY**
On Dec. 28, 1999, LJM will purchase from Enron North America $23.2 million face value of MEGS debt and 90% of MEGS equity for total consideration of $26,313,609.78.

**CASH FLOW SUMMARY**
LJM is entitled to the 14.15% monthly coupon on the debt. Equity is expected to receive a 25% return paid monthly. Both the debt and equity investments amortize monthly by the amount that contractual cashflows exceed return on capital.

**RETURN SUMMARY**
LJM's investment, if held to maturity, would yield a blended return of 10.28%.

**EXIT STRATEGY**
- LJM has entered into a marketing agreement with ENA, whereby ENA agrees to use its reasonable best efforts to market the equity on LJM's behalf.
- ENA will have a 90 day exclusivity period during which any gain on sale that exceeds LJM's targeted 25% return on investment will be split 90% to ENA and 10% to LJM.
- Exclusivity period ends 90 days from signing of contracts. At that point any gain on sale that exceeds LJM's targeted 25% return on investment will be split 75% to ENA and 25% to LJM.
- It is expected a resale of the equity will take place within two months.
- ENA has agreed to bear syndication risk on the debt. It is expected that the debt will be monetized in a Merlin-like vehicle which will purchase the debt to yield LJM a 25% annualized return in the first half of 2000.

**RISKS AND MITIGANTS**

| Risk | Mitigant |
|---|---|
| Credit risk | Mariner and Burlington are the counterparties to the gathering agreement which stipulates contractual cashflows for each party, regardless of actual volumes shipped (ship or pay contract). Burlington credit risk is mitigated its A- credit rating and the guarantee provided to MEGS by Burlington. Mariner credit risk is mitigated by above market pricing on the Mariner tranche of debt. |
| Reserve risk | The contractual cashflows in the gathering agreement are predicated on natural gas volumes expected over the life of the Burlington/Mariner well. Should the reserves be substantially less than projected, the gathering agreement may become uneconomic for the counterparties. |
| Operating risk | Mariner, as operator, is responsible for all operating expenses and maintenance related to the gathering system. ENA will act as Managing Member and will be responsible for all other operations. |
| | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| GEM Lead | Cheryl Lipshutz | | 2/10/00 |
| Business Unit Originator | ~~Brian Redmond~~ RANDY MAFFETT | | 2/10/00 |
| Business Unit Legal | ~~Joel Ehrlich~~ Scott Sefton | S. Sefton | 2/10/00 |

# LJM APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or L" "1 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition t  t in lieu of) any other Enron approvals that may be required.

**GENERAL**

Deal name: Nowa Sarzyna

Date Approval Sheet completed: December 17, 1999

Enron person completing this form: Nicole Alvino

Expected closing date: December 20, 1999

Business Unit: Enron Europe

Business Unit Originator: Anne Edgley

This transaction relates to ☐LJM1 and/or ☒LJM2.

This transaction is ☒a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:__________________________.

Person(s) negotiating for Enron: Anne Edgley, Maroun Abboudy, Cheryl Lipshutz, Trushar Patel

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Freshfields, London – Julian Makin

Legal counsel for LJM: Kirkland &Ellis, Los Angeles – Eva Davis

**DEAL DESCRIPTION** [Insert short description of the transaction involving/between Enron and LJM; do not describe the underlying asset or transaction.]

LJ"" will purchase 75% of the Nowa Sarzyna power project from Enron Europe.

**ECONOMICS** [Insert short description of the Enron economics of the transaction involving/between Enron and LJM; do not describe the economics of the underlying asset or transaction.]

LJM2 will purchase 75% of Enron's economic interests in Enron Poland Investments B.V. for $30 MM. LJM2 is entitled to 75% of the cash flow in the form of dividends and shareholder loans.

**DASH** [Attach the DASH relating to the underlying asset or transaction. Insert brief update on the DASH if the underlying asset or transaction has changed materially since the original DASH was completed.]

Attached

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LJM APPROVAL SHEET
Page 2

ISSUES CHECKLIST

1. Sale Options

a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Chewco ☒Third Party ☐Direct Sale. Please explain: Third party could not transact quickly enough.

b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain:____________.

c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes☒No. If yes, please explain how this issue was resolved: ________________________________________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: ________________________________________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings ☐Other:__________________________.

b. Was this transaction done strictly on an arm's-length basis? ☒Yes ☐No. If no, please explain:________________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain:________________________________________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: ________________________________________.

d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | John Sherriff | | |
| Business Unit Legal | Mark Evans | | |
| Enron Corp. Legal | Rex Rogers | [signature] | 12/20/99 |
| Global Finance Legal | Scott Sefton | S. Sefton | 12/20/99 |
| RAC | Rick Buy | R. [signature] | 12 20 99 |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM APPROVAL SHEET
Page 2

## ISSUES CHECKLIST

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

   ☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Chewco ☒Third Party ☐Direct Sale. Please explain: Third party could not transact quickly enough.

   b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain: ______

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☒No. If yes, please explain how this issue was resolved: ______

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: ______

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings ☐Other: ______

   b. Was this transaction done strictly on an arm's length basis? ☒Yes ☐No. If no, please explain: ______.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain: ______.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: ______

   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | John Sherriff | | |
| Business Unit Legal | Mark Evans | | |
| Enron Corp. Legal | Rex Rogers | [signature] | 12/20/99 |
| Global Finance Legal | Scott Sefton | S. Sefton | 12/20/99 |
| RAC | Rick Buy | [signature] | 12/20/99 |
| Accounting | Rick Causey | Rick Causey | 12/20/99 |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

FROM STRUCTURE FINANCE — MON.12 20'99 17 33/ST 17 29/NO 4350145106 P 3

**LJM APPROVAL SHEET**
**Page 2**

**ISSUES CHECKLIST**

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

   ☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Cornwe ☒Third Party ☐Direct Sale. Please explain: Third party could not transact quickly enough.

   b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain: ______.

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☒No. If yes, please explain how this issue was resolved ______.

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: ______.

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings ☐Other: ______.

   b. Was this transaction done strictly on an arm's-length basis? ☒Yes ☐No. If no, please explain: ______.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain. ______.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: ______.

   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No. ANNUAL REVIEW NOT YET TAKEN PLACE.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | John Sherriff | [illegible] | 21/12/99 |
| Business Unit Legal | Mark Evans | [illegible] | 21/12/99. |
| Enron Corp. Legal | Rex Rogers | [illegible] | 12/20/99 |
| Global Finance Legal | Scott Sefton | S. Sefton | 12/20/99 |
| RAC | Rick Buy | R. Buy | 12/20/99 |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# Poland Investment Summary

DEAL NAME: Poland
Originated: Enron Europe
Expected Closing Date: December 20, 1999
Expected Funding Date: December 21, 1999

Date Completed: December 17, 1999
Investment Analysts: Trushar Patel, Nicole Alvino
Investment Type: Equity

EXPECTED MAXIMUM COMITTMENT OF LJM2

| | | | |
|---|---|---|---|
| | Capital Commitment | $ 30 MM | |
| **Poland Discount Rate Components:** *(Used by Underwriting Group)* | | | |
| US Risk Free Rate (2yr) | 5.81% | Sovereign Rating | BBB-/Baa3 |
| Country Premium (Pol' 04) | 2.00% | | |
| Equity Premium (Underwriting) | 5.69% | | |
| **Discount Rate** | 13.5% | | |

**DEAL DESCRIPTION**

Purchase of indirect 75% equity interest in the Nowa Sarzyna Facility ("ENS") located in southeastern Poland, a gas-fired heat and power station with a generating capacity of 116 MW and thermal generating capacity of 70 MW. The Facility is located within the chemical complex of Organika (state owned chemical producer).

**Power Sales:**
Electric power will be sold to the Polish Grid Company (state owned owner and operator of Poland's transmission grid and principal purchaser and wholesale supplier of electricity in Poland) under a 20 year Power Delivery Agreement ("PDA"). The price of energy and capacity is expressed in zlotys but indexed to the US dollar every 6 months for the previous six months.

**Fuel Supply:**
The Polish Oil and Gas Company (a state owned integrated monopoly that controls the entire natural gas sector in Poland) will supply natural gas to ENS under a 20 year Fuel Supply Agreement. The fixed and variable price of fuel is passed through the power and steam sales agreements. ENS will not bear the risk of fuel price fluctuation as energy prices in the PDA and fuel costs in the Fuel Supply Agreement are indexed using the same indices.

**Steam Sales:**
ENS has agreed to sell low and high pressure steam to Organika (state owned chemical company) under a 20 year steam sales agreement. This agreement represents approximately 90% of the Facility's total thermal output. ENS is also negotiating to sell the remaining 10% of thermal energy to the City of Nowa Sarzyna for residential heating purposes.

**TRANSACTION SUMMARY**

Enron Europe Limited, through a 100%-owned affiliate, Nowa Sarzyna Holding BV, owns 100% of the Nowa Sarzyna Facility. LJM2 will purchase 75% of Enron's economic ownership interests and 75% voting interests(relating to dividend and share issuance matters only) through a purchase of 75% of Enron Poland Investments BV.

**CASH FLOW SUMMARY**

With its 75% ownership of the economic interest in Enron Poland Investments BV, LJM2 is entitled to 75% of the cash flows in the form of dividends and/or shareholder loans.

**RETURN SUMMARY**

Given the underlying assumptions of the Enron Europe Nowa Sarzyna model, LJM2 will pay $30 MM for 75% of EPI. LJM2 is taking on full equity risk with no Enron guarantees, and has used a discount rate of 14.255% in valuing this investment. LJM2 assumes they can sell the asset to a strategic buyer by 3/31/00 at the model discount rate of 13.5%

**EXIT STRATEGY**

Enron Europe commits to make reasonable and best efforts to launch Project Margaux, a securitization of Enron Europe assets. If Margaux is launched, Margaux will make an offer to buy the asset to be included in the Margaux asset pool. If Margaux is not launched by 3/31/00, EEL will make reasonable and best efforts to sell LJM2's equity interests to a "qualified" third party buyer.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM Deal Approval Sheet

RISKS AND MITIGANTS

| Risk | Description | Mitigation/Comments |
|---|---|---|
| Plant Completion Risk | Risk that project is not completed on time. | Builder's all risk insurance and delay in start-up insurance at the project level, ENS, of which LJM2 owns 75%. |
| Operator Risk | Risk that Operator will not operate and maintain the plant to meet contractual capacity and availability requirements. | The project company has contracted with an affiliate of Enron Corp., EE&CC to construct, operate and maintain the facility. Proven GE frame 6B turbines will be used. |
| Fuel Supply/Price Risk | Supply reliability and low volatility of fuel prices is critical to the plant performing to contractual requirements. | The state gas & oil company will be fuel supplier under a 20yr agreement. The fixed and variable components of the fuel cost will be passed through to the energy price in the PPA. |
| Offtaker Credit Risk | Risk that the offtaker will not be able to honor their obligations to pay for capacity and power delivered under the PPA. | The offtaker will be the Polish Grid Company (state owned power company), which solicited tenders for this project to satisfy the need to replace older coal fired plants (65% of their generation is over 25 years old). |
| Regulatory Risk | As part of the new energy laws in Poland - the supply, transmission and distribution sectors may be privatized. The Polish Grid Company has the right to assign the PPA to a private entity. | The PPA also stipulates that any assignee assumes all obligations under the PPA, is capable and qualified to perform and its obligations under the PPA are guaranteed by the Polish Grid Company or an entity of comparable creditworthiness to the Polish Grid Company. The Polish Grid Company cannot assign the PPA without prior written consent from ENS. |
| Environmental/Permitting Risks | Risk that the required permits are not obtained to proceed with commercial operations. | All permits have been obtained. |
| Inflation Risk | Risk of value being eroded due to inflation. | Contracts are structured to escalate with inflation indexes. |
| Currency Risk | Payments are to be made in Zlotys. | Zloty payments are indexed to the US dollar and adjustments are made every six months for the previous six-month period. |
| Political Risk | Country specific events that may degrade anticipated revenues and returns from the project. | LJM2 will be provided with an insurance policy underwritten by Enron, with payment guaranteed by Enron which will mirror the sovereign risk policy in place for the project at present. |

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**APPROVALS**

| Name | Signature | Date |
| --- | --- | --- |
| John Sherriff | | 21-12-99 |
| Anne ~~Edgeir~~ Edgley | Anne J. Edgley | 21.12.99 |
| Mark Evans | | 21.12.99 |
| Cheryl Lipshutz | | 12-20-99 |

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AF100157

21/12 '99 TUE 16:02 FAX +44 1717530718 ENRON TREASURY 004

# LJM APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P ("LJM1") or LJ Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (... in lieu of) any other Enron approvals that may be required.

## GENERAL

Deal name: EEX

Date Approval Sheet completed: December 28, 1999

Enron person completing this form: Chris Loehr

Expected closing date: December 29, 1999

Business Unit: Enron North America

Business Unit Originator: Joe Deffner, Tim Proffitt

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☑ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:________________.

Person(s) negotiating for Enron: Joe Deffner, Tim Proffitt

Person(s) negotiating for LJM: Michael Kopper, Greg Caudell

Legal counsel for Enron: Andrews & Kurth (Wes Dorman)

Legal counsel for LJM: Kirkland & Ellis (Rob Marks)

## DEAL DESCRIPTION

LJM2 will purchase from Enron North America a 90% equity interest in Bob West Treasure, L.L.C. for $2,953,125. Bob West Treasure is a special purpose vehicle created to be the counterparty for a prepay with EEX involving $105 million for up to 63 Bcfe of na' gas.

## ECONOMICS

LJM2 will purchase the equity with the expectation of receiving a 25% IRR on its investment. LJM2 and ENA will enter into a marketing agreement under which ENA agrees to use its best efforts to sell the equity on LJM2's behalf and under which ENA receives 90% of any gains exceeding a 25% return to LJM2.

## DASH

Attached.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM APPROVAL SHEET
Page 2

ISSUES CHECKLIST

1. Sale Options

a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☑Condor ☐JEDI II ☐Third Party ☐Direct Sale. Please explain: A sale to Condor would achieve deconsolidation of the debt but would not allow Enron to book earnings.

b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:____________.

c. Were any other bids/offers received in connection with this transaction? ☑Yes ☐No. Please explain: The debt and equity were marketed to several banks including Chase, Deutsche and Paribas.

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: ____________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: ____________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☑Earnings

☑Other: Funds flow of approximately $105 million.

b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:____________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:____________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: ____________.

d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM APPROVAL SHEET
Page 3

| ... PROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | [illegible] | [illegible] | 12/28/99 |
| Business Unit Legal | [illegible] | [illegible] —SMS | 12-28-99 |
| Enron Corp. Legal | ~~Rex Rogers~~ [illegible] | [illegible] | 12-28-99 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 12/28/99 |
| RAC | Rick Buy | [illegible] | 12/28/99 |
| Accounting | Rick Causey | Richard A. Causey | 12-28-99 |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# ENRON INVESTMENT SUMMARY

**DEAL NAME: EEX**
Originated: Enron North America
Expected Closing Date: 12/28/99
Expected Funding Date: 12/28/99

Date Completed: December 27, 1999
Investment Analyst: Chris Loehr
Investment Type: Equity

**APPROVAL AMOUNT REQUESTED**
Capital Commitment $ 2,953,125.00

**DEAL DESCRIPTION**
Purchase 90% of the equity in Bob West Treasure, L.L.C. ("Bob West"). Bob West is a special purpose vehicle created to be the counterparty for a prepay with EEX involving $105 million for up to 63 Bcfe of natural gas.

**TRANSACTION SUMMARY**
- On Dec. 28, 1999, LJM will purchase from Enron North America 90% of the Bob West equity for $ 2,953,125.00.
- $2,700,000.00 will be in the purchase price paid to Enron North America.
- $253,125.00 will be a capital contribution to Bob West Treasure LLC.
- ENA will pay LJM2's legal and tax advisory fees upfront.

**CASH FLOW SUMMARY**
LJM2, as a 90% equity holder in Bob West, is entitled to 90% of cashflows remaining after payment of interest on the $105 million of debt.

**RETURN SUMMARY**
LJM2's investment is expected to yield a return of 25%.

**EXIT STRATEGY**
- LJM2 has entered into a marketing agreement with ENA, whereby ENA agrees to use its reasonable best efforts to market the equity on LJM2's behalf.
- ENA will have a 90 day exclusivity period during which any gain on sale that exceeds LJM2's targeted 25% return on investment will be split 90% to ENA and 10% to LJM2.
- Exclusivity period ends 90 days from signing of contracts. At that point any gain on sale that exceeds LJM2's targeted 25% return on investment will be split 75% to ENA and 25% to LJM2.
- It is expected a resale of the equity will take place within six months to coincide with refinancing of the $105 million bridge financing.

**RISKS AND MITIGANTS**

| Risk | Mitigant |
|---|---|
| Refinancing risk | LJM2 is entitled to cashflows after debt servicing. The bridge financing in place will need to be refinanced within ten months. Depending on the terms of the refinancing, equity cashflows may not support LJM2's targeted 25% return. LJM will have right to approve/reject terms of permanent financing. |
| Reserve risk | EEX has sold up to 63 Bcfe under the prepay agreement. While actual production of these reserves is a risk, 72% of the volumes are proved developed producing. |
| Interest rate risk | LJM2 is entitled to cashflows after debt servicing. The bridge financing in place is a floating rate facility (LIBOR+75bps); however, there is an existing swap which will be assigned to Bob West that fixes the rate on the bridge at 7.48%. |
| Operating risk | ENA will act as Managing Member and will be responsible for all operations. |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

| APPROVALS | Name | Signature | Date |
| --- | --- | --- | --- |
| GEM Lead | Cheryl Lipsbutz | | 2/10/00 |
| Business Unit Originator | Andrea Reed | | 2/10/00 |
| Business Unit Legal | ~~Joel Ephross~~ Scott Sefton | S. Sefton | 2/10/00 |

# LJM APPROVAL SHEET

Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or L...2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

**GENERAL**

Deal name: Cortez

Date Approval Sheet completed: January 4, 2000

Enron person completing this form: Trushar Patel

Expected closing date: January 6, 2000

Business Unit: Enron Energy Services

Business Unit Originator: Jimmie Williams

This transaction relates to ☐LJM1 and/or ☒LJM2.

This transaction is ☐ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☒other: Investment in Cortez, LLC which holds shares in EMW Energy Services Corp.

Person(s) negotiating for Enron: Jimmie Williams, Cheryl Lipshutz

Person(s) negotiating for LJM: Michael Kopper,

Legal counsel for Enron: Vinson & Elkins

Legal counsel for LJM: Kirkland & Ellis

**DEAL DESCRIPTION** [Insert short description of the transaction involving/between Enron and LJM; do not describe the underlying asset or transaction.]

L...2 will invest $673,200 equal to 51% ownership of the Class A membership interests in Cortez, LLC with EES owning the remaining 49% of the Class A membership interests. In turn, Cortez, LLC owns 25% of the common shares (with voting rights) in EMW Energy Services Corp.

**ECONOMICS** [Insert short description of the Enron economics of the transaction involving/between Enron and LJM; do not describe the economics of the underlying asset or transaction.]

The Class A Members (including LJM2) will receive 100% of the cash Cortez, LLC receives in the form of dividends, distribution or other payment on the Class A Common Stock of EMW Energy Services Corp. held by Cortez, LLC until the Class A Members attain the targeted IRR. Upon LJM2 receiving their targeted return, the cash will be distributed 99.75% to EES and 0.25% to LJM2.

**DASH** [Attach the DASH relating to the underlying asset or transaction. Insert brief update on the DASH if the underlying asset or transaction has changed materially since the original DASH was completed.]

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LJM APPROVAL SHEET
Page 2

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ISSUES CHECKLIST

Sale Options

a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☐Condor ☒JEDI II ☐Third Party ☐Direct Sale. Please explain: Chewco, Enserco and Rawhide considered.

b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain:___________.

c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: LJM2 was offered this investment.

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes☒No. If yes, please explain how this issue was resolved: _________________________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: _________________________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings ☒Other: New business opportunity & Deconsolidation.

b. Was this transaction done strictly on an arm's-length basis? ☒Yes ☐No. If no, please explain:_______________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain:_________________________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No.

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No (Certain EES employees may receive compensation not directly related to this transaction)

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: _________________________.

d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☒Yes ☐No.

e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☒Yes ☐No.

f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☒No (Audit committee has not reviewed any transactions to date).

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LJM APPROVAL SHEET
Prge 3

| ²ROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | Jimmie Williams | [signature] | 1/5/00 |
| Business Unit Legal | Vicki Sharp | [signature] | 1/5/00 |
| Enron Corp. Legal | Rex Rogers/Robert Eickenroht | [signature] | 1/5/00 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 1/5/00 |
| RAC | Rick Buy | [signature] | 1/5/00 |
| Accounting | Rick Causey | [signature] | 1/5/00 |
| Executive | Jeff Skilling | | |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# Cortez Investment Summary

DEAL NAME: Cortez Investment
Originated: Enron Energy Services
Expected Closing Date: January 6, 2000
Expected Funding Date: January 6, 2000

Date Completed: January 4, 2000
Investment Analysts: Trushar Patel
Investment Type: Equity

EXPECTED MAXIMUM COMITTMENT OF LJM II

| | |
|---|---|
| Capital Commitment | $673,200 |

DEAL DESCRIPTION

Enron Energy Services, LLC ("EES") along with strategic partners ("Investors") is forming EMW Energy Services Corp. (the "Company") to engage in the retail marketing and retail sale of natural gas, electricity and other commodities, products and services to residential and small commercial customers in the United States. Prior to cash contributions from the Investors (outlined below), EES and Enron Corp. will contribute or cause to be contributed (in exchange for Common Stock and Special Warrants) to the Company certain assets of the residential and small commercial retail electric power and gas marketing business of EES and its affiliates. Immediately following the contribution by EES and Enron Corp. the Investors will invest an aggregate of $100 million in exchange for Common Stock, Special Warrants and Investor Warrants in the Company.

Along with the Common Stock and Special Warrants issued to EES for its contribution, the Company will issue to EES 25,000 shares of Common Stock, which EES will promptly contribute to Cortez Energy Services, LLC ("Cortez"). The authorized membership interests of Cortez at closing will consist of Class A and Class B membership interests. At closing, EES will own 49% of the Class A interests and 100% of the Class B interests. LJM2 will own 51% of the Class A interests. EES will be managing member of Cortez. At closing, the LLC Agreement stipulates that prior to an Initial Public Offering or five years from the closing date, neither of the owners may transfer their interests in Cortez. The exception being that the transfer of the interests be to an Affiliate of EES or Enron Corp. or Cortez if, but only if, at least 80% of the economic and voting interests represented by the transferred interests continue to be held, directly or indirectly, by EES or Enron Corp.

The following table outlines the capitalization of the Company following consummation of the transactions described above:

| | Contribution Amount | Shares | % of Common Shares (primary) |
|---|---|---|---|
| **EES:** | **Assets** | | |
| Common | | 50,000 | 50% |
| Special Warrants | | 225,000 | 0% |
| **Cortez:** | **NA** | | |
| Common | | 25,000 | 25% |
| **DLJ:** | **$35 MM** | | |
| Common | | 8,750 | 8.8% |
| Special Warrants | | 26,250 | 0% |
| Investor Warrants | | 8,065 | 0% |
| **GE:** | **$35 MM** | | |
| Common | | 8,750 | 8.8% |
| Special Warrants | | 26,250 | 0% |
| Investor Warrants | | 18,065 | 0% |
| **CalPERS:** | **$15 MM** | | |
| Common | | 3,750 | 3.75% |
| Special Warrants | | 11,250 | 0% |
| Investor Warrants | | 7,742 | 0% |
| **Ontario Teachers:** | **$15 MM** | | |
| Common | | 3,750 | 3.75% |
| Special Warrants | | 11,250 | 0% |
| Investor Warrants | | 7,742 | 0% |

TRANSACTION SUMMARY

LJM 2 will invest $673,200 equal to 51% ownership of the Class A membership interests in Cortez with EES owning the remaining 49% of the Class A membership interests. In turn, Cortez owns 25% of the common shares (with voting rights) in EMW.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM Deal Approval Sheet

RETURN SUMMARY

The Class A Members (including LJM2) will receive 100% of the cash Cortez receives in the form of dividends, distribution or other payment on the Common Stock of the Company held by Cortez, until the Class A Members attain the targeted IRR. Upon the Class A Members receiving their targeted return, the cash will be distributed 99.75% to EES and 0.25% to LJM2.

EXIT STRATEGY

LJM2 will be allowed to sell its interests in Cortez at the earlier of the Initial Public Offering date (subject to the required legal holding period) or five years from the closing date. LJM2 does have the ability to sell prior to the earlier of the Initial Public Offering date (subject to the required legal holding period) or five years from the closing date. In this case the transfer of the interests must be to an Affiliate of EES or Enron Corp. or Cortez if, but only if, at least 80% of the economic and voting interests represented by the transferred interests continue to be held, directly or indirectly, by EES or Enron Corp.

Risks

EMW Energy Services Corp.'s failure to execute on its business plan to engage in the retail marketing and retail sale of natural gas, electricity and other commodities, products and services to residential and small commercial customers in the United States. This would preclude the ability to proceed with an initial public offering in the next six to twelve months. This in turn will hamper LJM2's ability to exit the investment, as the underlying asset in Cortez is shares of Common of the Company.

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# LJM APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or 12 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition not in lieu of) any other Enron approvals that may be required.

**GENERAL**

Deal name: **Yosemite**

Date Approval Sheet completed: February 6, 2000

Enron person completing this form: Catherine Pernot

Expected closing date: February 15, 2000

Business Unit: Enron Corp.

Business Unit Originator: Bill Brown/ Doug McDowell

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☑ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:______________________.

Person(s) negotiating for Enron: Bill Brown / Doug McDowell / Ben Glisan / Nicole Alvino

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Gareth Bahlmann

Legal counsel for LJM: Dave Lambert of Kirkland & Ellis

**DEAL DESCRIPTION**

LJM2 is purchasing Beneficial ownership in a Delaware Business Trust (Yosemite Securities Trust I) that owns Trust Investments ·isting of AAA securities, U.S. obligations, and payment obligations supported, in whole or in part, directly or indirectly, by . on. The face amount of the Trust Investments equals the amount of Notes and Certificates in the Trust. The Trust and Citibank have entered into the Citibank Swap, which will provide for yield payments on the Certificates and for certain settlement payments under credit events, in exchange for actual interest payments on the Trust Investments. LJM2 intends to sell this investment to Condor within one week of purchase.

**ECONOMICS**

LJM2 is purchasing the beneficial ownership at face value for $33,750,000 to achieve a yield of 11%

**DASH**

Included

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**LJM APPROVAL SHEET**
**Page 2**

ISSUES CHECKLIST

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

   ☐Condor ☐JEDI II ☐JEDI ☐Margaux ☐EnSerCo ☐Rawhide ☐Chewco
   ☑Third Party ☐Direct Sale.

   Please explain: Enron entered into a Letter of Understanding with LJM2 and LJM2 subsequently entered into a similar arrangement to sell the Certificates to Condor.

   b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:__________.

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☑No. Please explain: ______.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: __________.

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: __________.

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings

   ☑Other: Sale of asset to third party (full risk transfer); non-consolidation of Yosemite Debt on Enron's balance sheet

   b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:__________.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:__________.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: __________.

   d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

   e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

   f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☑No.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | Bill Brown | [signature] | 2/28/00 |
| Business Unit | Doug McDowell | [signature] | 2/24/00 |
| Business Unit Legal | Gareth Bahlmann | [signature] | [illegible] |
| .on Corp. Legal | Rex Rogers | [signature] | [illegible] |

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

**LJM APPROVAL SHEET**
**Page 2**

| | | | |
|---|---|---|---|
| Global Finance Legal | Scott Sefton | Scott Sefton | 2/10/00 |
| \C | Rick Buy | [illegible] | 2/24/00 |
| Accounting | Rick Causey | Richard A. Causey | 2/17/00 |
| Executive | Jeff Skilling | | |

AF100179

"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

**INTEROFFICE MEMORANDUM**

To: Rick Buy

From: Dave Gorte

Date: February 23, 2000

Re: LJM2 Investment in Certificates of Beneficial Interest in Yosemite Securities Trust I

I have reviewed this proposed LJM2 investment. The 11% yield at which LJM proposes to purchase $33.75 million of the $37.5 million of Certificates of Beneficial Interest (the "Certificates") in Yosemite Securities Trust I is identical to the stated yield of these Certificates. In addition, this 11% yield is identical to the yield on the remaining $37.5 million of these Certificates purchased by Citibank at the closing of this transaction in November 1999.

As such, I am of the opinion that the pricing at which Enron is selling these Certificates to LJM reflects the market yield for these certificates. (LJM2 intends to resell these certificates to Condor within one week of its purchase of these certificates).

If you have any questions or comments, please let me know.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# LJM2 APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

## GENERAL

Deal name: Raptor

Date Approval Sheet completed: April 18, 2000

Enron person completing this form: Trushar Patel

Expected closing date: May 4, 2000

Business Unit: Enron Corp.

Business Unit Originator: Ben Glisan

This transaction relates to ☐LJM1 and/or ☒LJM2.

This transaction is ☐ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☒other: __creation of hedging structure________.

Person(s) negotiating for Enron: Ben Glisan

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Vinson & Elkins

Legal counsel for LJM: Kirkland & Ellis

## DEAL DESCRIPTION

Talon I LLC ("Talon") is a special purpose entity organized for the purpose of entering into certain derivative transactions. LJM2, through its 100% voting control of Talon, has the unilateral ability to make the investment decisions for Talon and is not contractually obligated to execute any derivative transactions with Enron. LJM2 will execute derivative transactions with Harrier I LLC ("Harrier"), a wholly-owned subsidiary of Enron, to the extent those investment decisions are aligned with LJM2's investment objectives. Enron, through Harrier, will offer LJM2 the opportunity to execute derivative instruments relating to both public and private energy and telecommunication investments made by Enron.

## ECONOMICS

Talon's distributions to equity holders will be limited by earnings at Talon. To the extent there are earnings and sufficient cash to distribute, distributions will be made according to the following waterfall:

- First, $41 million to LJM2
- Second, distributions as necessary until LJM2 receives a 30% IRR over the term of the structure (unless the IRR was achieved through the $41 million distribution above)
- Third, 100% to the special limited partnership interest, Harrier I LLC, a wholly-owned subsidiary of Enron

## DASH

See attached.

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM APPROVAL SHEET
Page 2

ISSUES CHECKLIST

1. Sale Options

a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☐Condor ☐JEDI II ☐Third Party ☐Direct Sale. Please explain: Not a sale of an asset by Enron

b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:__________.

c. Were any other bids/offers received in connection with this transaction? ☐Yes ☑No. Please explain: Private structured finance transaction

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: __________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: __________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings

☑Other: Ability to hedge mark-to-market exposure on investments in publicly and privately held companies

b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:__________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:__________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: __________.

d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. (The Audit Committee has not held a meeting since LJM2's formation.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

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LJM APPROVAL SHEET
Page 3

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | Ben Glisan | Ben Glisan | 6-12-00 |
| Business Unit Legal | | | |
| Enron Corp. Legal | Rex Rogers | Rex Rogers | 5-24-00 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 5-22-00 |
| RAC | Rick Buy DRB | [illegible] | 5-22-00 |
| Accounting | Rick Causey | Richard A. Causey | 5-22-00 |
| Executive | Jeff Skilling | | |

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# ENRON DEAL SUMMARY

DEAL NAME: Raptor
Originated: Enron Corp.
Expected Closing Date: 4/18/00
Expected Funding Date: 5/04/00

Date Completed: April 18, 2000
Investment Analyst: Chris Loehr
Investment Type: Equity

## INVESTMENT

LJM2 Capital Commitment $ 30,000,000

## DEAL DESCRIPTION

Talon I LLC ("Talon") is a special purpose entity organized for the purpose of entering into certain derivative transactions. LJM2, through its 100% voting control of Talon, has the unilateral ability to make the investment decisions for Talon and is not contractually obligated to execute any derivative transactions with Enron. LJM2 will execute derivative transactions with Harrier I LLC ("Harrier"), a wholly-owned subsidiary of Enron, to the extent those investment decisions are aligned with LJM2's investment objectives. Enron, through Harrier, will offer LJM2 the opportunity to execute derivative instruments relating to both public and private energy and telecommunication investments made by Enron.

## TRANSACTION SUMMARY

- On April 21, 2000, LJM2 will purchase 100% of the voting interest in Talon for $30,000,000
- Talon is a bankruptcy remote, special purpose vehicle that will be capitalized with:
  - LJM2's capital investment
  - A series of forward sales on Enron shares ($500 million of gross value but $350 million of net value after a 30% liquidity discount has been ascribed given the restrictions imposed on the underlying shares) resulting in ultimate ownership by Talon of Enron common stock
  - The sale of puts on [7 million] Enron shares with a strike of [$57.50], a maturity in [six months] from close and a premium due of [$6] per share.
- In exchange for the above capitalization, Talon will provide Harrier: (i) a $400 million note whose principal is convertible into derivatives, and (ii) a special limited partnership interest in Talon initially valued at $1,000.
- To limit Talon's exposure to the mark-to-market movements of the underlying derivative transactions, Talon and Harrier agree to limit the notional amount of swaps and premiums paid as follows: (i) up to $1.5 billion notional value of at-the-money swaps, (ii) up to $400 million of net premiums on other derivative transactions, and (iii) up to $1 billion of loss on premium paid derivatives.
- LJM2 will have a fair market value put for its membership interest in Talon that allows LJM2 to put its interest back to Harrier in the event that LJM2 has not received the greater of $41 million or a 30% IRR by October 31, 2000. Enron has provided support for Harrier's financial obligation under such an event in the form of a guaranty.
- At the maturity of the structure, Talon will liquidate the excess value, if any, of the Enron shares under the forward sales over the derivative losses, if any, at Talon and any principal outstanding on the Talon note. The excess proceeds, if any, will be distributed to LJM2 and Harrier in accordance with their capital accounts and the distribution waterfall.

## INVESTMENT RETURN SUMMARY

*Base Case Return*

It is expected that Talon will have earnings and cash sufficient to distribute $41 million to LJM2 within six months, yielding an annualized return on investment to LJM2 of 76.8%

*Distributions*

Talon's distributions to equity holders will be limited by earnings at Talon. To the extent there are earnings and sufficient cash to distribute, distributions will be made according to the following waterfall:

- First, $41 million to LJM2
- Second, distributions as necessary until LJM2 receives a 30% IRR over the term of the structure (unless the IRR was achieved through the $41 million distribution above)
- Third, 100% to the special limited partnership interest, Harrier I LLC, a wholly-owned subsidiary of Enron

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"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

*Fair Market Value Put*
In the event that LJM2 has not received the greater of $41 million or a 30% IRR on its investment by October 31, 2000, LJM2 will have a fair market value put whereby LJM2 can put its interest in Talon back to Harrier. The fair market value of the membership interest is determined largely by Enron's stock price and is summarized below:

| Enron Stock Price | Fair Market Put Value | LJM2 IRR |
|---|---|---|
| [$57.50] | $41.0 million | 76.8% |
| [$48.95] | $34.5 million | 30.0% |
| [$48.35] | $30.0 million | 0.0% |

*Expenses*
Enron has agreed to cover all of LJM2's accounting and legal expenses related to this transaction. Enron will cover expenses related to formation of the structure as well as ongoing expenses.



AF100187

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit Originator | Ben Glisan | Ben Glisan | 6-12-00 |
| Business Unit Legal | [illegible] | S. Sefton | 5-23-00 |



AF100188

"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

# LJM2 APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

## GENERAL

Deal name: EECC Blue Dog Turbine Purchase

Date Approval Sheet completed: as of 05/12/00

Enron person completing this form: Gehle/Marlow/Kelly

Expected closing date: 05/12/00

Business Unit: Enron Engineering & Construction

Business Unit Originator: Fred Kelly

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☐ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☑other:_An option agreement to purchase turbines.

Person(s) negotiating for Enron: Fred Kelly

Person(s) negotiating for LJM: Michael Hinds

Legal counsel for Enron: David Bargainer

Legal counsel for LJM: Mike Edsall, Amy Harvey

## DEAL DESCRIPTION

LJM2 will enter into a Letter of Agreement with General Electric Company to acquire the rights to purchase two PG7121EA Gas Turbine Generator Sets. LJM2 will appoint EECC as its Agent to negotiate the Purchase Agreement and EECC will enter an Option Agreement with LJM2 to acquire LJM2's rights to purchase the two Gas Turbine Generator Sets.

In consideration of LJM2s role in facilitating this transaction, EECC will pay LJM2 a non-refundable option payment of $846,378. In consideration for EECC acting as Agent for LJM2 in negotiating this transaction. LJM2 will pay EECC a pro-rated Agency Fee of $100,000 for each six months the Agency agreement is in effect.

In the event that EECC fails to complete negotiation of the Purchase Agreement by May 31, 2000 and the letter agreement is terminated by either party, EECC shall pay LJM2 as liquidated damages all amounts paid by LJM2 to GE under the Letter Agreement including the $2,000,000 initial payment. EECC will also reimburse LJM2 for the amount of the Agency fee payable by LJM2, and for all transaction costs incurred by LJM2 as a result of such failure. The Purchase Agreement is substantially complete, however, and it is definitely expected that it will be executed by May 31, 2000.

EECC will have the option to acquire the turbines until November 10, 2000. It is anticipated that by that date EECC will identify a profitable power project opportunity within Enron or with a third party in which to utilize the turbines and will exercise its option to purchase the turbines from LJM2, although there is no obligation for EECC to exercise such option.

## ECONOMICS

This transaction will require EECC to pay the above-mentioned amounts to LJM2. Additionally, if EECC elects to exercise its option, it will acquire LJM2's rights to acquire the turbines, for the then Fair Market Value of the turbines.

This transaction will allow EECC to potentially secure these turbines off balance sheet until it is clear on which project opportunity and under which structure they will be employed.

## DASH

Please reference the approved DASH dated 04/14/00 and the approved Amendment dated 04/28/00. Please note that the LJM2 option premium and the commitment fee, combined, is higher than $200,000 anticipated in the original DASH. Please also note the liquidated damages that will apply in the event EECC is unable to complete the negotiation of a Purchase Agreement by May 31,2000.

## ISSUES CHECKLIST

1. Sale Options

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a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☐Condor ☐JEDI II ☐Third Party ☐Direct Sale. Please explain: this transaction involves the purchase of an asset (the option).

b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:__________

c. Were any other bids/offers received in connection with this transaction? ☐Yes ☑No. Please explain: in view of time constraints LJM2 is considered the most expeditious vehicle for this transaction. Enron accounting and finance staff agree that the terms of the agreements with LJM2 are fair and at market for LJM2's role in this transaction.

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: __________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: __________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings

☑Other: Since there is not a specific identified use for the turbines at this time, this transaction will provide accounting flexibility and will avoid the need to carry the transaction on Enron's balance sheet

b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:__________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:__________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: __________.

d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. (The Audit Committee has not held a meeting since LJM2's formation.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

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| ?PROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | Fred Kelly/Larry Izzo | | 22 May 00 |
| Business Unit Legal | John Schwartzenburg | | 22 May 00 |
| Enron Corp. Legal | Rex Rogers | | 5-24-00 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 5.23.00 |
| RAC | Rick Buy RB | Richard B. Buy | 5/25/00 |
| Accounting | Rick Causey | Richard A. Causey | 5/26/00 |
| Executive | Jeff Skilling | | |

verbal from Rick Buy on 5/25/00

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CONFIDENTIAL

PRIVATE PLACEMENT MEMORANDUM

# LJM2 CO-INVESTMENT, L.P.

Merrill Lynch & Co.

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PRIVATE PLACEMENT MEMORANDUM CONFIDENTIAL

LJM2 CO-INVESTMENT, L.P.
**$200,000,000**
**Limited Partnership Interests**

This Private Placement Memorandum ("Memorandum") is being furnished to prospective investors on a confidential basis in order that such prospective investors may consider an investment in limited partner interests (the "Interests") in LJM2 Co-Investment, L.P., a Delaware limited partnership ("LJM2" or the "Partnership"), and may not be used for any other purpose. Each potential investor, by accepting delivery of this Memorandum, agrees not to make a photocopy or other copy or to divulge the contents hereof to any other person other than a legal, business, investment, or tax advisor in connection with obtaining the advice of such person with respect to this offering.

The Interests are being offered in a private placement to a limited number of accredited investors and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws. Accordingly, unless a disposition is exempt from the registration requirements of such laws, the Interests must be held until the Partnership is liquidated. In addition, the transferability of the Interests will be restricted by the Amended and Restated Limited Partnership Agreement of the Partnership (the "Partnership Agreement").

This Memorandum is intended to present, among other things, a general outline of the objectives and structure of the Partnership. The Partnership Agreement, which specifies the rights and obligations of the partners, should be reviewed thoroughly by each prospective investor. The summary of certain provisions of the Partnership Agreement contained herein is necessarily incomplete and is qualified by reference to such Partnership Agreement. Copies of the Partnership Agreement and other relevant material will be made available to prospective investors upon request.

In making an investment decision, investors must rely on their own examination of the Partnership and the terms of the offering, including the merits and risks involved. Each prospective investor or its representative may request copies of such documents, ask questions, and obtain additional information reasonably necessary to verify the accuracy of the information contained in this Memorandum. Except as provided herein, no person has been authorized in connection with this offering to give any information or to make any representations other than as contained in this Memorandum.

The Interests have not been approved or disapproved by the Securities and Exchange Commission ("SEC") or any state securities commission, and neither the SEC nor any state securities commission has passed upon the accuracy or adequacy of this Memorandum. Any representation to the contrary is a criminal offense.

Merrill Lynch & Co.

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Investment in the Interests described herein will involve significant risks, including those described in the section titled "Risk Factors" below. Investors should have the financial ability and willingness to accept the risks and lack of liquidity which are characteristic of the investment described herein.

Prospective investors are not to construe the contents of this Memorandum as legal, investment, business, or tax advice. Each investor should consult its own counsel, accountant, and other advisors as to legal, investment, business, tax, and related aspects of a purchase of the Interests offered hereby. The Partnership is not making any representations to any offeree or purchaser of the Interests regarding the legality of an investment therein by such offeree or purchaser under appropriate legal investment or similar laws.

The Partnership reserves the right to withdraw this offering of the Interests at any time and the Partnership and LJM2 Capital Partners, LLC, a Delaware limited liability company that is the general partner of the Partnership (the "General Partner"), reserve the right to reject any commitment to subscribe for the Interests in whole or in part and to allot to any prospective investor less than the full amount of the Interests sought by such investor. The General Partner and certain related persons may acquire for their own account a portion of the Interests.

This Memorandum does not constitute an offer to sell, or a solicitation of an offer to buy, any Interests in any jurisdiction where, or to or from any person to or from whom, such offer or solicitation is unlawful or not authorized.

None of Enron Corp., an Oregon corporation ("Enron"), and its subsidiaries has issued, or guaranteed any payments with respect to, the Interests, and none of Enron and its subsidiaries is responsible for the financial or other performance of the Partnership.

This Memorandum includes or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Memorandum, including, without limitation, statements regarding the Partnership's future financial position, business strategy, and plans and objectives, including the ability of the Partnership to participate in investment opportunities generated by Enron and its subsidiaries, are forward-looking statements. Important factors that could cause actual results to differ materially from those anticipated by the Partnership include the willingness of Enron to permit the Partnership to participate in investment opportunities generated by Enron and its subsidiaries, the success of the Partnership in identifying other investment opportunities, the ability of the Partnership to participate in such investments on terms acceptable to the Partnership, and the actual performance of the investments in which the Partnership participates. Although the Partnership believes its expectations are reasonable, it can give no assurance that its investment objectives will be achieved.

No person has been authorized to give any information or to make any representation concerning the Partnership or the offer of the Interests other than the information contained in this Memorandum, and, if given or made, such information or representation must not be relied upon as having been authorized by the Partnership, the General Partner, or Merrill Lynch & Co. The information contained in this Memorandum has been compiled as of October 13, 1999 (except as otherwise stated herein). Certain information presented herein about Enron has been compiled from publicly available sources. Enron has not prepared this Memorandum and Enron has not approved or endorsed the contents of this Memorandum. Neither the delivery of this Memorandum at any time, nor any sale hereunder, shall under any circumstances create an implication that the information contained herein is correct as of any time subsequent to such date, and none of the Partnership, the General Partner, and Merrill Lynch & Co. undertakes an obligation to update or revise the information contained in this Memorandum, whether as a result of new information, future events or otherwise. The information is from sources believed to be reliable, but none of the Partnership, Merrill Lynch & Co., and any other person has independently verified the information contained herein.

Merrill Lynch, Pierce, Fenner & Smith Incorporated has been engaged as placement agent in connection with the formation of the Partnership and may use its affiliates to assist in its placing activities. Reference in this Memorandum to "Merrill Lynch & Co." shall be deemed to include Merrill Lynch, Pierce, Fenner & Smith Incorporated and, where the context so permits, its affiliates that assist in its placing activities.

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## I. EXECUTIVE SUMMARY

**Introduction**

LJM2 Co-Investment, L.P., a Delaware limited partnership ("LJM2" or the "Partnership"), is being organized by Andrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron Corp., an Oregon corporation ("Enron"), to make privately negotiated equity and equity-related investments in energy- and communications-related businesses and assets. The Partnership expects that Enron will be the Partnership's primary source of investment opportunities and that the Partnership will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment interest from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. It is expected that in connection with the foregoing investments, Enron will retain a significant economic or operating interest in the businesses or assets in which the Partnership invests. The Partnership may also from time to time make investments in businesses or assets where Enron has no involvement. This is the second such fund formed by Mr. Fastow targeted at investing primarily in companies owned or controlled by Enron. The Partnership's objective is to generate an annualized internal rate of return ("IRR") in excess of 30% to investors in the Partnership after payment of all Partnership fees and expenses and payment of the carried interest to the General Partner.

Enron, headquartered in Houston, Texas, is one of the largest sellers of natural gas and electricity in deregulated and privatized markets on three continents. Additionally, Enron is the largest provider of energy risk management services in the world and owns the largest natural gas pipeline system in the U.S. Enron is also constructing a 10,000 mile nationwide fiber-optic telecommunications network. Enron is frequently characterized as the agent of change in the rapidly deregulating and privatizing energy markets and has been named the "Most Innovative Company in the World" for four consecutive years by *Fortune*. Enron currently ranks among the Fortune 100 companies with annual revenues of over $30 billion. Importantly, Enron has made investments of over $7 billion in each of the last two years in a variety of energy-related businesses and currently owns merchant investments of over $10 billion. *See* – "Overview of Enron." Under Mr. Fastow's management, the Partnership expects to have the opportunity to co-invest with Enron in many of Enron's new investment activities and the opportunity to acquire existing Enron assets on a highly selective basis. This access to deal flow should provide the Partnership with unusually attractive investment opportunities.

The target size of the Partnership is $200 million. The General Partner reserves the right to accept additional commitments in excess of $200 million. The Partnership is expected to generate significant co-investment opportunities for investors in the Partnership because the Partnership will be limited to investing no more than 10% of its committed capital in any one company, and the General Partner expects many of the opportunities the Partnership pursues to require capital in excess of the amount the Partnership is able to provide under this diversification limitation. Co-investment amounts will not be subject to a carried interest.

The General Partner of the Partnership will be LJM2 Capital Partners, LLC, a Delaware limited liability company (the "General Partner"), an entity owned and controlled by one or more of the Principals (as defined below). The Partnership will be managed on a day-to-day basis by a team of three investment professionals who all currently have senior level finance positions with Enron: Andrew S. Fastow, Michael J. Kopper, and Ben Glisan, Jr. (collectively, the "Principals"). The Principals will continue their current responsibilities with Enron while managing the day-to-day operations of the Partnership. *See* – "Risk Factors – Dependence on Key Personnel" and "Conflicts of Interest – Dual Role of Principals."

Investment Opportunity

The Principals believe that LJM2 provides investors with an unusually attractive investment opportunity for the following reasons:

*Access to Significant Proprietary Deal Flow.* Enron has extensive deal origination capability that is derived from approximately 2,000 fully dedicated Enron-employed origination and monitoring professionals located around the world. The deal flow emanating from this origination infrastructure has resulted in Enron making over $7 billion of energy-related investments in each of the last two years and holding merchant investments of over $10 billion. As a result of Enron's in-house deal sourcing capability as well as its leading market position in most businesses in which it operates, Enron frequently has access to investment opportunities that are not available to other investors. The Partnership expects to benefit from having the opportunity to invest in Enron-generated investment opportunities that would not be available otherwise to outside investors.

*Enron's Investment Record.* Enron's record as a successful investor is reflected in returns it has generated for its shareholders as measured by the appreciation in its common stock, which, from January 1, 1990, through September 30, 1999, has increased 641% (price increase plus assumed re-investment of dividends), as compared to returns of 363% for the S&P 500 and 141% for the S&P Energy Index for the same period. Furthermore, Enron has successfully managed two institutionally funded private equity partnerships, Joint Energy Development Investments Limited Partnership ("JEDI I") and Joint Energy Development Investments II Limited Partnership ("JEDI II"), which have generated (or are estimated to generate, as the case may be) an IRR after payment of fees and expenses of the partnership and payment of a carried interest, if any, to the partnerships' general partners (each, a "Net IRR") of 23% and 194%, respectively, compared to targeted IRRs for the partnerships on invested capital before fees, expenses, and carried interest (a "Gross IRR") of 15% and 20%, respectively. The General Partner believes that a significant portion of this superior performance can be attributed to the quality of investment opportunities sourced by Enron. *See* – "Summary of Investment Experience."

*Enron's Capabilities to Analyze and Structure Investments and Operate Assets.* Over the years, Enron has developed a rigorous process of investment analysis, which employs approximately 130 professionals in varying disciplines such as engineering, research, credit, tax, legal, accounting, insurance, and risk analysis. As LJM2 expects that it primarily will be investing in assets in which Enron has an interest, it should benefit from Enron's expertise in all areas relating to the investment in and management of energy and communications assets, including the physical and financial risk management of energy assets and extensive operating capabilities in all aspects of the energy industry and certain aspects of the communications industry.

*The Ability to Evaluate Investments with Full Knowledge of the Assets.* Due to their active involvement in the investment activities of Enron, the Principals will be in an advantageous position to analyze potential investments for LJM2. The Principals, as senior financial officers of Enron, will typically be familiar with the investment opportunities LJM2 considers. The Principals believe that their access to Enron's information pertaining to potential investments will contribute to superior returns.

*Speed and Knowledge Advantage of LJM2.* LJM2 will be positioned to capitalize on Enron's need to rapidly access outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives, which should facilitate LJM2's ability to quickly execute transactions. This ability to act quickly is invaluable to Enron and should enhance the flow of opportunities for LJM2.

*Investment and Financial Expertise of Principals.* The Principals are a group of highly talented financial professionals with extensive experience originating and structuring complex transactions. This experience has given the Principals the ability to create innovative financial structures around investments, which should enhance returns to investors in LJM2. The Principals have been involved in managing JEDI I and JEDI II.

**The Principals**

The day-to-day activities of the Partnership will be managed by Messrs. Fastow, Kopper, and Glisan. Each of the Principals has spent a significant portion of his professional career in energy and communications investing, structured finance, and risk management (including substantial involvement in the organization, operation, and investment management of each of JEDI I and JEDI II), and, as a team, the Principals possess specific expertise necessary to maximize the Partnership's performance.

Andrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron, has been the Chief Financial Officer of Enron since 1997; prior to that, he was a Managing Director and principal financial officer for Enron Capital & Trade Resources Corp. ("ECT"), Enron's principal merchant and investing subsidiary. In these capacities, he has been involved in structuring and managing many of Enron's investments. Mr. Fastow has been with Enron for nine years. Michael J. Kopper, Managing Director in Enron's Global Equity Markets Group, is responsible for Enron's Global Equity and Structured Finance businesses. He has been with Enron for five years. Ben Glisan, Jr., Vice President in Enron's Global Equity Markets Group, is primarily responsible for Enron's structured finance activity. Mr. Glisan has been with Enron for three years. Summary biographies of the Principals are included elsewhere in this Memorandum. *See* – "Management of the Partnership – Biographies of the Principals."

The Principals will remain employees of Enron and will devote such of their business time and attention as they deem reasonably necessary to manage the affairs of the Partnership, subject to their obligation to devote their business time and attention primarily to the discharge of their responsibilities as senior financial officers of Enron. The Partnership should also benefit indirectly from time spent by the Principals in evaluating and structuring investments for Enron, as many of these investments may become candidates for investment by the Partnership.

## II. INVESTMENT STRATEGY

**Investment Strategy**

LJM2 believes that it will be uniquely positioned to capitalize on Enron's need for outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives and LJM2's ability to quickly execute transactions. This ability to act quickly is valuable to Enron and should result in a steady flow of opportunities for the Partnership to make investments at attractive prices. In order to fully capitalize on its advantages, LJM2 will seek to implement the following investment strategy:

> *Invest with Enron.* LJM2 expects that Enron will be LJM2's primary source of investment opportunities and that LJM2 will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment interest from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. LJM2 may, however, make investments in businesses or assets where Enron has no involvement.
>
> *Invest in Assets and Businesses Where the Seller Retains an Ongoing Economic Interest.* LJM2 will typically require that the seller (expected to be Enron in most cases) retain a significant ongoing economic or operating interest in the assets. By requiring Enron to retain a significant economic or operating interest in its deals, LJM2 should ensure that it will have access to the significant resources of Enron in order to manage assets on an ongoing basis.
>
> *Capitalize on Financial Expertise.* Once a target investment has been identified, the Principals will seek to enhance the risk/return profile of such investment through the use of innovative transaction structures and will implement rigorous risk management techniques in order to seek to protect investments from downside risk.

LJM2 will typically seek to exit transactions either by negotiating co-sale rights or by securitizing and placing investments into the capital markets. LJM2 will typically have no hold restrictions and may also individually re-market an investment to industry and financial investors.

**Rationale for Enron Providing Investment Opportunities to LJM2**

Enron has been active in making investments over the past seven years. It is notable that, as of June 30, 1999, Enron had $34 billion of assets on its balance sheet, but was owner or manager of assets in excess of $51 billion (the difference between these numbers represents the amount of assets financed off-balance sheet, often through co-investment partnerships or joint ventures). When Enron acquires an investment, it may decide to reduce its operating and financial risk by selling a portion of its investment to co-investors; in many cases, it seeks to maintain an active or controlling role in the underlying investment.

The pace of sales of investments by Enron to co-investors has increased recently for three reasons. First, Enron's investment opportunities continue to accelerate. The global energy markets in which Enron is a leading participant exceed $1 trillion per year in revenues. The natural gas and electricity industries are among the most capital-intensive industries in the world. Enron, as one of the leaders in these industries on three continents, must invest significant amounts of capital in order to retain and enhance its leadership position. Enron has also recently entered the communications business, which has significant investment opportunities as well.

Second, Enron's growth capital is derived from the sale or partial sale of investments. To capitalize on its unique growth (as evidenced by its more than $10 billion in merchant investments and its ability to invest $7 billion a year for the past two years), Enron must have significant capital resources. Although investments in the natural gas, electricity, and communications industries may have very attractive rates of return, such investments often do not generate cash flow or earnings in the first several years. Lack of cash flow may restrict a company's ability to finance the investment with debt, and lack of current earnings may restrict a company's ability to issue public equity. By bringing in co-investors or by disposing of portions of investments, Enron can finance substantial growth and make investments while maintaining its investment grade credit rating, meeting current earnings expectations, and retaining desired financial and operating involvement in its investments.

Third, in addition to the equity return earned on its investments, a significant portion of Enron's earnings is derived from fees garnered from the physical marketing of commodities, price risk management (related to those commodities), and asset development and management. Notwithstanding that the initial investment is still generating significant returns, in order to invest in new, additional fee-generating assets, Enron may sell down investments.

As a result of Enron's substantial investment opportunities and because of its need to optimize its financial flexibility, the Principals expect that Enron will continue to seek co-investors or to dispose of portions of investments. The Partnership's strategy will be to capitalize on Enron's needs by being a value-added investor for Enron through the Partnership's ability to invest quickly and its ability to structure deals that match Enron's objectives.

**Profiles of Selected Example Investments**

Described below are three transactions that Enron either has completed or is in the process of completing and that are representative of the types of investments in which LJM2 might participate:

*East Coast Power LLC – Co-Investment with Enron.* In February 1999, JEDI II (whose partners are Enron (or a subsidiary thereof) and California Public Employee Retirement System ("CalPERS")) formed East Coast Power LLC ("East Coast Power") in order to acquire assets from Cogen Technologies Group for a total of $1.5 billion. East Coast Power indirectly owns equity interests in three combined-cycle natural gas co-generation power plants in New Jersey. Each plant sells electricity to investor-owned utilities in New York or New Jersey pursuant to long-term power purchase agreements. The facilities have a combined nameplate capacity of 1,037 megawatts of electrical power production. By securitizing the power purchase agreements, Enron was able to reduce the equity capital required to finance the acquisition from 30% to 9% of total capitalization. This generated base case equity returns in excess of 20% compared to similar projects that typically generate returns in the low teens. In July 1999, JEDI II sold approximately 50% of its ownership interest in East Coast Power to a third party, generating a Gross IRR of 5048% for the portion of the investment sold. Messrs. Fastow and Kopper were involved in the structuring of this transaction.

*Project Margaux – Investment in Existing Enron Assets.* Enron is currently working on Project Margaux, a new structured finance transaction that monetizes the dividend streams of five European assets developed or acquired by Enron over the past 10 years. In this transaction, Margaux Holdings, a newly formed entity, is expected to acquire indirect equity interests in the five European assets from Enron. Project Margaux would be capitalized with approximately $525 million of high yield debt or bank debt and approximately $50 million of equity. Repayments of the high yield issuance or bank facility and a return to the equity investors will come from the distributions made by the individual projects to their equity owners.

*Enron Energy Services – Investment in an Existing Enron Business.* In 1997, Enron created a new business unit named Enron Energy Services ("EES"). Unlike Enron's existing businesses, which were selling energy products and services at the wholesale level, EES was developing a business model to sell products "around" the utility and directly to various end-users. While this market had been open previously on a limited basis, new legislation at the state levels was pending that would open much of the $300 billion market to competition. Mr. Fastow helped Enron obtain investments in EES by two pension funds totaling $165 million in exchange for 8.7% of the equity of EES. Based on these investments, the implied market value of EES at the time of the investment was $1.9 billion. Equity research analysts currently estimate the value of EES to be between $4 billion and $10 billion, which would generate an estimated Gross IRR of between 77% and 229% if the investors were to liquidate the investment at year-end 1999.

**Dual Role Advantages**

Mr. Fastow will continue to hold the titles and responsibilities of Executive Vice President and Chief Financial Officer of Enron, and Messrs. Kopper and Glisan will continue to serve as senior financial officers of Enron, while acting as the owners and managers of the General Partner. As a result, investors in the Partnership should benefit from Mr. Fastow's and the other Principals' dual roles which will facilitate the Partnership's access to Enron deal flow. The Principals' dual roles in managing the Partnership while remaining employed as senior financial officers of Enron, however, raise certain conflicts of interest that could affect the Partnership. *See* – "Conflicts of Interest."

## III. INVESTMENT HIGHLIGHTS

The Principals believe that the Partnership represents an attractive investment opportunity for the following reasons:

### Access to Significant Proprietary Deal Flow

Enron has extensive deal origination capability that is derived from approximately 2,000 fully dedicated Enron-employed origination and monitoring professionals located around the world. The deal flow emanating from this origination infrastructure has resulted in Enron making over $7 billion of energy-related investments in each of the last two years and holding merchant investments of over $10 billion.

Enron's leadership position in the markets in which it competes also creates proprietary investment opportunities for Enron. The global energy markets in which Enron is a leading participant exceed $1 trillion per year in revenues. The forces of deregulation and privatization are driving the restructuring of this enormous industry. As gas and electricity markets have opened up in the U.S. and internationally, Enron has consistently been or has become a market leader. In most deregulated markets in which it operates, Enron sells more gas and electricity than any of its competitors, including the incumbent utilities. This market leader position has led to unique and proprietary investment opportunities for Enron. Enron has recently entered the communications business, which has significant investment opportunities as well.

As a result of Enron's in-house deal sourcing capability as well as its leading market position in most businesses in which it operates, Enron frequently has access to investment opportunities that are not available to other investors. The Partnership expects to benefit from having the opportunity to invest in Enron-generated investment opportunities that would not be available otherwise to outside investors.

### Enron's Investment Record

Enron's record as a successful investor is reflected in returns it has generated for its shareholders as measured by the appreciation in its common stock, which, from January 1, 1990, through September 30, 1999, has increased 641% (price increase plus assumed re-investment of dividends), as compared to returns of 363% for the S&P 500 and 141% for the S&P Energy Index for the same period. Furthermore, Enron has successfully managed two institutionally funded private equity partnerships, JEDI I and JEDI II, which have generated (or are estimated to generate, as the case may be) Net IRRs to outside investors of 23% and 194%, respectively, compared to targeted Gross IRRs of 15% and 20%, respectively. *See* – "Summary of Investment Experience."

### Enron's Capabilities to Analyze and Structure Investments and Operate Assets

A key element of Enron's ability to create value has been its ability to structure and implement complex transactions. Over the years, Enron has developed a rigorous process of investment analysis, which employs approximately 130 professionals in varying disciplines such as engineering, research, credit, tax, legal, accounting, insurance, and risk analysis. This creative approach to structuring many of its investments has enabled Enron to mitigate downside risk, provide opportunities for early return of capital, enhance its returns, and provide additional upside opportunity. The Principals have been the key architects of many of these innovative structures and will employ such structures, where appropriate, for the benefit of investments made by LJM2. Since LJM2 expects that it primarily will be investing in assets in which Enron has an interest, it should benefit from Enron's expertise in all areas relating to the investment in and management of energy and communications assets, including the physical and financial risk management of energy assets and extensive operating capabilities in all aspects of the energy industry and certain aspects of the communications industry.

**The Ability to Evaluate Investments with Full Knowledge of the Assets**

Due to their active involvement in the investment activities of Enron, the Principals will be in an advantageous position to analyze potential investments for LJM2. The Principals, as senior financial officers of Enron, will typically be familiar with the investment opportunities the Partnership considers. The Principals believe that their access to Enron's information pertaining to potential investments will contribute to superior returns.

**Speed and Knowledge Advantage of LJM2**

LJM2 will be positioned to capitalize on Enron's need to rapidly access outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives. The Principals' positions at Enron should enable them to recognize investment opportunities early, to make decisions quickly, and to structure investments to meet LJM2's and Enron's objectives. This ability to act quickly is invaluable to Enron and should enhance the flow of opportunities for the Partnership.

**Investment and Financial Expertise of Principals**

The Principals are a group of highly talented financial professionals with extensive experience in originating and structuring complex transactions. This experience has given the Principals the ability to create innovative financial structures around investments, which should enhance returns to investors in LJM2. The Principals have been involved in managing both JEDI I and JEDI II.

## IV. SUMMARY OF INVESTMENT EXPERIENCE

The Principals have extensive experience in originating, structuring, and executing complex transactions, and each has had extensive involvement in the organization, investment activity, and operations of JEDI I and JEDI II. The Principals believe that the performance information regarding JEDI I and JEDI II presented below will be useful to investors considering an investment in LJM2 because of the Principals' involvement in JEDI I's and JEDI II's investment activity, and because the investments made by those partnerships are indicative of some of the types of investment opportunities that will be available to LJM2. Prospective investors should note that past performance is not necessarily indicative of future results, and there can be no assurance that LJM2 will achieve comparable results. Prospective investors should also note that there are material differences between LJM2 and each of JEDI I and JEDI II, including overlapping but different investment mandates (JEDI I and JEDI II target co-investment with Enron in new energy investments, but cannot purchase existing investments from Enron) and different profit-sharing arrangements among the partners, which should be considered when evaluating the investment performance information presented below.

JEDI I was formed in 1993 with $500 million of capital commitments. Enron and CalPERS each contributed $250 million to JEDI I. Enron Capital Management, L.P., an affiliate of Enron, is the general partner of JEDI I. The investment guidelines for JEDI I were to achieve a Gross IRR of 15% by investing in new investments (primarily natural gas-related) made by Enron in the debt, equity-linked, and equity securities of energy companies located in the U.S. Using a combination of contributed capital, debt financing, and reinvestment of investment proceeds, JEDI I invested $2.1 billion in 63 separate transactions. Upon a sale of its interest in JEDI I in 1997, CalPERS realized $383 million on its $250 million of contributed capital, generating a Net IRR to CalPERS of 23%.

JEDI II was formed in 1997 with $1 billion of capital commitments. Enron and CalPERS each committed $500 million to JEDI II. Enron Capital Management II Limited Partnership, an affiliate of Enron, is the general partner of JEDI II. The investment guidelines for JEDI II are to achieve a Gross IRR of 20% by investing in new investments (energy-related) made by Enron in debt, equity-linked, and equity securities of energy companies located in the U.S. and internationally. Using a combination of contributed capital, debt financing, and reinvestment of investment proceeds, JEDI II has invested $810 million in 31 separate transactions to date. As of June 30, 1999, the partners of JEDI II had made capital contributions to JEDI II of $237.5 million. The Principals estimate that, if JEDI II's unrealized investments had been liquidated for their then fair value and JEDI II had been liquidated as of June 30, 1999, the unrealized value of CalPERS' $118.8 million of contributed capital would have been $214.7 million, generating a Net IRR to CalPERS of 194%.

The estimated value of JEDI II's investments is determined in accordance with the fair value accounting methodology. Generally, an investment's "fair value" is an estimate, based on a variety of factors, of the amount that may be realized currently upon an orderly disposition of such investment; under the fair value accounting methodology, the carrying value of investments is periodically increased or decreased to reflect changes in their fair value, even where no realization event has occurred. For publicly traded securities, fair value is based upon quoted market prices; for securities that are not publicly traded, fair value is determined based on other relevant factors, including dealer price quotations, price activity for comparable instruments, and valuation pricing models. "Fair value" is only an estimate of current value for an unrealized investment. The actual realized return on all unrealized investments will depend on the value of the investments at the time of disposition, any related transaction costs, and the manner of disposition. Accordingly, the actual realized returns on all unrealized investments may differ materially for the values indicated herein.

Summary of Investment Experience[a]
($ in millions, as of June 30, 1999)

| Partnership | Year Established | Contributed Capital | Value: Realized | Value: Estimated Unrealized[b] | Value: Total | Net IRR[c] |
|---|---|---|---|---|---|---|
| JEDI I | 1993 | $250.0 | $383.0 | $0.0 | $383.0 | 23% |
| JEDI II | 1997 | 118.8 | 0.0 | 214.7 | 214.7 | 194% |

[a]This table presents investment performance information for the outside investor in each of JEDI I and JEDI II. The amounts shown under the headings "Contributed Capital," "Realized," "Estimated Unrealized," "Total," and "Net IRR" represent the performance investment for such outside investor.

[b]Unrealized values are accounted for under the fair value accounting methodology. Generally, an investment's "fair value" is an estimate, based on a variety of factors, of the amount that may be realized currently upon an orderly disposition of such investment; under the fair value accounting methodology, the carrying value of investments is periodically increased or decreased to reflect changes in their fair value, even where no realization event has occurred. For publicly traded securities, fair value is based upon quoted market prices. For securities that are not publicly traded, fair value is determined based on other relevant factors, including dealer price quotations, price activity for comparable instruments, and valuation pricing models.

[c]The fees, expenses, and carried interests of JEDI I and JEDI II are different from the proposed terms of the Partnership.

## V. MANAGEMENT OF THE PARTNERSHIP

### Overview

The General Partner of the Partnership is LJM2 Capital Partners, LLC, a Delaware limited liability company owned by one or more of the Principals. The manager of the Partnership is LJM2 Capital Management, L.P., a Delaware limited partnership ("Manager"), and as such will manage the day-to-day affairs of the Partnership. The Manager is owned, directly and indirectly, by the Principals. Each of the Principals is and will remain an employee of Enron. Enron's Office of the Chairman has waived certain provisions of Enron's employee code of conduct to permit the Principals to form and operate the Partnership, and Enron's Board of Directors has ratified that waiver as it applies to Mr. Fastow. The Principals will devote such of their business time and attention as they deem reasonably necessary to manage the affairs of the Partnership, subject to their obligation to devote their business time and attention primarily to the discharge of their responsibilities as senior financial officers of Enron. The Partnership should also benefit indirectly from time spent by the Principals in evaluating and structuring investments for Enron, as many of these investments may become candidates for investment by the Partnership. The Principals also have plans to hire additional personnel to provide support services to the Partnership. Furthermore, the Manager will enter into a support services agreement with Enron, pursuant to which the Manager will receive and pay for certain support services from Enron. *See* – "Risk Factors – Dependence on Key Personnel."

### Conflict of Interest

One of the most challenging due diligence issues for the Partnership is the potential for a conflict as a result of the Principals' dual positions as Enron employees and Principals of the Partnership. *See* – "Risk Factors – Dependence on Key Personnel" and "Conflicts of Interest – Dual Role of Principals." Several steps have been taken to assure that the conflict-of-interest issue is fully vetted and appropriate procedures are put in place to allow for operation of the Partnership in situations where conflicts arise. The Partnership will establish an Advisory Committee (as defined below) to provide for an independent review of decisions made by the General Partner in a situation where the General Partner believes a conflict of interest exists. In addition, Richard Causey, Executive Vice President and Chief Accounting Officer of Enron, will, in behalf of Enron, monitor and mediate conflict-of-interest issues between Enron and the Partnership.

### Biographies of the Principals

The following are professional biographies of the Principals. Each of the Principals has spent a significant portion of his professional career in energy and communications investing, structured finance, and risk management, and, as a team, the Principals possess the specific expertise necessary to maximize the Partnership's performance.

*Andrew S. Fastow*

Andrew S. (Andy) Fastow, 37, is Executive Vice President and Chief Financial Officer of Enron, and, as such, is responsible for Enron's finance and treasury activity. Previously, Mr. Fastow was a Managing Director with ECT. He joined ECT in 1990 to develop the company's funding business and to obtain and manage the debt and equity capital required for ECT's third-party finance business as well as for ECT's physical and financial acquisitions and investments. During 1996, Mr. Fastow led the development of Enron's retail energy business. Mr. Fastow was named CFO of Enron in 1997 and Executive Vice President of Enron in 1999.

Mr. Fastow has been responsible for the formation and operation of three private equity partnerships while at Enron. Currently, Mr. Fastow owns the general partner of LJM Cayman, L.P., a Cayman Islands excepted limited partnership ("LJM1"), an investment partnership with total capital commitments of $16 million. LJM1 was formed in 1999 with objectives that are substantially similar to those of LJM2.

Prior to joining ECT, Mr. Fastow served as senior director in Continental Bank's Asset Securitization Group in Chicago, where he structured short- and medium-term asset backed securities for commercial banks, leasing companies, and corporate clients.

Mr. Fastow received a B.A. in Economics and Chinese from Tufts University and an M.B.A. in Finance from Kellogg Graduate School of Management at Northwestern University.

*Michael J. Kopper*

Michael J. Kopper, 34, is a Managing Director in Enron's Global Equity Markets Group. He also manages the general partner of Chewco, an investment fund with approximately $400 million in capital commitments that was established in 1997 to purchase from Enron an interest in a defined pool of Enron assets. Prior to his current position, Mr. Kopper was a Managing Director in Enron Capital Management (in its Structured Finance Group) arranging financing for electric power projects, oil and gas producers, other supply-side customers, and end-users such as local distribution companies and co-generation facilities.

Before joining Enron, Mr. Kopper was employed by Toronto Dominion Bank from 1991 to 1994. There he specialized in negotiating and structuring project financings. His client focus was primarily non-regulated subsidiaries of electric utility companies, independent power producers, and natural gas pipeline companies. Mr. Kopper specialized in off-balance sheet project and structured financings relying on the interrelationship of cash flows as an economic basis for investment. These investments included natural gas pipelines, natural gas storage fields, and electric co-generation facilities.

From 1988 to 1991, Mr. Kopper was at Chemical Bank where he assisted marketing officers and transaction officers in documenting and closing a variety of financings across a broad spectrum of clients. At Chemical Bank, he focused on non-recourse facilities and project financings in the energy and utility sectors.

Mr. Kopper received his B.A. in economics from Duke University and completed his graduate work in accounting and finance at the London School of Economics.

*Ben Glisan, Jr.*

Ben Glisan, Jr., 33, is a Vice President in Enron's Global Equity Markets Group. Prior to his current position, Mr. Glisan worked at Enron Capital Management in its Structured Finance Group. Mr. Glisan has worked at Enron, or an affiliate thereof, for the past three years. Mr. Glisan's responsibilities include leading transaction teams that execute highly complex non-recourse or limited recourse joint venture and asset-based financings.

Before joining Enron, Mr. Glisan worked at Coopers & Lybrand and Arthur Andersen. His responsibilities included providing accounting and finance services principally to financial institutions as well as helping to develop financing transaction structures.

Mr. Glisan received his B.B.A. and his M.B.A. from the University of Texas at Austin.

# VI. OVERVIEW OF ENRON

Enron is one of the world's leading international integrated natural gas and electricity companies. Enron's activities are conducted through its subsidiaries and affiliates, which are principally engaged in the transportation of natural gas through pipelines to markets throughout the U.S.; the generation and transmission of electricity to markets in the northwestern U.S.; the marketing of natural gas, electricity and other commodities, and related risk management and finance services worldwide; the development, construction, and operation of power plants, pipelines, and other energy-related assets worldwide; and the delivery of high bandwidth communication applications throughout the U.S. Enron has a proven track record of creating value in markets that are deregulating and privatizing in North America, Europe, and other areas worldwide.

**Transportation and Distribution**

Enron's transportation and distribution business is comprised of its North American interstate natural gas transportation systems and its electricity transmission and distribution operations in Oregon.

*Interstate Transmission of Natural Gas.* Included in Enron's domestic interstate natural gas pipeline operations are Northern Natural Gas Company ("Northern"), Transwestern Pipeline Company ("Transwestern"), and Florida Gas Transmission Company ("Florida Gas") (indirectly 50% owned by Enron). Northern, Transwestern, and Florida Gas are interstate pipelines and are subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission. Each pipeline serves customers in a specific geographical area: Northern serves the upper Midwest, Transwestern serves principally the California market and pipeline interconnects on the east end of the Transwestern system, and Florida Gas serves the State of Florida. In addition, Enron holds an interest in Northern Border Partners, L.P., which owns a 70% interest in the Northern Border Pipeline system. One of Enron's subsidiaries operates the Northern Border Pipeline system, which transports gas from western Canada to delivery points in the midwestern United States.

*Electricity Transmission and Distribution Operations.* Enron conducts its electric utility operations through its wholly owned subsidiary, Portland General Electric Company ("Portland General"). Portland General is engaged in the generation, purchase, transmission, distribution, and sale of electricity in the State of Oregon. Portland General also sells energy to wholesale customers throughout the western U.S. Portland General's Oregon service area is approximately 3,170 square miles. At June 30, 1999, Portland General served approximately 711,000 customers.

**Wholesale Energy Operations and Services**

Enron's wholesale energy operations and services businesses operate in North America, Europe, and evolving energy markets in developing countries. These businesses provide integrated energy-related products and services to wholesale customers worldwide. Wholesale energy operations and services can be categorized into two business lines: (a) Commodity Sales and Services, and (b) Energy Assets and Investments.

*Commodity Sales and Services.* Enron's commodity sales and services operations include the purchase, sale, marketing, and delivery of natural gas, electricity, liquids, and other commodities; the restructuring of existing long-term contracts; and the management of Enron's commodity portfolios.

In addition, Enron provides risk management products and services to energy customers that hedge movements in price and location-based price differentials. Enron's risk management products and services are designed to provide stability to customers in markets impacted by commodity price volatility. Also included in this business is the management of certain operating assets that directly relate to this business, including domestic intrastate pipeline and storage facilities.

*Energy Assets and Investments.* In the energy assets and investments business, Enron manages and operates assets related to natural gas, electricity, and communications and offers financing alternatives to customers. Activities include developing, constructing, operating, and managing energy assets, including power plants and natural gas pipelines. Enron also provides capital to energy and communication customers seeking debt or equity financing.

**Retail Energy Services**

EES is a nationwide provider of energy outsource products to U.S. business customers. These services include sales of natural gas and electricity and energy management services directly to commercial and industrial customers as well as investments in related businesses. EES provides end-users with a broad range of energy products and services at competitive prices. These products and services include energy tariff and information management, demand-side services, and financial services.

**Communications**

Enron is building a long-haul fiber-optic network on strategic routes throughout the United States to create the nation's first Pure IPSM (Internet Protocol) backbone known as the Enron Intelligent Network (the "EIN"). The EIN, which is enabled with intelligent messaging software, enhances Enron's existing national fiber-optic network to bring to market a reliable, bandwidth-on-demand platform for delivering data and applications and streaming rich media to the desktop. Enron's strategy is based on a business model that offers immediate national reach while minimizing capital deployed through strategic alliances with industry technology leaders whose presence, customer access, market share, and content enable Enron to efficiently enter this new, emerging marketplace.

**Available Information**

Enron is subject to the informational requirements of the Securities and Exchange Act of 1934, as amended, and in accordance therewith files reports, proxy statements, and other information with the Securities and Exchange Commission ("SEC"). Such reports, proxy statements, and other information may be inspected and copied at the public reference facilities maintained by the SEC at 450 Fifth Street, NW, Room 1024, Washington, DC 20549, and at the following regional offices of the SEC: Midwest Regional Office, Citicorp Center, Suite 1400, 500 West Madison Street, Chicago, IL 60661-2511; and Northeast Regional Office, 7 World Trade Center, New York, NY 10048. Copies of such materials may also be obtained from the Public Reference Section of the SEC at 450 Fifth Street, NW, Room 1024, Washington, DC 20549, at prescribed rates or from the site maintained by the SEC on the World Wide Web at http://www.sec.gov. Enron's common stock is listed on the New York, Chicago, and Pacific Stock Exchanges. Reports, proxy statements, and other information concerning Enron may be inspected and copied at the respective offices of these exchanges at 20 Broad Street, New York, NY 10005; 120 South LaSalle Street, Chicago, IL 60603; and 301 Pine Street, San Francisco, CA 94014.

Certain of the information herein relating to Enron has been taken from reports filed by Enron with the SEC. The information regarding Enron herein is qualified by the other information in such reports, including information regarding forward-looking statements.

## VII. SUMMARY OF PRINCIPAL TERMS

This Summary of Principal Terms is qualified by reference to the Partnership Agreement of the Partnership and the Subscription Agreement relating thereto (collectively, the "Agreements"). This Memorandum and forms of the Agreements should be reviewed carefully.

| | |
|---|---|
| **The Partnership:** | LJM2 Co-Investment, L.P., a Delaware limited partnership (the "Partnership"). |
| **Investment Objective and Focus:** | The objective of the Partnership is to achieve significant long-term capital appreciation through privately negotiated equity and equity-related investments ("Investments") in companies principally engaged in energy- or communications-related businesses. The Partnership expects that Enron will be the Partnership's primary source of investment opportunities and that the Partnership will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. It is expected that in connection with the foregoing Investments, Enron will retain a significant economic or operating interest in the business or assets in which the Partnership invests. The Partnership may also from time to time make Investments in businesses or assets where Enron has no involvement. |
| The General Partner: | LJM2 Capital Partners, LLC, a Delaware limited liability company (the "General Partner") owned by one or more of the Principals. |
| The Manager: | LJM2 Capital Management, L.P., a Delaware limited partnership (the "Manager") owned by the Principals. |
| The Principals: | Andrew S. Fastow, Michael J. Kopper, Ben Glisan, Jr. |
| Committed Capital: | The Partnership is targeting an aggregate of $200 million in capital commitments from prospective investors ("Limited Partners"), although the General Partner reserves the right to accept capital commitments in an aggregate amount less than or greater than $200 million. The minimum capital commitment for a Limited Partner in the Partnership will be $5 million; provided that the General Partner reserves the right to reduce the minimum capital commitment for selected investors. |

**Sponsor Commitment:**

The General Partner will commit to invest, or cause the Manager or other affiliates to invest, a minimum of one percent (1%) of the Partnership's aggregate capital commitments in or alongside the Partnership (the "Sponsor Commitment"). The Sponsor Commitment may be increased (but not decreased) by up to $1 million annually.

**Management of the Partnership:**

The General Partner will manage the Partnership and will have sole discretionary authority with respect to Investments. The Manager will manage the day-to-day affairs of the Partnership in behalf of the General Partner.

**Commitment Period:**

All partners of the Partnership ("Partners") will be obligated to fund their capital commitments during the period (the "Commitment Period") commencing on the initial closing date and ending on the third anniversary of the final closing date, and thereafter, to the extent necessary, to: (i) cover expenses, liabilities, and obligations of the Partnership, including Management Fees; (ii) complete Investments by the Partnership in transactions which were in process as of (or contemplated by the terms of securities held by the Partnership prior to) the end of the Commitment Period; and (iii) effect additional Investments in companies in which the Partnership had an Investment as of the end of the Commitment Period (in an aggregate amount not to exceed 10% of the Partnership's capital commitments).

**Term:**

The Partnership will have a term of ten years from the date of the final closing of the Partnership, but may be extended at the discretion of the General Partner for up to a maximum of two additional one-year periods to facilitate an orderly liquidation of the Partnership's assets.

**Initial and Subsequent Closings:**

An initial closing of the Partnership will be held once the General Partner determines that a sufficient minimum amount of capital commitments has been obtained.

The General Partner has the right to accept additional capital commitments and to permit existing Limited Partners to increase their capital commitments to the Partnership in subsequent closings ("Subsequent Closings"). Such newly admitted Limited Partners (or Limited Partners increasing their capital commitments to the Partnership) will make contributions to the Partnership such that each Limited Partner (regardless of when such Limited Partner's capital commitment is made) will participate pro rata in all Investments and expenses of the Partnership in the manner provided below.

Subsequent Closings may occur up to 270 days after the initial closing of the Partnership. In the event that Limited Partners fund any portion of their capital commitments to the Partnership prior to the expiration of such 270-day period, each Limited Partner that makes capital commitments on closing dates subsequent to any such funding will pay (i) the amount of its capital commitment that would have been funded if such Limited Partner (and all other Limited Partners) had funded its capital commitment at the time of such funding, and (ii) interest on the amount set forth in clause (i) above from the date of each such funding at the prime rate plus 2%. Any amounts paid under clauses (i) and (ii) above shall be distributed as follows: (x) to the Manager in an amount equal to all Management Fees (as defined below) payable in respect of such Limited Partner's commitment retroactive to the initial closing date (together with any interest thereon at the prime rate plus 2% from the initial closing date), and (y) the remaining amount to the Partners that participated in prior closings ratably based on the amount and timing of their previous capital contributions to the Partnership.

**Drawdowns; Reinvestment:**

Each Partner's capital commitment will be payable when called by the General Partner to make Investments and to meet anticipated Partnership expenses and liabilities (including Management Fees). Any amounts returned to the Partners (i) as a distribution of Investment Proceeds (as defined below) prior to the second anniversary of the final closing date, (ii) in connection with the subsequent admission of additional Limited Partners (less any interest received with respect thereto), or (iii) as a return of capital contributions made in respect of an unconsummated Partnership Investment, may, in each case, be recalled and will be available for future investments.

If 25% or more of the Limited Partner commitments are from employee benefit plans or other funds subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), each Limited Partner will pay its pro rata share of each quarterly Management Fee and other Partnership expenses directly to the General Partner or the Manager, as appropriate, until the Partnership has qualified for the "venture capital operating company" exception to the Department of Labor plan asset regulations (i.e., until the Partnership has made its first qualifying investment), but for purposes of calculating when each Limited Partner has fulfilled its commitment and for purposes of calculating gains, losses, distributions, and sharing ratios, all amounts so paid, as well as any corresponding amounts payable by the General Partner to fulfill its commitment, will be treated as having been paid into the Partnership as a capital contribution by each Partner.

**Co-Investment Opportunities:** Where possible and appropriate, the General Partner intends, but will be under no obligation, to provide an opportunity to the Limited Partners to co-invest alongside the Partnership.

**Diversification:** Without the approval of a majority in interest of the Limited Partners, no more than 10% of the total capital commitments of the Partners may be invested in a single portfolio company.

**Distributions:** Distributions of the net proceeds from disposition of Investments, as well as distributions of securities in kind, together with any dividends, interest, or other investment income (other than certain short-term investment income) received with respect to Investments (collectively, "Investment Proceeds"), generally will be made in the following order of priority:

(a) first, 100% to the Partners in proportion to funded commitments until the cumulative amount distributed equals (i) the aggregate funded capital commitments of the Partners, *and* (ii) a preferred return on amounts included in clause (i) at a rate of 8% per annum, compounded annually (the "Preferred Return");

(b) second, 100% to the General Partner until such time as the General Partner has received, pursuant to this paragraph (b), 20% of the sum of the distributed Preferred Return and distributions made pursuant to this paragraph (b); and

(c) third, (i) 80% to all Partners in proportion to funded commitments, and (ii) 20% to the General Partner in respect of its carried interest.

Prior to the second anniversary of the final closing date, the General Partner will have the right to elect to distribute, hold, or re-invest Investment Proceeds (and for purposes of clause (c) of the distribution provisions above, the General Partner's funded commitment will be deemed to include 20% of the realized gains upon Investments, the Investment Proceeds from which were re-invested in accordance with this sentence). After the second anniversary of the final closing date, the General Partner will distribute (i) the net proceeds from the sale or other disposition of Investments within 180 days of receipt by the Partnership, and (ii) dividends, interest, and other short-term investment income at least annually, each subject to the availability of cash after paying Partnership expenses and setting aside appropriate reserves by the General Partner for reasonably anticipated liabilities and obligations of the Partnership.

Prior to the termination of the Partnership, distributions will be in cash or marketable securities. Upon termination of the Partnership, distributions may also include restricted securities or other assets of the Partnership.

Notwithstanding the foregoing, the General Partner may cause the Partnership to make distributions from time to time to the General Partner in amounts sufficient to permit the payment of the tax obligations of the General Partner and its members in respect of allocations of income related to the carried interest. The General Partner will endeavor to make annual aggregate distributions to the Limited Partners in an amount sufficient to permit payment of the Limited Partners' tax obligations in respect of their interests in the Partnership. Cash held by the Partnership prior to expenditure or distribution will be invested in short-term, high-grade instruments.

The amount of any taxes paid by or withheld from receipts of the Partnership allocable to a Partner from an Investment will be deemed to have been distributed to such Partner.

**Allocation of Income, Expenses, Gains, and Losses:**

Income, expenses, gains, and losses of the Partnership will generally be allocated among the Partners in a manner consistent with the distribution of proceeds described in "Distributions" above.

| | |
|---|---|
| **Management Fee:** | During the Commitment Period, the Partnership will pay the Manager an annual management fee (the "Management Fee"), payable semi-annually in advance, equal to 2.0% of the aggregate commitments of Limited Partners. After the expiration of the Commitment Period, the Management Fee will equal 2.0% of an amount ("Capital Under Management") equal to the lesser of (i) the aggregate commitments of the Limited Partners and (ii) the aggregate amount invested by the Partnership in Investments. Capital Under Management will be calculated as of the beginning of each semi-annual period to which the Management Fee applies. |
| **Operating Expenses:** | The Manager will pay all ordinary operating expenses of the Partnership for salaries, rent, and similar expenses in connection with the investigation of investment and disposition opportunities for the Partnership and monitoring of the Partnership's Investments (to the extent not reimbursed by a portfolio company), except as set forth below under "Partnership Expenses." |
| **Partnership Expenses:** | The Partnership will pay or reimburse the General Partner, the Manager, and their respective affiliates for: (i) out-of-pocket expenses of the General Partner and Manager (including third-party fees and expenses) incurred in connection with unconsummated Investments; (ii) out-of-pocket expenses, including, but not limited to, all expenses incurred in connection with the origination, making, holding, monitoring, sale, or proposed sale of Investments (not otherwise paid in connection with the closing of the proposed origination or disposition), litigation or other extraordinary expenses, insurance, and indemnity expenses and expenses of liquidating the Partnership; and (iii) any other direct expenses incurred in connection with the Investments. The Partnership will also be responsible for all routine administrative expenses of the Partnership, including, but not limited to, the cost of the preparation of the annual audit, financial statements, and tax returns, expenses of the Advisory Committee, cash management expenses, and legal expenses. |
| **Offering and Organizational Expenses:** | The Partnership will bear all legal, accounting, and other offering and organizational expenses, including out-of-pocket expenses of the General Partner or the Manager incurred in connection with the formation of the Partnership. The Manager will bear the cost of placement |

agent fees charged in connection with the formation of the Partnership.

**Transaction, Break-up, and Advisory Fees:** The General Partner and the Manager will not charge any transaction fees, break-up fees, advisory, monitoring, or similar fees in connection with actual or prospective Investments.

**Other Investment Activities:** Without the approval of a majority in interest of Limited Partners, none of the General Partner, the Manager, and the Principals will commence investment activities for a Competing Fund (as defined below) in which such entity or person acts as sponsor or general partner until the earlier of (i) the termination of the Commitment Period or (ii) the date on which at least 70% of the total aggregate capital commitments of the Partnership have been taken down or committed. However, there will be no restrictions on the activities of the Principals in their capacities as employees of Enron, and these restrictions will not bind or otherwise obligate Enron. A "Competing Fund" means a pooled equity investment vehicle other than the Existing Funds (as defined below), the Partnership, and any Parallel Investment Vehicle (as defined below) which has investment objectives and strategies that are substantially similar to those of the Partnership and does not include any pooled equity investment vehicle managed, sponsored, or controlled by Enron or its subsidiaries or affiliates or any Parallel Investment Vehicle.

**Allocation of Investment Opportunities:** The Principals currently are involved in the management of investment limited partnerships, including LJM1 and Chewco (the "Existing Funds"), that have investment objectives and strategies that are substantially similar to those of the Partnership. The General Partner expects that to the extent that both the Partnership and the Existing Funds would have capital available for investment in an opportunity, the Principals would cause the investment opportunity to be allocated to the Partnership and the Existing Funds in a manner determined to be fair and reasonable to both (taking into account the amount of available capital for each Partnership) consistent with prudent portfolio management and fiduciary concerns. Neither Enron nor any Existing Fund in which Enron has an interest has any obligation to offer investment opportunities to the Partnership, and the ability of Enron or any such Existing Fund to offer certain investments may be restricted by contractual obligations to third parties.

**Advisory Committee:**

An Advisory Committee, whose members will be selected representatives of the Limited Partners, will be established. The Advisory Committee will advise the General Partner and resolve issues involving conflicts of interest presented by the General Partner.

**Parallel Investment Vehicles:**

The General Partner may establish one or more additional entities or other similar arrangements (a "Parallel Investment Vehicle") prior to the expiration of the 270-day period following the initial closing to facilitate the ability of certain types of investors to invest in parallel with the Partnership. If formed, any Parallel Investment Vehicle will invest in each Investment on a pro rata basis (based on available capital) and on substantially the same terms and conditions as the Partnership.

**Alternative Investment Structure:**

If the General Partner determines in good faith that for legal, tax, regulatory, or other reasons it is in the best interests of the Partners that an Investment be made through an alternative investment structure, the General Partner may structure the making of all or any portion of such Investment outside of the Partnership by requiring the Partners to make such Investment through a limited partnership or other entity (other than the Partnership) that will invest on a parallel basis with or in lieu of the Partnership, as the case may be.

**Exculpation and Indemnification:**

None of the Principals, the General Partner, the Manager, their respective affiliates, and each of their respective officers, directors, members, managers, partners, employees, agents, and representatives (each, an "Indemnified Person") will be liable to the Partnership or to any Limited Partner for any act or omission by such Indemnified Person in connection with the conduct of the business of the Partnership, unless such act or omission constitutes such Indemnified Person's bad faith, gross negligence, or willful misconduct. The Partnership will indemnify each Indemnified Person from and against any losses, claims, liabilities, damages, and expenses (including legal fees and expenses, judgments, and amounts paid in settlement) incurred by such Indemnified Person in connection with the Partnership's activities, unless such losses, claims, liabilities, damages, or expenses result from such Indemnified Person's bad faith, gross negligence, or willful misconduct. The General Partner may require the Partners to return distributions made to each such Partner for the purpose of meeting such

Partner's pro rata share of the Partnership's indemnification obligations referred to above or to satisfy any other Partnership obligations (subject to certain limitations).

**Limited Partner Withdrawal and Transfer:**

Limited Partners generally may not withdraw from the Partnership. In addition, no Limited Partner may transfer or assign any of its interests, rights, or obligations with respect to its interest, except with the written consent of the General Partner, which written consent may be given or withheld in the General Partner's sole and absolute discretion. No such assignee, purchaser, or transferee of an interest may be admitted as a substitute Limited Partner without the written consent of the General Partner, which written consent may be given or withheld in its sole and absolute discretion. The General Partner may require a Limited Partner to withdraw from the Partnership under certain limited circumstances. Subject to certain conditions, the General Partner may (or may be required to) permit a Limited Partner to withdraw from the Partnership under certain limited circumstances.

**ERISA Considerations:**

The General Partner intends to cause the Partnership to qualify as a "venture capital operating company" under the Department of Labor plan asset regulations.

**Tax Considerations:**

An investment in the Partnership will have particular consequences for certain kinds of investors under the U.S. Federal income tax laws. The Partnership may engage in transactions that will cause tax-exempt Limited Partners to recognize "unrelated business taxable income" ("UBTI") within the meaning of Section 512 of the Internal Revenue Code of 1986, as amended (the "Code"), as a result of their investment in the Partnership, and the Partnership may engage in transactions that will cause foreign Limited Partners to recognize income treated as effectively connected with the conduct of a trade or business within the United States within the meaning of Section 864 of the Code as a result of their investment in the Partnership. Prospective investors should consult with their own tax advisors as to the consequences of making an investment in the Partnership. The General Partner intends to work with prospective investors to address their individual tax concerns.

**Reporting:**

The General Partner will send the Limited Partners within 120 days after the end of each fiscal year of the Partnership (or as soon thereafter as practicable in the event of delays in receiving information from portfolio companies) an audited annual financial report and tax information necessary for completion of each Limited Partner's U.S. Federal income tax return. The Partnership will also send its Limited Partners unaudited financial statements and other information within 60 days after the end of each quarter.

| | |
|---|---|
| **Auditors:** | PricewaterhouseCoopers. |
| **Legal Counsel:** | Kirkland & Ellis. |
| **Placement Agent:** | Merrill Lynch & Co. |

## VIII. RISK FACTORS

Potential investors should be aware that an investment in the Partnership involves a high degree of risk. There can be no assurance that the Partnership's investment objectives will be achieved or that a Limited Partner will receive a return of its capital. The following considerations, among others, should be evaluated carefully before making an investment in the Partnership.

### Dependence on Access to Enron Investment Opportunities

The Partnership's investment strategy is dependent upon the Partnership's access to investment opportunities from Enron. The Principals expect that Enron will continue for the foreseeable future to generate sufficient attractive investment opportunities to enable the Partnership to execute its investment strategy. Enron has no obligation to present investment opportunities to the Partnership, and no assurances can be given that Enron will continue to generate suitable investment opportunities or make such investment opportunities available to the Partnership. Changes in law, regulation, accounting principles, credit, capital or commodities markets, general or sector-specific economic conditions, or other changes may cause Enron to cease, or slow the rate of, its investment activities or to decrease its reliance on capital provided by co-investors or purchasers of investments from Enron. Enron may determine not to make investment opportunities available to the Partnership for any reason, including that the Principals, or certain of them, have ceased to be employees of Enron. The Principals may not be involved in all investments that Enron makes, and their involvement in some of Enron's investments may be limited. Enron will have no obligation to offer investment opportunities to the Partnership, and the ability of Enron to make investments available to the Partnership may be restricted by contractual obligations to third parties.

### Highly Competitive Market for External Investment Opportunities

The activity of identifying, completing, and realizing private equity investments is highly competitive and involves a high degree of uncertainty. Although the Partnership expects to invest principally in companies and assets owned or controlled by Enron, the Partnership also may seek to invest in other external investment opportunities. In these situations, the Partnership will be competing with other private equity investment vehicles, as well as individuals, financial institutions, and other institutional investors.

### Dependence on Key Personnel

The Limited Partners will be relying entirely upon the General Partner and the Manager to conduct and manage the affairs of the Partnership. The General Partner and the Manager depend upon the efforts and expertise of the Principals to enable them to render investment management services to the Partnership. The Principals are obligated to dedicate their business time and attention primarily to the discharge of their responsibilities as management employees of Enron. In addition, the Principals also dedicate a portion of their business time and attention to managing existing investment limited partnerships. Subject to the demands of these other responsibilities, the Principals will devote as much of their business time and attention as they deem to be reasonably necessary to manage the affairs of the Partnership. There can be no assurance that the Principals will continue to be employed by Enron throughout the life of the Partnership. As noted above, if the Partnership were to lose the services of the Principals, the Partnership could be adversely affected.

Limited Operating History

The Partnership, the General Partner, and the Manager will be newly formed entities, and none of the Partnership, the General Partner, and the Manager has an operating history of making private equity investments upon which prospective investors may base an evaluation of the likely performance of the Partnership.

Limited Sector Focus

The Partnership intends to concentrate on investments in energy- and communications-related businesses, and will be less diversified for industry risk than other, more broadly focused investment vehicles. As a result of the Partnership's sector focus, the effect on the Partnership of industry or general economic factors that have a greater impact upon the energy or communications sector than other industry sectors may be more pronounced than in more broadly focused investment vehicles.

Non-Control Investments

The Partnership expects to make Investments in portfolio companies over which Enron will acquire or retain ownership or control. The Partnership may not have the power, acting alone, to control a portfolio company's board of directors, management, or operations. In addition, the Partnership may not have the ability, acting alone, to cause a portfolio company to take, or refrain from taking, certain actions, or to cause a portfolio company to engage, or refrain from engaging, in material transactions, which conceivably could have an adverse effect on the Partnership's Investment, and the Partnership may not have the ability, acting alone, to control the timing of the liquidation of its Investment. In such Investments, the Partnership may be forced to rely on the fact that Enron will possess some or all of the foregoing control rights and that the interests of the Partnership and Enron will be sufficiently aligned such that Enron will exercise those rights in a manner that will protect the Partnership's Investment. Enron will have no obligation to align its interests with those of the Partnership.

Illiquid and Long-Term Investments

Although Investments may generate some current income, the return of capital and the realization of gains, if any, from an Investment generally will occur only upon the partial or complete disposition of such Investment. While an Investment may be sold at any time, frequently this will not occur for a number of years after the Investment is made. As noted above, in certain cases, the Partnership may be dependent upon Enron to create liquidity through a sale of, or other "exit" transaction involving, the portfolio company in which the Partnership holds an Investment. It is unlikely that there will be a public market for the securities held by the Partnership at the time of their acquisition. The Partnership generally will not be able to sell its securities publicly unless such sale is registered under applicable securities laws or unless an exemption from such registration requirements is available. In addition, in some cases, the Partnership may be prohibited by contract from selling certain securities for a period of time.

### Non-U.S. Investments

The Partnership may invest in portfolio companies organized and operating outside of the U.S. Foreign securities involve certain risks not typically associated with investing in U.S. securities, including risks relating to: (i) currency exchange matters and costs associated with conversion of investment capital and income from one currency into another; (ii) differences between the U.S. and foreign securities markets, including potential price volatility in and relative illiquidity of some foreign securities markets and the absence of uniform accounting and financial reporting standards and disclosure requirements; (iii) certain economic and political risks, including potential restrictions on foreign investment and repatriation of capital and the risks of political, economic, or social instability; and (iv) the possible imposition of foreign taxes on income and gains recognized with respect to such securities.

### Passive Investment in Interests

Limited Partners will be relying entirely on the General Partner and the Manager to conduct and manage the affairs of the Partnership. The Agreement will not permit the Limited Partners to engage in the active management and affairs of the Partnership. Because specific Investments of the Partnership have not yet been identified, the Limited Partners must rely on the ability of the General Partner to make appropriate Investments for the Partnership and to dispose of such Investments and of the Manager to manage such Investments.

### No Market for Partnership Interests

The Interests have not been registered under the Securities Act, the securities laws of any state, or the securities laws of any other jurisdiction and, therefore, cannot be resold unless they are subsequently registered under the Securities Act and other applicable securities laws or exemptions from registration are available. It is not contemplated that registration of the Interests under the Securities Act or other securities laws will ever be effected. There is no public market for the Interests, and one is not expected to develop. A Limited Partner will not be permitted to assign its Interests, except by operation of law, without the prior written consent of the General Partner, which may be given or withheld in the General Partner's sole and absolute discretion. Except in extremely limited circumstances, voluntary withdrawals from the Partnership will not be permitted. Limited Partners must be prepared to bear the risks of owning Interests for an extended period of time.

### Tax-Exempt Investors

The Partnership may engage in transactions that would generate UBTI. *See* – "Summary of Principal Terms – Tax Considerations" and "Certain Tax and Regulatory Considerations – Federal Income Tax Matters – *General.*"

### Foreign Investors

The Partnership may engage in transactions that will cause foreign Limited Partners to recognize income effectively connected with the conduct of a trade or business within the U.S. *See* – "Summary of Principal Terms – Tax Considerations" and "Certain Tax and Regulatory

Considerations - Federal Income Tax Matters - *Certain U.S. Tax Considerations for Foreign Investors.*"

# IX. CONFLICTS OF INTEREST

Investors should be aware that there will be occasions where the General Partner and its affiliates may encounter potential conflicts of interest in connection with the Partnership's activities. The following discussion enumerates certain potential conflicts of interest which should be carefully evaluated before making an investment in the Partnership.

**Dual Role of Principals**

The Principals are employees of Enron and owe fiduciary duties to Enron and its subsidiaries; such fiduciary duties may from time to time conflict with fiduciary duties owed to the Partnership and its partners. Accordingly, the Principals, and entities controlled by the Principals, may take (or refrain from taking) such actions in behalf of the Partnership as the Principals in good faith determine to be necessary or appropriate in view of such conflicting duties. The Principals intend to consult regularly with the Advisory Committee regarding potential conflicts of interest regarding transactions with or involving Enron and its affiliates.

**Transactions Involving Enron**

To execute the Partnership's investment strategy (to capture investment opportunities generated by Enron), the Partnership will regularly evaluate, structure, negotiate, consummate, hold, manage, and liquidate Investments in companies in which Enron or its affiliates have an existing investment or which Enron or its affiliates control (including investments acquired directly from Enron or its affiliates). The evaluation (and valuation) of Investment opportunities and the negotiation of the price, terms, and conditions of an Investment will be conducted in behalf of the Partnership by the Principals acting in behalf of the General Partner.

Portfolio companies in which the Partnership invests may also engage in transactions with Enron or its affiliates, and profits derived by Enron or its affiliates from such transactions will not be shared with the Partnership.

In many cases, the Partnership will have a non-control Investment in a portfolio company controlled by Enron or its affiliates. The Partnership may invest in securities that are different from those held by Enron or may hold securities with a cost basis different from those held by Enron. Factors that influence Enron's or its affiliates' decision to exercise their rights in respect of their investment in such company (such as a decision to sell the company) may be more or less significant from the Partnership's perspective.

**Carried Interest**

The existence of the General Partner's carried interest could be viewed as an incentive for the General Partner to make riskier or more speculative investments in behalf of the Partnership than would be the case in the absence of this arrangement.

**Diverse Limited Partner Group**

The Limited Partners may have conflicting investment, tax, and other interests with respect to their investments in the Partnership. The conflicting interests of individual Limited Partners may relate to or arise from, among other things, the nature of Investments made by the Partnership, the structuring or the acquisition of Investments, and the timing of disposition of Investments. As a consequence, conflicts of interest may arise in connection with decisions made by the General Partner, including with respect to the nature or structuring of Investments, that may be more beneficial for one investor than for another investor, especially with respect to investors' individual tax situations. In selecting and structuring investments appropriate for the Partnership, the General Partner will consider the investment and tax objectives of the Partnership and its Partners as a whole, not the investment, tax, or other objectives of any Limited Partner of the Partnership individually.

## X. CERTAIN TAX AND REGULATORY CONSIDERATIONS

**Federal Income Tax Matters**

*General*

The following discussion summarizes certain U.S. Federal income tax considerations generally applicable to a person considering the acquisition of an Interest. The discussion does not deal with all tax considerations that may be relevant to specific investors or classes of investors in light of their particular circumstances. In particular, the discussion does not address any considerations applicable to persons who acquire Interests in connection with the performance of services. Furthermore, no state, local, or foreign tax considerations are addressed. ALL PERSONS CONSIDERING AN INVESTMENT IN THE PARTNERSHIP ARE URGED TO CONSULT WITH THEIR OWN TAX ADVISORS AS TO THE SPECIFIC U.S. FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES TO THEM OF SUCH INVESTMENT.

The Partnership will receive an opinion from Kirkland & Ellis, counsel for the Partnership, that the Partnership will be classified for federal income tax purposes as a partnership rather than as an association taxable as a corporation under currently applicable tax laws. Opinions of counsel, however, are not binding on the Internal Revenue Service ("IRS") or the courts, and no ruling has been or will be requested from the IRS. No assurance can be given that the IRS will concur with such opinion or the tax consequences set forth below.

The Partnership will not pay federal income taxes, but each Partner will be required to report its distributive share (whether or not distributed) of the income, gains, losses, deductions, and credits of the Partnership (which may include the income and other tax items of any partnerships in which the Partnership invests). It is possible that the Partners could incur income tax liabilities without receiving from the Partnership sufficient distributions to defray such tax liabilities. For example, the Partners will be allocated Partnership income and gains for U.S. Federal income tax purposes even if funds from such Partnership income and gains are used by the Partnership to make Investments or to pay Partnership expenses and liabilities and are not distributed to such Partners (or are distributed but are then recalled by the Partnership for future Investments). The Partnership Agreement will provide that the General Partner may elect to re-invest rather than distribute (or distribute and recall for investment) Investment Proceeds prior to the second anniversary of the Partnership's final closing date. The Partnership's taxable year will be the calendar year, or such other year as required by the Code. Tax information will be distributed to each Partner annually.

The following discussion summarizes certain significant U.S. Federal income tax consequences to a prospective investor who (i) owns, directly or indirectly through another partnership, an Interest as a Limited Partner, (ii) is, with respect to the U.S., a citizen or resident individual, a domestic corporation or partnership, an estate the income of which is subject to U.S. Federal income taxation regardless of its source, or a trust for which a court in the U.S. is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions, as such terms are defined for U.S. Federal income tax purposes (a "U.S. Investor"), and (iii) is not tax-exempt.

Interest on any amount borrowed by a Limited Partner (other than a corporation) to purchase an Interest in the Partnership will generally be "investment interest," subject to a limitation on deductibility. In general, investment interest will be deductible only to the extent of the taxpayer's "net investment income." For this purpose "net investment income" will generally include net income from the Partnership and other income from property held for investment (other than property which generates passive activity income). However, long-term capital gain is excluded from the definition of net investment income unless the taxpayer makes a special election to treat such gain as ordinary income rather than long-term capital gain. Interest that is not deductible in the year incurred because of the investment interest limitation may be carried forward and deducted in a future year in which there is sufficient investment income.

The Agreement will contain provisions intended to comply substantially with IRS regulations describing partnership allocations that will be treated as having "substantial economic effect," and hence, the Partnership's allocation will be respected for tax purposes. However, those regulations are extremely complex, and there can be no assurance that the allocations of income, deduction, loss, and gain for tax purposes made pursuant to the Partnership Agreement will be respected by the IRS, if reviewed. Even if the IRS were to review the Partnership allocations and determine that they do not technically comply with such regulations, such allocations would be determined "in accordance with each partner's interest in the partnership (determined by taking into account all facts and circumstances)." The allocations under the Partnership Agreement should, in most cases, be substantially identical to each "partner's interest in the partnership."

Under Section 67 of the Code, a non-corporate taxpayer (including a shareholder of an S corporation) may deduct certain miscellaneous deductions (e.g., investment advisory fees, tax preparation fees, unreimbursed employee expenses, and subscriptions to professional journals) only to the extent such deductions exceed, in the aggregate, 2% of the taxpayer's adjusted gross income. Each Limited Partner's share of the Management Fee and other Partnership expenses probably will be treated as miscellaneous itemized deductions. Accordingly, a Limited Partner who is an individual generally will be permitted to deduct such expenses only to the extent that the sum of such expenses plus the individual's other miscellaneous itemized deductions exceed 2% of the individual's adjusted gross income. However, corporate Limited Partners (other than S corporations) and tax-exempt organizations are not affected by the 2% floor (unless, in the case of a tax-exempt organization, it is not a corporation and has unrelated business taxable income from the Partnership). Section 68 of the Code separately imposes limitations on the deductibility of itemized deductions by an individual whose adjusted gross income exceeds a specified amount (e.g., $126,600 for unmarried individuals, or married individuals filing jointly, for 1999, adjusted annually for inflation), which may also affect the ability of any Partner who is an individual to deduct his or her share of the Management Fee and other Partnership expenses. A Limited Partner who is an individual also generally will not be permitted to deduct his or her share of the Management Fee and other Partnership expenses for purposes of calculating such individual's alternative minimum tax liability.

Non-corporate investors (and certain closely held, personal service, and S corporations) are subject to the limitations on using losses from passive business activities to offset business income, salary income, and portfolio income (i.e., interest, dividends, capital gains from portfolio investments, royalties, etc.). The Partnership's distributive share of income or losses from a portfolio company which is a partnership or limited liability company engaged in business generally will be treated as passive activity income or losses. Accordingly, an investor will be subject to the passive activity loss limitations on the use of any such portfolio company losses, but any such portfolio company income may be offset by other passive losses (such as losses from limited partnership interests in tax shelters). Other partnership income generally will be treated as portfolio income. Therefore, an investor generally will not be able to use passive activity losses to offset such portfolio income from the Partnership.

Except as described in the following paragraph, a tax-exempt Limited Partner's distributive share of the Partnership's income should consist principally of income from dividends, interest, and capital gain from corporate stock and corporate securities – types of income which (subject to the discussion of debt-financing below) are expressly excluded UBTI.

However, the Partnership may invest in securities (including equity interests in partnerships and limited liability companies) that will generate UBTI ("UBTI Investments"). Each tax-exempt Limited Partner generally would be subject to U.S. Federal income tax on its share of any UBTI earned by the Partnership (and the receipt of UBTI could give rise to additional tax liability for certain limited categories of tax-exempt investors).

If a tax-exempt Limited Partner borrows any amount to fund its capital commitment, some or all of its distributive share of income from the Partnership could be UBTI, which could be taxable to such tax-exempt Limited Partner (and which could give rise to additional tax liability for certain limited categories of tax-exempt Limited Partners). Moreover, debt incurred either by the Partnership directly or in connection with a UBTI Investment could give rise to UBTI to a tax-exempt Limited Partner.

*Certain U.S. Tax Considerations for Foreign Investors*

Limited Partners that are not U.S. Investors and are not tax-exempt ("Foreign Investors") generally should not be subject to U.S. Federal income tax on gains from the sale of Investments. Notwithstanding the foregoing, a Foreign Investor's share of the net gain recognized upon disposition by the Partnership of a United States real property interest would be treated for Federal income tax purposes as if it were effectively connected with a U.S. trade or business. In general, the Partnership would be required to withhold tax from allocations to Foreign Investors of such net gain and each Foreign Investor would be required to report its share of such gain on a U.S. Federal income tax return. For this purpose, the term "United States real property interest" generally would include: (i) shares of stock in a U.S. corporation that does not have a publicly traded class of stock outstanding if 50% or more of the value of the corporation's assets at any point during the preceding five years consisted of interests in U.S. real property, and (ii) shares of stock in a U.S. corporation that does have a publicly traded class of stock outstanding where (A) the corporation satisfies the real property ownership test described in clause (i) above, and (B) the Partnership held (directly or pursuant to certain attribution rules) more than 5% of the outstanding stock of any publicly traded class of shares or held shares of non-publicly traded stock with a fair market value greater than that of 5% of the publicly traded class of the corporation's stock with the lowest fair market value. In addition, if the Partnership invests in partnerships or other persons that generate income that is treated as effectively connected with a U.S. trade or business (including gain recognized upon disposition of an United States real property interest), Limited Partners will be subject to U.S. Federal income tax, including withholding tax (and possibly the branch profits tax), on their share of such income and on their share of gain realized on the Partnership's disposition of its interest in such other partnership's (or other person's) assets attributable to such U.S. trade or business, and they will be required to file appropriate returns. Dividends paid by portfolio companies generally will, and interest paid by portfolio companies and capital gains upon realization of certain Investments may, in certain circumstances, be subject to withholding taxes, including U.S. withholding taxes, but such taxes may be reduced or eliminated by treaty.

THIS MEMORANDUM DOES NOT ADDRESS ALL UNITED STATES FEDERAL TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP THAT MAY APPLY TO AN INVESTOR, AND IT DOES NOT ADDRESS ANY STATE, LOCAL, OR FOREIGN TAX CONSEQUENCES OF SUCH AN INVESTMENT. IN ADDITION, THE ABOVE DISCUSSION IS BASED ON CURRENT PROVISIONS OF THE CODE, TREASURY REGULATIONS, ADMINISTRATIVE RULINGS, AND JUDICIAL DECISIONS, AND NO ASSURANCE CAN BE GIVEN THAT FUTURE LEGISLATIVE, JUDICIAL, OR ADMINISTRATIVE ACTION WILL NOT AFFECT THE ACCURACY OF ANY STATEMENT IN THIS DISCUSSION, POSSIBLY WITH RETROACTIVE EFFECT. THE TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP MAY VARY DEPENDING ON AN INVESTOR'S PARTICULAR CIRCUMSTANCES. FOR THE FOREGOING REASONS, EACH PROSPECTIVE INVESTOR IS ADVISED TO CONSULT ITS OWN TAX COUNSEL AS TO THE FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP.

**Certain ERISA Considerations**

The U.S. Department of Labor ("DOL") has issued regulations under ERISA, which generally provide that when an employee benefit plan invests in an entity such as the Partnership, the plan's assets include both the limited partnership interest and an undivided interest in each of the underlying assets of the Partnership, unless (i) the equity participation in the Partnership by benefit plan investors is not "significant" (defined as 25% of any class of the Partnership equity interests), (ii) the Partnership complies with the "venture capital operating company" ("VCOC") exception, or (iii) the Partnership qualifies for another exception under the DOL plan asset regulations. If the underlying assets of the Partnership were to be considered plan assets of the ERISA plan investor, the General Partner of the Partnership would be an ERISA fiduciary and the Partnership would be subject to undesirable ERISA requirements with which the Partnership generally cannot comply.

The Partnership will not limit investment by benefit plan investors, and it is therefore possible that investment by benefit investors will be "significant." However, the Partnership has been designed and is intended to be managed to comply with the VCOC exception. If it qualifies for the VCOC exception, the Partnership will not be subject to the ERISA fiduciary rules and the underlying assets of the Partnership will not be deemed "plan assets" of any ERISA plan investor. The Partnership will qualify if it (i) has direct contractual rights to substantially participate in or substantially influence the management of operating companies comprising at least 50% of its portfolio (measured by cost), and (ii) in the ordinary course of its business, actively exercises such management rights with respect to at least one of the operating companies in which it invests. An "operating company" is an entity engaged in the production or sale of a product or service, as distinguished from a re-investing entity.

The determination as to whether the fund qualifies as a VCOC is made when the Partnership makes its first long-term investment and thereafter on an ongoing basis. The Partnership must meet the 50% test at the time it makes its first long-term investment and on at least one day during each 90-day annual valuation period (generally beginning on the anniversary of the Partnership's first long-term investment) thereafter. The Partnership also would cease to qualify if it did not in the ordinary course of its business actually exercise its management rights with respect to at least one portfolio company each year. Special rules will apply to any wind-up of the Partnership when it enters into it "distribution period" as defined in the DOL regulations.

Prospective Limited Partners who are subject to the provisions of ERISA (such as pension funds or certain insurance company accounts) should consult with their counsel and advisors as to the provisions of ERISA applicable to an investment in the Partnership.

**Certain Regulatory Matters**

*Investment Company Act of 1940, as amended (the "1940 Act")*

The Partnership has not registered and does not plan to register under the 1940 Act in reliance on the exception provided in Section 3(c)(7) of the 1940 Act. As a condition to its admittance to the Partnership, each prospective Limited Partner will be required to represent to the Partnership and its General Partner that such prospective Limited Partner is a "qualified purchaser" within the meaning of Sections 2(a)(51) and 3(c)(7) of the 1940 Act and the regulations promulgated thereunder.

*Securities Act*

The offer and sale of the Interests will not be registered under the Securities Act in reliance upon the exemption from registration provided by Section 4(2) thereof and Regulation D promulgated thereunder. Each purchaser must be an "accredited investor" (as defined in Regulation D under the Securities Act) and will be required to represent, among other customary private placement representations, that it is acquiring its Interest in the Partnership for its own account for investment purposes only and not with a view to resale or distribution.

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ENRON CORP.

Short-Form Questionnaire for
Executive Officers, Directors and Nominees for Director

Information Furnished by

ANDREW S. FASTOW
for 2000 Proxy Statement and
Annual Report on Form 10-K
for the Fiscal Year
Ended December 31, 1999

This questionnaire is being sent to the executive officers, directors and nominees for director of Enron Corp. (the "Company"). *Please answer all questions using the entry "None" or "N/A" (to indicate not applicable) where appropriate. Reference is made to Appendix A for definitions of terms marked with an asterisk.*

(a) **Holdings of Equity Securities of the Company and its Subsidiaries.**

(i) State the total amount of each class of equity securities of the Company and its subsidiaries, other than directors' qualifying shares, deemed to be beneficially owned by you as of the close of business on February 15, 2000, because you or a family member who shares your household has voting or investment power* over such securities.

In computing this total, you should include not only the securities which you own of record including shares held by the transfer agent in a dividend reinvestment account, but also all other securities of which you may be deemed to be the beneficial owner by virtue of the Rule 13d-3 definition of "beneficial ownership" set forth in the Appendix, including but not limited to, shares held in broker accounts, IRA's, trusts, partnerships, corporations and private foundations (*which may not be included on your Form 4 direct and indirect holdings because you have no pecuniary interest* in such securities*), as well as shares which you have a right to acquire from conversions or exercise of publicly traded options. DO NOT include unvested restricted shares or shares that may be acquired by you pursuant to outstanding stock options under a stock plan of the Company or its subsidiaries or shares held for your account in the Company's Savings Plan and the Employee Stock Ownership Plan. These numbers will be obtained from Company records. In the event that you may be required, by virtue of such definition, to include in your response certain securities which you do not consider to be beneficially owned by you for Section 16 purposes because you have no pecuniary interest* in such securities, you are free to state that your response shall not be construed as an admission that you are, for purposes of Section 16 of the Securities Exchange Act of 1934, the beneficial owner of such securities.

* See Appendix A for definition

EnronCorpShortQuest2000names

If you have shared voting power* or shared investment power*, indicate separately the number of shares or units with respect to which (i) voting power is shared or (ii) investment power is shared. Briefly describe any contract, arrangement, understanding or other basis on which such powers are shared. Disregard shared voting or investment power created under joint tenancy or marital property laws as between you and your spouse, if any.

The classes of equity securities for the Company and its subsidiaries* which are included in the table below are as follows:

Enron Corp. Common Stock ("ENE Common")
Enron Corp. Cumulative Second Preferred Convertible Stock ("ENE/PJ")
Enron Capital LLC 8% Cumulative Guaranteed Monthly Income Preferred Shares ("ENE/PC")
Enron Capital Resources, L.P. 9% Cumulative Preferred Securities, Series A ("ENE/PA")
Enron Capital Trust I 8.30% Trust Originated Preferred Securities ("ENE/TOPrS I")
Enron Capital Trust II 8 1/8 % Trust Originated Preferred Securities ("ENE/TOPrS II")
Northern Border Partners, L.P. Common Units ("NBP Units")
EOTT Energy Partners, L.P. Common Units ("EOT Units")
Transportadora de Gas del Sur S.A. American Depositary Shares ("TGS ADS")
Portland General Electric Company 7.75% Preferred Shares ("PGE Preferred")
Azurix Corp. Common Stock ("AZX Common")

My beneficial ownership, as of February 15, 2000, in each class of equity of the Company and its subsidiaries*, other than directors' qualifying shares, is as follows:

Answer:

| | *No. of shares for which I have* | | | |
|---|---|---|---|---|
| Title of Class | Sole Voting and Investment Power | Shared Voting and Investment Power | Other Voting and Investment Power | Description of Other |
| ENE Common | 57,780 | | | |
| ENE/PJ | | | | |
| ENE/PC | | | | |
| ENE/PA | | | | |
| ENE/TOPrS I | | | | |
| ENE/TOPrS II | | | | |
| EOG Common | | | | |



* See Appendix A for definition

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| | | | | |
|---|---|---|---|---|
| NBP Units | | | | |
| TGS ADS | | | | |
| PGE Preferred | | | | |
| AZX Common | | | | |

(ii) With respect to any shares or units included in the table above which I have the right to acquire on or before April 16, 2000, from conversions or exercises of options or warrants, etc. EXCLUDING options issued pursuant to Company or subsidiary stock plans, I have provided the number of any such shares or units and have identified the Class as follows:

Answer: None

(b) *Voting Arrangements.* Describe any arrangement or agreement you have with the Company or any subsidiary*, director, officer or shareholder thereof, to vote the shares or units owned by you or such director, officer or shareholder.

Answer: None

(c) *Five-Year Business History.* Attached as Appendix B is the information in last year's Form 10-K and/or Proxy Statement about your five-year business history. If your employment or occupation has changed within the last year, please update that information. If no information is attached as Appendix B, please provide your business history for 1995 - present.

Answer: N/A

(d) *Family Relationships.* State the nature of any family relationship by blood, marriage or adoption between yourself and any director or officer of the Company or any subsidiary* or any person nominated or chosen by the Company to serve in any such capacity. Relationships more remote than first cousin need not be included.



* See Appendix A for definition

Answer: None

(e) *Compensation.* Describe any compensation paid to you by a third party pursuant to any arrangement between the Company and any such third party.

Answer: None

(f) *Compensation Committee Interlocks.*

(i) Did you serve during the fiscal year ended December 31, 1999 as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on the compensation committee of the Company? If yes, please describe.

Answer: No

(ii) Did you serve during the fiscal year ended December 31, 1999 as a director of another entity, one of whose executive officers served on the compensation committee of the Company? If yes, please describe.

Answer: No

(iii) Did you serve during the fiscal year ended December 31, 1999 as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as a director of the Company? If yes, please describe.



* See Appendix A for definition

Answer: No

(g) *Transactions with the Company and its Subsidiaries**. Describe briefly any transaction or series of similar transactions, since December 31, 1998, or any currently *proposed* transaction, or series of similar transactions, to which the Company or any of its subsidiaries* was or is to be a party, in which the amount involved exceeds $60,000, and in which you or any member of your immediate family* had, or will have, a direct or indirect interest*. Please include in your description of such transaction the nature of your interest in the transaction, the amount of such transaction and the amount of your interest in such transaction.

*Please note:*

- ***The "amount" of the interest of a person is to be computed without regard to the amount of the profit or loss involved in the transaction(s).***

Answer: See Addendum to Questionnaire

(h) ***Entities in Which You Are or Were a 10% Owner or Executive Officer, Partner, etc.*** The Proxy Statement must disclose relationships between the Company and its subsidiaries and *any business or professional entity:*

(i) that, since December 31, 1998, made payments to, received payments from, or proposes to make to or receive payments from, the Company or any subsidiary* for property or services;

(ii) which payments exceed 5% of such entity's consolidated gross revenues for its last full fiscal year or which entity is a law firm or an investment banking firm; and

(iii). in which you are or were at any time since December 31, 1998:

- an owner of in excess of 10 percent of the equity interest; or
- an executive officer or partner; or
- a member or of counsel (in the case of a law firm); or
- a partner or executive officer (in the case of an investment banking firm).

Please list each such entity, indicate your relationship(s) with such entity and describe generally the nature and amount of payments made and proposed to be made.



* See Appendix A for definition

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Answer: See Addendum to Questionnaire

(i) *Arrangements Regarding Election.* Was or is there any arrangement or understanding regarding your election as an officer or director of the Company between you and any other person or persons, except the directors and officers of the Company acting solely in that capacity? If so, name such other person or persons and describe briefly such arrangement or understanding.

Answer: No

(j) *Indebtedness to the Company or its Subsidiaries**. Describe below any indebtedness to the Company and/or its subsidiaries* in excess of $60,000 owed at any time since December 31, 1998 by you, members of your immediate family*, your associates*, any corporation or organization of which you are an officer or partner or of which you are the beneficial owner* of 10% or more of any class of equity securities or any trust or other estate in which you have a substantial beneficial interest or to which you serve as trustee or in a similar capacity.

Answer: N/A

(k) *Legal Proceedings.* The Company must disclose any of the following events that occurred since December 31, 1994:

- the filing of a petition under the federal bankruptcy laws or any state insolvency law by or against, or the appointment by a court of a receiver, fiscal agent or similar agent for, your business or property, the business or property of any partnership in which you were a general partner at, or within two years before, the time of such filing or the business or property of a corporation or business association of which you were an officer at or within two years before the time of such filing;



* See Appendix A for definition

- any criminal convictions or pending criminal proceedings in which you are a named subject, excluding traffic violations and other minor offenses;

- any court order, judgment or decree, not subsequently reversed, suspended or vacated, which permanently or temporarily enjoined or otherwise limited you from (i) acting as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor broker, leverage transaction merchant, any other person regulated by the Commodity Futures Trading Commission or an associated person of any of the foregoing, or as an investment advisor, underwriter, broker or dealer in securities, or as an affiliated person, director or employee of any investment company, bank, savings and loan association or insurance company, or engaging in or continuing any conduct or practice in connection with such activities; (ii) engaging in any type of business practice; or (iii) engaging in any activity in connection with the purchase or sale of any security or in connection with any violation of federal or state securities laws or federal commodities laws;

- any order, judgment or decree, not subsequently reversed, suspended or vacated, of any federal or state authority barring, suspending or otherwise limiting for more than 60 days your right to engage in any of the activities described above or your right to be associated with persons engaged in any of such activities;

- any finding by a court in a civil action or by the Securities and Exchange Commission that you violated any federal or state securities law, where such judgment has not subsequently been reversed, suspended or vacated;

- any finding by a court of competent jurisdiction in a civil action or by the Commodities Futures Trading Commission that you violated any federal commodities law where such judgment has not subsequently been reversed, suspended or vacated; and

- any pending material* legal proceeding in which you or any of your associates* is a party adverse to the Company or any subsidiary* or has a material* interest adverse to the Company or any subsidiary* and any such proceeding that you know to be contemplated by governmental authorities.

If you are aware of any such event, please include a general description of it below.

Answer: None



* See Appendix A for definition

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(l) *Relationship with NASD Member.* Please describe any direct or indirect interest* or affiliation you have in or with any member of the National Association of Securities Dealers, Inc. (other than a wholly-owned subsidiary of the Company).

Answer: None

(m) *Reports Under Section 16 of Securities Exchange Act of 1934.* Please indicate whether or not you have filed all reports (*i.e.*, Forms 3, 4 and 5), or amendments thereto, required to be filed by you under Section 16(a) of the Securities Exchange Act of 1934. If you have not, please describe generally the report or amendment to be filed.

Answer: Yes

(n) *Relationships with Arthur Andersen LLP.* Please describe any interest or affiliation you have in or with Arthur Andersen LLP.

Answer: None

(o) *Directorships of Public Companies.* If you are director of the Company or nominee for director of the Company, please also update the information in Appendix B regarding directorships you hold in companies that file periodic reports with the Securities and Exchange Commission (or indicate that there has been no change).

Answer: N/A



* See Appendix A for definition

-0025301

The foregoing information is supplied by the undersigned at the request of the management of the Company for use in connection with the preparation of the Proxy Statement and the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999 to the Securities and Exchange Commission. Such information is correctly and completely stated to the best of the undersigned's knowledge, information and belief. The undersigned will promptly notify Rebecca Carter, P. O. Box 1188, Houston, Texas 77251-1188 (telephone: 713/853-7241) in the event any change occurs prior to March 31, 2000, which renders inaccurate or incomplete as of such date any of the information given herein.

DATED: 2/23, 2000.

Signature

See attached Addendum to Questionnaire

TWO COMPLETED SIGNED QUESTIONNAIRES SHOULD BE SENT PROMPTLY TO:

Rebecca Carter, Senior Vice President, Board Communication and Secretary
Enron Corp.
P. O. Box 1188
Houston, Texas 77251-1188

The third copy is for your records.



* See Appendix A for definition

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## APPENDIX A

Certain Terms Used in Questionnaire

Associate

The term "associate," used to indicate a relationship with any person, is defined in Rule 14a-1 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 to mean:

(1) any corporation or organization (other than the Company or any subsidiary*) of which you are an officer or partner;

(2) any corporation or organization (other than the Company or any subsidiary*) of which you are, directly or indirectly*, the beneficial* owner of 10% or more of any class of equity securities;

(3) any trust or other estate in which you have a substantial beneficial interest or as to which you serve as trustee or in a similar capacity; and

(4) your spouse or any relative of yours, or any relative of your spouse, who has the same home as you or who is a director or officer of the Company or any subsidiary*.

Beneficial Ownership

Rule 13d-3 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 establishes certain criteria for determining beneficial ownership of securities. Under such Rule, a person is regarded as the beneficial owner of securities if such person presently, directly or indirectly, has or shares or has the right to acquire within 60 days, (i) voting power which includes the power to vote, or to direct the voting of, such securities, or (ii) investment power which includes the power to dispose of, or to direct the disposition of, such securities.

Voting power and investment power are deemed to exist even if shared with others. The right to acquire may arise from, among other things, (a) the exercise of any option, warrant or right, (b) the conversion of a security, (c) the existence of power to revoke a trust, discretionary account or similar arrangement or (d) the automatic termination of a trust, discretionary account or similar arrangement. Further, a person who acquires a power specified in clauses (a), (b) or (c) above in connection with any transaction having the purpose or effect of changing or influencing the control of the issuer is deemed to be the beneficial owner of the securities immediately upon acquisition of such power, regardless of when such power may take effect.

You should be aware of the strong historical presumption of beneficial ownership of securities held by a person for such person's own benefit (regardless of how registered) and securities held by others for his benefit (regardless of how registered), such as by custodians, brokers, nominees, pledgees, etc. Absent special circumstances, a person has been presumed to be the beneficial owner of securities held in the name of such person's spouse and minor children or in the name of a relative living in such person's house, held by an estate or trust in which such person has an interest as legatee or beneficiary, owned by a partnership of which such person is a partner, or held by a personal holding company of which such person is a stockholder, etc.

All securities of the same class beneficially owned by a person, regardless of the form which such beneficial ownership takes, must be aggregated in calculating the number of shares beneficially owned by such person.

A number of exceptions to the foregoing exist for members of national securities exchanges, pledgees under written pledge agreements and underwriters. If you are not sure whether an exception applies to you, the Company's legal department will be glad to assist you.

Immediate Family

The term "immediate family" is defined in the Instructions to Paragraph (a) of Item 404 of Regulation S-K promulgated by the Securities and Exchange Commission under the Securities Act of 1933 to include a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, and brothers and sisters-in-law.

Indirect Interest in a Transaction

An "indirect interest in a transaction" on the part of a person may result from a position or relationship with or interest in a firm, corporation or other entity which engages in the transaction, except where the position or relationship arises only from (i) a position as a director of a corporation or other organization (other than a partnership), (ii) the direct or indirect ownership* on the part of such person and all directors and officers of the Company, all nominees for election as a director, all holders of record or beneficially* of 10% or more of the outstanding voting securities of the Company and all associates* of such persons, in the aggregate, of less than a 10% equity interest in such firm, corporation or other entity or (iii) both such position and ownership.

Indirect Ownership

If a person has a pecuniary interest*, by reason of any contract, understanding or relationship (including a family relationship or arrangement) in securities held in the name of another person, that person is an indirect beneficial owner of those securities.

Investment Power

The term "investment power," with regard to any security, is defined in Rule 13d-3 under the Securities Exchange Act of 1934 to include the power to dispose, or to direct the disposition, of such security.

Material

As defined by Rule 405 promulgated by the Securities and Exchange Commission under the Securities Act of 1933, the term "material,"

> "when used to qualify a requirement for the furnishing of information as to any subject,-limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered."

Pecuniary Interest

You have a "pecuniary interest" in the securities if you have or share the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the securities.

Subsidiary

As defined by Rule 405, a "subsidiary" is a corporation or other entity which is directly controlled by the Company or indirectly controlled by the Company through one or more intermediaries.

Voting Power

The term "voting power," with regard to any security, is defined in Rule 13d-3 under the Securities Exchange Act of 1934 to include the power to vote, or to direct the voting of, such security.

| | |
|---|---|
| Andrew S. Fastow (37) | Senior Vice President and Chief Financial Officer since March 1998. Senior Vice President, Finance, Enron Corp., from January 1997 to March 1998. Managing Director, Retail and Treasury, ECT, from May 1995 to January 1997. Vice President, ECT, from January 1993 to May 1995. Account Director, ECT, from 1990 to 1993. |

Promotion to EVr

E 15.

Addendum to Questionnaire
For Andrew S. Fastow

In response to question (a)(i) and in addition to shares that I otherwise report pursuant to the Questionnaire, I am associated with LJM Cayman, L.P. ("LJM1"). LJM1 and certain of its affiliates own approximately 6.6 million shares of Enron's common stock. Some of such shares are subject to various contractual arrangements. I do not believe I have voting or investment power with respect to such shares, but I suggest this issue be discussed in detail with Scott Sefton. If such shares are ultimately reported in response to this question, my response shall not be construed as an admission that I am, for purposes of Section 16 of the Securities Exchange Act of 1934, the beneficial owner of such shares.

In response to question (g), LJM1 and LJM2 Co-Investment L.P. ("LJM2") entered into various related party transactions with Enron during the second half of 1999 that should be reported. Scott Sefton is preparing a draft of the disclosure relating to these transactions, which he will provide shortly.

In response to question (h), Scott Sefton can discuss whether any disclosure would be required as a result of my association with LJM1 and LJM2.

All my other responses to the questions in the Questionnaire are made subject to my disclosures herein regarding LJM1 and LJM2.

In light of the complexity surrounding my association with LJM1 and LJM2 and the difficulty in applying the proxy disclosure rules to my association, I think it would be prudent for the Enron attorney who is responsible for proxy disclosure issues to meet with Scott Sefton to resolve these issues.

Dated: 2/23/00

Andrew S. Fastow

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# Memo

**ANDERSEN**

To The Files

From Thomas H. Bauer

Date November 2, 2001

Subject Chewco Investigation

- CONFIDENTIAL -

October 26, 2001 I received a call from Rodney Faldyn and Ryan Siurek regarding formation of Chewco in 1997. Faldyn inquired about the requirements of EITF 90-15 for outside equity in an SPE if the investors include employees. I replied that the SPE needs to be capitalized with 3% of outside equity exclusive of the employee and that such conclusion is consistent with previous advice given on Chewco and more recently on LJM. Siurek acknowledged that LJM equity was grossed up for the percentage of Andy Fastow in the LJM transaction. Faldyn then advised that he had learned that Chewco may not have the requisite equity and inquired as to the accounting impact. I advised that the SPE would fail to qualify and the sponsor of the SPE would consolidate Chewco. Faldyn said he would meet with Rick Causey to discuss further and asked that I remain available. (Attached as Exhibit I is documentation prepared in 1997 upon initial advice given to Enron regarding its proposed Chewco structure.)

On October 27, 2001 I was asked to attend a meeting with Causey and Faldyn regarding Chewco. Also present at the meeting were Deb Cash and Dave Duncan. Causey presented a diagram of the Chewco transaction which he said had been constructed upon discussion with Ben Glisan. (Glisan is now treasurer of the company and was the principal accounting transaction support representative for Enron at the time of the transaction.) This diagram which was prepared by me from Causey's presentation is attached as Exhibit II.

Based upon the information presented, the group identified the following issues which would require further analysis:

- Did the Chewco partnership in fact have the requisite 3% of capital exclusive of any employee involvement?

  Based on information presented it was not possible to determine how much of Michael Kopper's contribution was included in the $115,000 equity strip. (At the time of formation in 1997 we advised Enron that the 3% of outside equity must be exclusive of any employee involvement.) We were also advised by Causey that one of the other investees was Bill Dodson, a nonemployee, who's the business and personal partner of Kopper. We advised additional information about the relationship between Kopper and Dodson would be necessary to ascertain whether Dodson would be considered a related party.

- Was the Barclay's equity strip residual equity at risk as required by EITF 90-15?

TBAA 000731
Confidential Treatment
Requested by Tom Bauer

Causey advised that Glisan indicated that, upon buyout of Chewco in the first quarter of 01, Sonar received a distribution of approximately $10 million. We discussed that if Glisan's connection was correct, the size of the distribution relative to Barclay's smaller distribution may indicate that Barclay's equity was disproportionate and perhaps in substance debt.

- Does Sonar control Chewco by virtue of a consent agreement from Big River?

  Per Causey, Glisan made reference to a consent agreement which provided Sonar the right to vote Barclay's shares of Chewco. Depending upon the terms or collateral of the consent (e.g. withdrawal rights, etc.) Sonar may be deemed to control, thereby invalidating the governance criteria.

I advised Causey and the group that we had never been provided access to any document beyond the amended JEDI partnership documents that were created upon the Chewco transaction. We requested Chewco documents at the time of the transaction, but were advised by Glisan that the documents were those of a third party and Enron does not have access to such documents. I advised Causey and the group that access to such documents would be necessary to answer the items raised. Causey reiterated that at the present time, he has seen no factual support for the items discussed above.

At that point, Faldyn indicated that he had been told that a memo exists within the treasury department from Kopper to accounting instructing Enron as general partner in JEDI to direct future distributions to Chewco from JEDI after some specified date to the attention of Lee Fastow at a home address. Lee Fastow is the wife of Andy Fastow and previously worked at Enron in the treasury department. Causey stated that he is unaware of any interest that Fastow or his wife may have in Chewco and therefore it is unclear why distributions would be sent to Lee. We requested that Causey gather information regarding the instructions and any subsequent cash disbursements that were executed pursuant to the instructions, if any. We asked that Causey inquire as to access to Chewco documents and related documents so we can perform additional audit procedures.

On November 2, 2001, Andersen received a set of documents related to Chewco from Wilmer & Cutler. Deb Cash and I reviewed the Chewco documents and constructed a diagram of ownership based upon our review as set forth in Exhibit III. This review of the transaction identified the following issues.

- The interest by Barclay's was in the form of a yield certificate which defines Big River and Little River as borrowers and requires a yield slightly above LIBOR.

- I reviewed a two page letter agreement dated December 30, 1997 between JEDI and Chewco which provided for a distribution to Chewco of approximately $16 million of which $10 million was to be paid to Enron as a guarantee fee on debt of Chewco and approximately $6 million to be deposited in reserve funding accounts of Big River and Little River. Based upon a review of other formation documents it appears that the deposit was a condition upon funding of the Barclay's certificate. As a consequence, a question arises as to whether the $11 million contributions by Barclay's was funded in part by a distribution from JEDI. Therefore Barclay's contribution would be a net $5 million which would be significantly below the 3% required.

On the evening of November 2, 2001 I was requested to attend a meeting with Mike Patrick, Alan Quaintance, Jim Brown, and Cris Sherman also from Andersen were Deb Cash, Patty Grutzmacher, Kimberly Scardino, Don

Holley and Kate Agnew. Patrick stated that the purpose of the meeting was to seek our guidance on analysis of Chewco and LJM transactions and to compare notes on what Andersen had done to date. Patrick stated that he and others in the meeting had not begun any review and did not yet have access to documents. Such documents were to be presented on Saturday morning, November 3. I advised the group that we had reviewed the Chewco documents provided and identified, among other issues, the two items discussed above. I stated that we were continuing our analysis and had not formed conclusions at that time. I encouraged the company to review the certificate agreements and letter agreement and form their own conclusion. I added if the company concluded that the transaction met all the requisite capitalization tests after review of these documents, we would like to have a discussion as to the basis of their conclusions.

On the evening of November 3, 2001 I received a call from Patrick to attend a meeting to discuss the Chewco transaction. Patrick advised that he had met with inhouse counsel, Vinson & Elkins and Glisan and believed the transaction didn't result in a failed SPE. Dave Duncan and I attended this meeting. Present were Mike Patrick, Jim Brown, Cris Sherman, and Rick Causey. Subsequent to the commencement of the meeting others joined the discussion from time to time, Christina Mordant, inhouse legal counsel, Ron Astin, Vinson & Elkins Counsel, and Wes Colwell, North American Chief Accounting Officer. We discussed the following.

- Ron Astin commented that he believed the equity certificates were in fact equity within a legal definition and that the certificate holders had rights with respect to voting, and limiting the voting ability other parties, far greater that a typical debt agreement. I advised that to comply with SPE equity requirement the third party equity would be required to be equity in form and substance.

- Causey indicated that he was not sure that Dodson should be considered a related party. Mordant stated that Texas State Law doesn't legally recognize such relationships. I advised that I believed for accounting purposes, the assessment of whether Dodson was a related party would have to consider factors in addition to the legal factors to develop a conclusion.

- I inquired as to the group's response to the impact of the letter agreement dated December 30, 1997 referred to above. They replied they had not found such a document in their materials. We assisted the group with a search of the documents in the room, and located the agreement. Glisan, Mordant, and Astin each stated that they had never previously seen this agreement and were unaware of its existence. I inquired of Glisan as to the business purpose of this agreement. He said he did not know. I asked Glisan why Jeremy Blackman would have been the authorized party to sign such an agreement and he replied "that is a good question". I presented the accounting implications of the agreement which could reduce the 3% net equity as discussed above. Mordant presented an argument as to why the agreement should not alter the investors right to the capital account which I could not comprehend. Causey, Brown, Patrick, Glisan, Astin and Mordant then left the meeting to pursue this matter further. Later, Brown and Patrick returned to the meeting and stated that Glisan concluded that the transaction failed the criteria. I asked if this Enron's final conclusion and Patrick indicated he did not know.

On November 4, 2001 we were asked by Causey to work with Enron employees to assess the effect Enron Financial Statements assuming Chewco was a failed SPE. During that process we were presented a copy of Chewco's unaudited financial statements from Mark Lindsey. Mark Lindsey said he had received these from

Shirley Hedler in the funds management group. Mark said he had not previously seen the Chewco financial statements or knew of their existence.

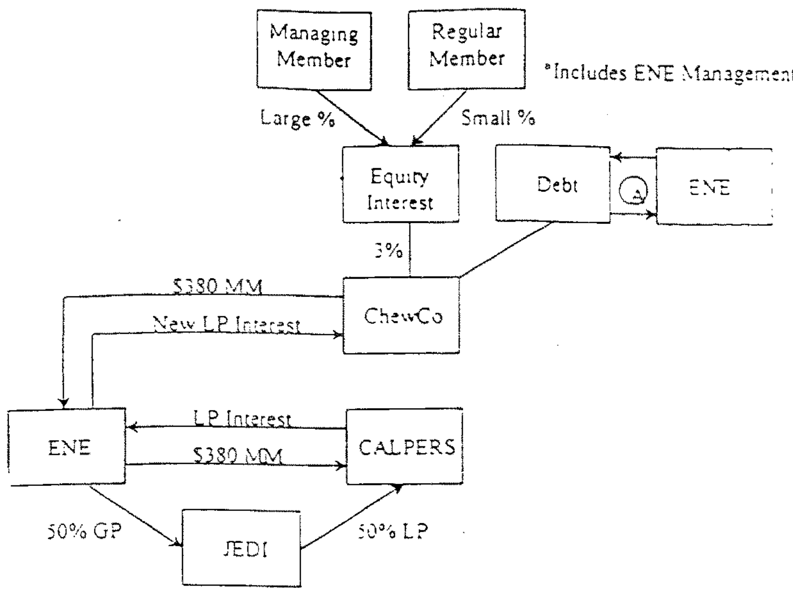
We completed our analysis regarding the impact of the adjustment and attended a meeting Sunday evening whereby the company presented its estimate of the effect on previously reported net income. We advised Causey that we had not audited these estimates and the complexity of the JEDI agreement would require significant additional analysis to develop a more precise estimate of the impact.

Cc: Nancy Temple

Attachments

Exhibit I

## ChewCo




A Enron to provide guarantee on ChewCo debt for a fee or to provide ChewCo with loan.

Per discussion with John Stewart, ChewCo can qualify as an SPE and exist off the balance sheet of JEDI as a limited partner with Enron as the guarantor of debt or with Enron as the debt provider. However, the following conditions should apply

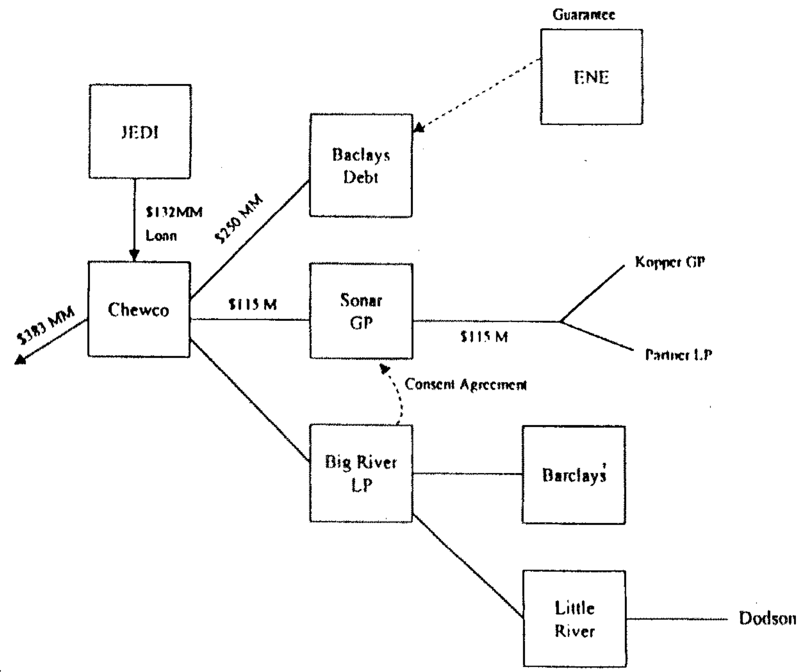
1) The loan/guarantee from Enron to ChewCo should be at market.
2) The loan/guarantee from Enron to ChewCo should be executed under customary terms and conditions.
3) The equity holders (Managing Members and Regular Members) of ChewCo should have first risk of loss (i.e., be subordinate to the debt holder).
4) Since the equity holders of ChewCo include a small percentage of Enron management, ChewCo will maintain 3% equity exclusive of these members and in no case shall the Enron Regular Members control ChewCo.

TBAA 000735
Confidential Treatment
Requested by Tom Bauer

Exhibit H

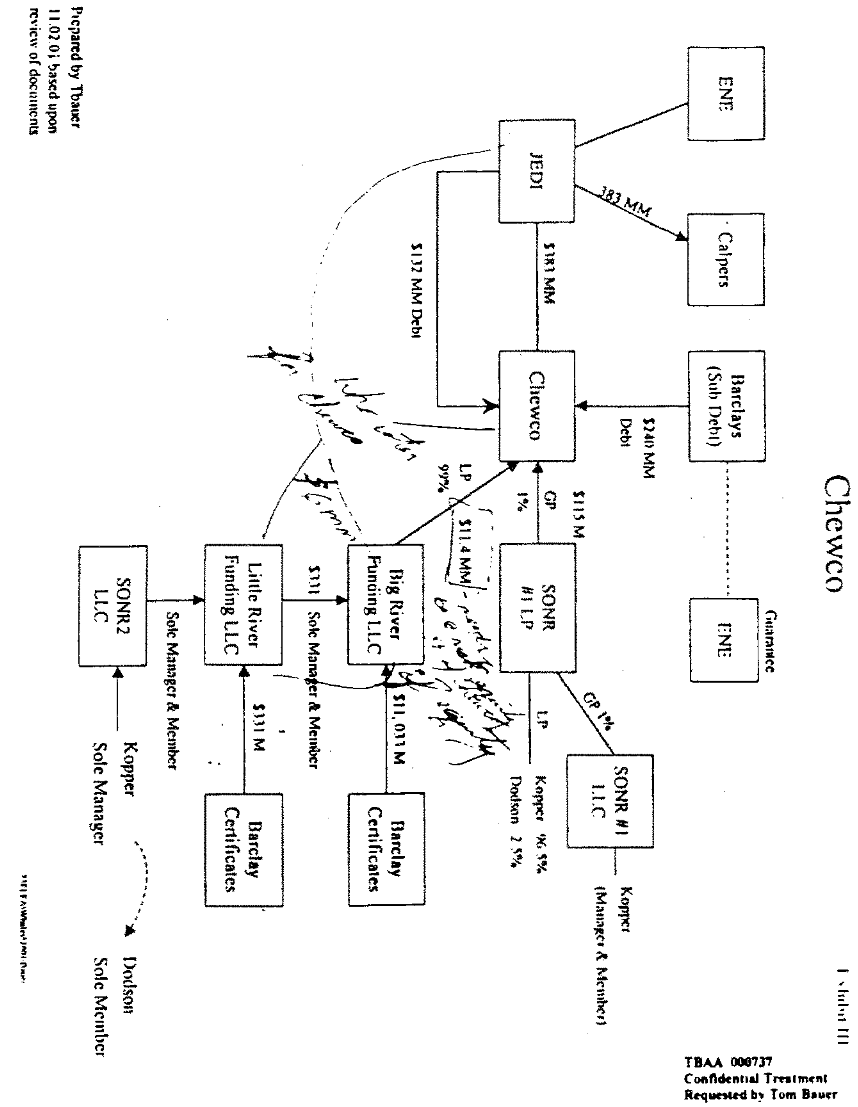
TBAA 000736
Confidential Treatment
Requested by Tom Bauer

# Chewco




Prepared by TBauer
10.27.01 based upon
discussion with Causey

F:\FLLA\Whales\2001\Bauer\Chewco\


Chewco
Exhibit III
ENE
JEDI
Calpers
383 MM
Barclays (Sub Debt)
$240 MM Debt
$181 MM
$132 MM Debt
Chewco
Guarantee
ENE
$115 M
GP 1%
LP 99%
SONR #1 LP
GP 1%
SONR #1 LLC
Kopper (Manager & Member)
LP
Kopper 96.5%
Dodson 2.5%
$11.4 MM
Big River Funding LLC
$331
Sole Manager & Member
$11,033 M
Barclay Certificates
Little River Funding LLC
$331 M
Barclay Certificates
SONR2 LLC
Sole Manager & Member
Kopper
Sole Manager
Dodson
Sole Member
Prepared by Tbauer
11.02.01 based upon
review of documents
TBAA 000737
Confidential Treatment
Requested by Tom Bauer

24

# V&E Shoots Back

Vinson & Elkins Offers Its Most Detailed Response Yet To Critical Report on Its Work for Embattled Enron Corp.

BY OTIS BILODEAU

For weeks, the press and public talked around the edges of the quality of the legal work Vinson & Elkins did for the disgraced and embattled Enron Corp.

Then the Powers report laid it bare.

Prepared by a former enforcement director of the Securities and Exchange Commission, Wilmer, Cutler & Pickering partner William McLucas, the Feb. 1 report on behalf of a special committee of the Enron Corp. board contends that Vinson & Elkins was in fact involved in many of Enron's most controversial deals—and was also involved in decisions about how to disclose those deals to the public.

The document never accuses Vinson & Elkins lawyers of violating any laws. But it sharply criticizes the firm for "an absence of . . . objective and critical professional advice." Enron was the Houston-based law firm's largest client, and last year accounted for 7.8 percent of V&E's $455 million in revenue, according to a firm spokesman.

Now the law firm is aiming to counter its portrayal in the report, commissioned by an Enron panel chaired by board member William Powers Jr., the

SEE ENRON, PAGE 17

# Vinson & Elkins Rebuts Critics of Its Enron Work

ENRON, FROM PAGE 1

dean of the University of Texas School of Law.

In a four-hour telephone interview, a senior partner at Vinson & Elkins, speaking for the firm, responded point by point to virtually every assertion in the report regarding the firm. Vinson & Elkins agreed to the interview on the condition that the partner not be identified by name.

"We are confident that when all the facts are known it will be understood that we fulfilled our professional obligations," this partner says.

### PUBLICITY-SHY

The Powers report focuses on the formation and activities of Enron's now-infamous partnerships—known as JEDI, Chewco, LJM1, LJM2, and the cluster of entities dubbed the Raptors. The report also details Enron's public disclosures—or lack thereof—of these entities, which were managed by Enron officials, and which entered into numerous complex deals with Enron.

The report's summary of Enron's use of Chewco, LJM1, and LJM2 is particularly damning.

"Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve *bona fide* economic objectives or to transfer risk."

It continues, "Other transactions were implemented—improperly, we are informed by our accounting advisors—to offset losses. They allowed Enron to conceal from the market very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged . . .

STACEY CRAMP

**POWERS LINE:** William Powers Jr. chaired the special Enron board committee that commissioned an investigation that concluded the company had used business deals to "conceal" giant financial losses.

chief financial ~~officer, Andrew Fastow~~— were represented by Kirkland & Ellis, the Vinson & Elkins ~~partner notes. The~~ Powers report identifies Kirkland as outside counsel to LJM1.

Kirkland & Ellis lawyers and spokespeople decline to comment. But lawyers with knowledge of the matter say that the Chicago-based law firm was called in to handle the LJM entities by Fastow, who developed a rapport with Kirkland when he was working at Chicago's Continental Bank during the 1980s. Continental was a major Kirkland client at that time. The LJM work was handled by Kirkland D.C.

"senior officer, who previously was the general partner of these partnerships, sold all of his financial interests." The filing does not say that the interest had been sold to another former Enron insider.

The Vinson & Elkins partner also asserts the firm made an oral report to the Enron board on Sept. 21, 2001. In that report, the partner says, "We advised them of concerns regarding conflicts of interest, and we advised them that these transactions could lead to litigation."

### PAYDAY

One scenario in the Powers report about

company to avoid the disclosure. Under the relevant regulation, Fastow's compensation would have to have been disclosed "where practicable." The Powers report, citing an in-house memo, describes how the lawyers reasoned that because the ultimate amount of Fastow's compensation depended on certain "open" transactions, disclosure of that amount was not "practicable."

Memo

A year later, a discussion again focused on Fastow. He had received substantial compensation from a major LJM deal that had closed. According to the report, in-house lawyers and Vinson & Elkins then reasoned, in effect, that the compensation had been already sufficiently disclosed in the prior year's proxy.

The report faults the lawyers for doing "little if any investigation into what transactions actually remained 'open.'

"The lawyers apparently searched for and embraced a technical rationale to avoid disclosure," the report concludes. It also notes that Vinson & Elkins never "pressed for" the amount "or even the magnitude" of Fastow's interest in the deals. "The magnitude of the amount was knowable and should have been disclosed," the report states.

The V&E senior partner says the firm's advice "would have been based upon the facts that had been given to us."

"We didn't know what [Fastow] made," he says. "They were asking our advice on what we thought their latitude was under [the relevant regulation]. What our lawyers were being told is that [Fastow's interest] was unclear. I'm not saying we didn't ask. I'm saying we didn't know.

"It's not our place to make an appoint-entity in which only Enron had a substantial economic stake."

The report asserts that these deals "resulted in" Enron overstating its earnings from the third quarter of 2000 through the third quarter of last year by almost $1 billion.

The report casts much of the blame for these deals, as well as Enron's "creative efforts to circumvent accounting principles," on company managers and Arthur Andersen, the company's then-auditor.

But the report also asserts that Vinson & Elkins played a significant role.

According to the Powers document, the law firm "provided advice and documentation" for many of these partnership deals and "assisted Enron with the preparation of its disclosures of related-party transactions in the proxy statements and the footnotes to the financial statements in Enron's periodic SEC filings."

Enron's managers and its board "relied heavily on the perceived approval by Vinson & Elkins of the structure and disclosure of the transactions," the report claims. While it would be "inappropriate to fault" V&E for accounting matters, the report concludes, the firm "should have brought a stronger, more objective and more critical voice to the disclosure process."

The senior Vinson & Elkins partner, who says Wilmer, Cutler lawyers interviewed only three V&E partners in connection with the report, confirms that the firm assisted with some of the documentation and disclosures of the partnerships. But he insists that he and his partners were "shocked" by some of the details disclosed in the report. "Many of the transactions in this report were completely unfamiliar to our lawyers," he says. He declined to be more specific.

He emphasizes that the Enron partnerships were not clients of V&E. Both of the LJM partnerships—which were originally developed and managed by Enron's then-

Edsall did not return calls seeking comment.

The senior V&E partner also says his firm was, as a rule, called in by Enron in-house counsel to provide legal advice on discrete matters.

"We were not charged with or given the information to evaluate [Enron's] overall financial disclosures," he says. As for advising on the partnership transactions, he adds, "Our task was to document a transaction that the parties had agreed upon, and not to pass upon the accounting treatment."

In general, the partner argues, the Powers report overstates V&E's input into Enron's business dealings. He stresses that Enron's huge in-house legal team—which numbered about 250 lawyers at its peak—dealt with much of Enron's legal matters.

The Vinson & Elkins partner claims that his firm was never asked for advice on "the whole notion of Fastow being involved" in managing the LJM entities. Fastow, who was originally the general partner of those limited partnerships, earned roughly $30 million from LJM deals done with Enron while Fastow was also Enron's CFO, according to the report.

In response to the Powers report claim that Vinson & Elkins was insufficiently critical of Enron's dealings, the partner points to advice the firm gave that Enron opted not to follow. According to the report, Fastow last year sold his interest in LJM2 to another former Enron employee, Michael Kopper. Vinson & Elkins "recommended disclosure of this fact," the report states, but Enron objected, "and the Vinson & Elkins lawyers felt that they could not say it was legally required."

As a result, Enron's 10-Q filing for the second quarter of 2001 says only that the

Enron.

"There was significant discussion, both within Enron Management and with outside advisors, about whether Enron could avoid disclosing Fastow's compensation" from the LJM deals, the report states. Vinson & Elkins was involved in those discussions, which related to the company's 2000 proxy statement.

According to the report, Vinson & Elkins and in-house lawyers came up with a rationale that would allow the

ing. That is a misunderstanding of how this process worked.

"When clients ask us is there a legal way to do something, our job is to take the facts given us and figure out if there is a legally appropriate way to do it. That's what we do. And so does every other law firm in America."

The partner says the firm never believed that Enron's conduct was so egregious that the firm should drop the company as a client. ■

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Joint Energy Development Investments Limited Partnership
1400 Smith Street
Houston, Texas 77002

December 30, 1997

CHEWCO INVESTMENTS, L.P.
1400 Smith Street
Houston, Texas 77002

RE: Revolving Credit Agreement dated as of even date herewith (the "Credit Agreement") among CHEWCO INVESTMENTS, L.P., as borrower ("CHEWCO"), the lenders from time to time party thereto and Joint Energy Development Investments Limited Partnership ("JEDI")

Ladies and Gentlemen:

JEDI has, prior to the date hereof, sold its interest in Coda Energy, Inc. and its subsidiary, Taurus Energy Corp. (the "Investments"). JEDI and CHEWCO agree that, notwithstanding Section 2.07 of the Credit Agreement, any distributions of the proceeds from the sale of the Investments (the "Distributions") from time to time to CHEWCO, owner of a 50% limited partnership interest in JEDI, shall be used as follows:

(i) first, to fund the following accounts in an aggregate amount equal to $6,580,000.00: (a) the Little River Base Reserve Account No. 050-793896 in an amount equal to $197,400 and (b) the Big River Base Reserve Account No. 050-793870 in an amount equal to $6,382,600;

(ii) second, to pay up to $10,005,000 of the outstanding principal balance on the Subordinated Debt (as defined in the Credit Agreement); and

(iii) third, thereafter in accordance with Section 2.07 of the Credit Agreement.

Joint Energy Development Investments
Limited Partnership

By: Enron Capital Management Limited Partnership.
its sole general partner

By: Enron Capital Corp., its sole general partner

By: ______________________________ CSL
Name: Jeremy M. Blachman
Title: Vice President

CHEWCO INVESTMENTS, L.P.
By: SONR #1, L.P., its sole general partner
By: SONR #1, L.L.C., its sole general partner

By: Michael J. Kopper
Michael Kopper, its sole member

F:\JE\1139\ENR100 29000\SIG_PGS WPD
December 17, 1997

[Signature Page for Application of
Distributions Side Letter]

GUARANTY AGREEMENT

THIS GUARANTY AGREEMENT ( this "Guaranty") dated as of December 30, 1997, is made by ENRON CORP., an Oregon corporation (the "Guarantor"), in favor of Barclays Bank PLC ("Bank") and pertains to obligations of CHEWCO Investments, L.P. ("Borrower").

PRELIMINARY STATEMENTS

The Bank has agreed to loan the Borrower $239,995,000.00 on the condition that the Guarantor provide this Guaranty. The Guarantor may reasonably be expected to benefit, directly or indirectly, from providing this Guaranty.

NOW, THEREFORE, for and in consideration of the premises and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Guarantor agrees as follows:

ARTICLE 1

DEFINITIONS

Section 1.1 Certain Defined Terms. As used in this Guaranty, the following terms shall have the following meanings (such meanings to be equally applicable to both the singular and the plural forms of the terms defined):

"Bank" has the meaning specified in the first sentence of this Guaranty.

"Borrower" has the meaning specified in the first sentence of this Guaranty.

"Business Day" means any day of the year except Saturday, Sunday and any day on which banks are required or authorized to close in New York City or Houston, Texas.

"Consolidated" refers to the consolidation of the accounts of the Guarantor and its Subsidiaries in accordance with GAAP.

"Consolidated Net Worth" means at any date the Consolidated stockholders' equity of the Guarantor and its Consolidated Subsidiaries (excluding any Redeemable Preferred Stock of the Guarantor).

"Consolidated Tangible Net Worth" means at any date Consolidated Net Worth less the amount, if any, in excess of $110,000,000 of Consolidated "intangible assets" (as defined below) included in determining Consolidated Net Worth. For the purposes of this definition, "intangible assets" means the amount of (i) all write-ups (other than write-ups resulting from foreign currency translations and write-ups of assets of a going concern business made within twelve months after the acquisition of such business) subsequent to December 31, 1994, in the book value of any asset owned by the Guarantor or a Subsidiary and (ii) all unamortized goodwill, patents, trademarks, service marks, trade names, copyrights, organization or developmental expenses and other intangible items.

"Debt" of any Person means at any date, without duplication, (i) obligations for the repayment of money borrowed which are or should be shown on a balance sheet as debt in accordance with GAAP, (ii) obligations as lessee under leases which, in accordance with GAAP, are capital leases, and (iii) guaranties of payment or collection of any obligations described in clauses (i) and (ii) of other Persons, provided, that clauses (i) and (ii) include, in the case of obligations of the Guarantor or any Subsidiary, only such obligations as are or should be shown as debt or capital lease liabilities on a Consolidated balance sheet in accordance with GAAP; provided, further, that none of the following shall constitute Debt: (A) transfers of Permitted Receivables pursuant to a Permitted Receivables Purchase Facility (and indemnification, recourse or repurchase obligations thereunder), (B) the liability of any Person as a general partner of a partnership for Debt of such partnership, if the partnership is not a Subsidiary of such Person, and (C) obligations (other than borrowings, capital leases or financial guaranties by Guarantor or any Subsidiary) related to the sale, purchase or delivery of hydrocarbons in respect of production payments conveyed in transfers constituting sales under GAAP.

"Enron Indenture" means that certain indenture dated as of November 1, 1985 between the Guarantor (formerly InterNorth, Inc.) and Harris Trust and Savings Bank, as Trustee, without giving effect to any amendment or modification thereof.

"EOG Group" means Enron Oil & Gas Company, a Delaware corporation, and its subsidiaries.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended from time to time, and any successor statute of similar import, together with the regulations thereunder, as in effect from time to time.

"ERISA Affiliate" means any trade or business (whether or not incorporated) which is a member of a group of which the Guarantor is a member and which is under common control within the meaning of the regulations under Section 414 of the Code.

"Event of Default" has the meaning specified in the Note.

"FERC" means the Federal Energy Regulatory Commission, or any federal agency or authority of the United States from time to time succeeding to its function.

"GAAP" means United States generally accepted accounting principles and policies consistent with those applied in the preparation of the audited consolidated financial statements referred to in Section 3.01(d).

"Guarantor" has the meaning specified in the first sentence of this Guaranty.

"Guarantor Default" has the meaning specified in Section 5.01 of this Guaranty.

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"Guaranty" has the meaning specified in the first sentence of this Guaranty.

"Insufficiency" means, with respect to any Plan, the amount, if any, by which the present value of the accrued benefits under such Plan exceeds the fair market value of the assets of such Plan allocable to such benefits.

"Multiemployer Plan" means a "multiemployer plan" as defined in Section 4001(a)(3) of ERISA to which the Guarantor or any ERISA Affiliate is making or accruing an obligation to make contributions, or has within any of the preceding five plan years made or accrued an obligation to make contributions.

"Multiple Employer Plan" means an employee benefit plan, other than a Multiemployer Plan, subject to Title IV of ERISA to which the Guarantor or any ERISA Affiliate, and more than one employer other than the Guarantor or an ERISA Affiliate, is making or accruing an obligation to make contributions or, in the event that any such plan has been terminated, to which the Guarantor or any ERISA Affiliate made or accrued an obligation to make contributions during any of the five plan years preceding the date of termination of such plan.

"Note" means the promissory note dated December 30, 1997 executed by the Borrower and payable to the order of the Bank in the principal amount of $239,995,000.00.

"Notice" has the meaning specified in Section 6.01 of this Guaranty.

"Obligations" means all amounts owed from time to time by the Borrower pursuant to the terms of the Note, whether owed now or in the future, including, without limitation, all principal of and interest on the Note and all costs, expenses and indemnities provided for therein.

"PBGC" means the Pension Benefit Guaranty Corporation, or any federal agency or authority of the United States from time to time succeeding to its function.

"Permitted Receivables" means (a) any receivables and rights (whether now existing or hereafter arising) resulting from any Regulated Subsidiary's authority to collect revenue from any customer receiving service that is subject to the jurisdiction of the FERC, whether such revenue is collected by means of a demand charge, reservation fee, commodity charge, usage fee or other rate for such service set forth in such Regulated Subsidiary's FERC gas tariff or by means of any surcharge upon or other fee levied in conjunction with any such rate, (b) all indebtedness of any obligor (whether now existing or hereafter arising) under a contract for sale or transportation of crude oil, natural gas or other goods or services by the Guarantor or any of its Subsidiaries and all related rights of the Guarantor or such Subsidiary, which shall include, without limitation, any obligation of such obligor (whether now existing or hereafter arising) to pay amounts based on the monthly entitlement of such obligor to such sales or transportation service (for entitlements not to exceed 90 days from date of invoice) and any obligation of such obligor (whether now existing or hereafter arising) to pay interest, finance charges or amounts with respect thereto, and (c) with respect to any of the foregoing receivables or indebtedness, all guarantees, insurance, letters of credit and other agreements or arrangements of whatever character from time to time supporting or securing payment of any such receivables or indebtedness.

"Permitted Receivables Purchase Facility" means any agreement of the Guarantor or any of its Subsidiaries providing for transfers of Permitted Receivables purporting to be sales (and considered sales under GAAP) that do not provide, directly or indirectly, for recourse against the seller of such Permitted Receivables (or against any of such seller's affiliates), by way of a guaranty or any other support arrangement, for the collectibility of such Permitted Receivables (based on the financial condition or circumstances of the obligor thereunder), other than such limited recourse as is reasonable given market standards for transactions of a similar type, taking into account such factors as historical bad debt loss experience and obligor concentration levels.

"Person" means an individual, partnership, corporation, limited liability company, business trust, joint stock company, trust, unincorporated association, joint venture, firm or other entity, or a government or any political subdivision or agency, department or instrumentality thereof.

"Plan" means an employee benefit plan (other than a Multiemployer Plan) which is (or, in the event that any such plan has been terminated within five years after a transaction described in Section 4069 of ERISA, was) maintained for employees of the Guarantor or any ERISA Affiliate and covered by Title IV of ERISA.

"Principal Subsidiary" means as of any date of determination, any Subsidiary having consolidated assets (less any debt of such Subsidiary and any of such Subsidiary's consolidated subsidiaries with respect to which the Guarantor has not guaranteed payment) equal to or greater than 5% of the Guarantor's consolidated assets; provided that, as of any date of determination, each of the following named entities shall be deemed to be a Principal Subsidiary (but only if such entity is a "Subsidiary" as of such date of determination) without regard to the consolidated assets test described above in this definition: Enron Oil & Gas Company, Houston Pipe Line Company, Transwestern Pipeline Company, Northern Natural Gas Company, Enron Capital & Trade Resources Corp., and Enron Pipeline Company. For purposes of this definition, (a) consolidated assets of a Subsidiary shall be determined based on the most recent quarterly or annual consolidated financial statements of such Subsidiary available prior to such determination, and (b) consolidated assets of the Guarantor shall be determined based on the most recent quarterly or annual consolidated financial statements of the Guarantor available prior to such determination.

"Preferred Stock" means, as applied to any corporation, shares of such corporation which shall be entitled to preference or priority over any other shares of such corporation in respect of either the payment of dividends or the distribution of assets upon liquidation.

"Redeemable" means, as applied to any Preferred Stock, any Preferred Stock which (i) the issuer undertakes to redeem at a fixed or determinable date or dates (other than pursuant to the exercise of an option to redeem by the issuer, if the failure to exercise such option would not materially adversely affect the business, consolidated financial position or consolidated results of operations of the issuer and its subsidiaries taken as a whole), whether by operation of a sinking fund or otherwise, or upon the occurrence of a condition not solely within the control of the issuer, or (ii) is redeemable at the option of the holder.

"Regulated Subsidiary" means Transwestern Pipeline Company, Northern Natural Gas Company or any other Subsidiary regulated by FERC.

"Subordinated Debt" means, (a) the 8.25% Senior Subordinated Debentures due 2012 and the 6 ¾ % Senior Subordinated Debentures due July 1, 2005 of the Guarantor issued pursuant to the Indenture dated as of February 1, 1987 between the Guarantor and NationsBank of Texas, N.A., as trustee, (b) the obligations of the Guarantor under the Loan Agreement dated as of November 15, 1993, between the Guarantor and Enron Capital L.L.C., (c) the obligations of the Guarantor under the Loan Agreement dated as of August 3, 1994, between the Guarantor and Enron Capital Resources, L.P., and (d) any Debt of the Guarantor which is subordinate to any other obligations of the Guarantor so long as (i) the terms of such Debt are (x) substantially similar to and no less favorable to the holders of Senior Indebtedness (as defined in such Indenture) than the terms of such Senior Subordinated Debentures due 2012 of the Guarantor (and the parties confirm that it is their intention that all obligations of the Guarantor under this Guaranty constitute "Senior Indebtedness" for the purposes thereof) or (y) consented to by the Bank (which consent will not be unreasonably withheld), and (ii) no payments of principal shall be payable (whether by scheduled maturity, required prepayment, or otherwise, unless as a result of the acceleration of such Debt in accordance with the terms thereof) under such Debt prior to December 15, 2001.

"Subsidiary" of any Person means, any corporation, partnership, joint venture or other entity of which more than 50% of the outstanding capital stock or other equity interests having ordinary voting power (irrespective of whether or not at the time capital stock or other equity interest of any other class or classes of such corporation, partnership, joint venture or other entity shall or might have voting power upon the occurrence of any contingency) is at the time owned directly or indirectly by the Guarantor; provided, however, that no such corporation, partnership, joint venture or other entity shall (a) constitute a Subsidiary of the Guarantor unless such entity is a Consolidated Subsidiary of the Guarantor, or (b) constitute a Subsidiary of any other Person, unless such entity would appear as a consolidated subsidiary of such Person on a consolidated balance sheet of such Person prepared in accordance with GAAP. Unless otherwise provided or the context otherwise requires, the term "Subsidiary" when used herein shall refer to a Subsidiary of the Guarantor.

"Termination Event" means (i) a "reportable event", as such term is described in Section 4043 of ERISA (other than a "reportable event" not subject to the provision for 30-day notice to the PBGC), or an event described in Section 4062(e) of ERISA, or (ii) the withdrawal of the Guarantor or any ERISA Affiliate from a Multiple Employer Plan during a plan year in which it was a "substantial employer", as such term is defined in Section 4001(a)(2) of ERISA, or the incurrence of liability by the Guarantor or any ERISA Affiliate under Section 4064 of ERISA upon the termination of a Multiple Employer Plan, or (iii) the distribution of a notice of intent to terminate a Plan pursuant to Section 4041(a)(2) of ERISA or the treatment of a Plan amendment as a termination under Section 4041 of ERISA, or (iv) the institution of proceedings to terminate a Plan by the PBGC under Section 4042 of ERISA, or (v) any other event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Plan.

"Total Capitalization" means, at any time, the sum (without duplication) of (a) Total Senior Debt, (b) the total outstanding principal amount (or the book carrying amount of such Debt if issued at a discount) of Subordinated Debt of the Guarantor and its Consolidated Subsidiaries, (c) Consolidated Net

Worth less any amount thereof attributable to "minority interests" (as defined below), and (d) Redeemable Preferred Stock of the Guarantor and its Consolidated Subsidiaries other than the EOG Group. For the purpose of this definition, "minority interests" means any investment or interest of the Guarantor in any corporation, partnership or other entity to the extent that the total amount thereof owned by the Guarantor (directly or indirectly) constitutes 50% or less of all outstanding interests or investments in such corporation, partnership or entity.

"Total Senior Debt" means, at any time, all Consolidated Debt of the Guarantor and its Consolidated Subsidiaries other than Subordinated Debt.

"Withdrawal Liability" shall have the meaning given such term under Part I of Subtitle E of Title IV of ERISA.

Section 1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed in accordance with, and certificates of compliance with financial covenants shall be based on, GAAP; provided, however, the financial statements and reports required pursuant to Section 4.01(a)(i) and (vii) shall be prepared in accordance with generally accepted accounting principles consistently applied except to the extent stated therein.

Section 1.3 Miscellaneous. The words "hereof," "herein" and "hereunder" and words of similar import when used in this Guaranty shall refer to this Guaranty as a whole and not to any particular provision of this Guaranty, and Article and Section references are to Articles and Sections of this Guaranty, unless otherwise specified. The term "including" shall mean "including, without limitation."

ARTICLE II

GUARANTY

Section 2.1 Guaranty.

(a) The Guarantor hereby unconditionally, absolutely and irrevocably guarantees to the Bank, within three (3) Business Days of demand, the full and timely payment and satisfaction of (a) the Obligations as and when the same shall become due or payable, whether at maturity or otherwise, and (b) any and all fees and expenses (including reasonable counsel fees and expenses) incurred by the Bank in enforcing any of its rights under this Guaranty. If the Guarantor receives a demand for payment pursuant to this Guaranty, the Guarantor shall pay to the Bank, not later than the third Business Day following the Guarantor's receipt of such demand, the amount specified in such demand, which shall not exceed the amount of the Obligations to which such demand relates. Multiple demands may be made hereunder.

(b) If, at any time, the Bank provides notice to the Guarantor that (i) an Event of Default under the Note has occurred and the Bank is unable to accelerate or is blocked from accelerating the maturity of the Note and (ii) the Bank notifies the Guarantor that it elects to sell and assign the Note to the Guarantor, then the Bank shall assign and sell to the Guarantor, and the Guarantor shall accept, purchase and pay for the Note in accordance with the remaining provisions of this clause (b). The Closing of the assignment, acceptance, sale and purchase shall occur on the third Business Day following the notice from the Bank to the Guarantor referred to above. On such Business Day:

(i) the Bank shall deliver the Note (or in the event the Note is lost or missing, an affidavit certifying that the Note is lost or missing and indemnifying the Guarantor for losses it incurs as a result of the note being lost or missing) to the Guarantor; and

(ii) upon satisfaction of clause Section 2.01(b)(i), the Guarantor shall pay the Bank an amount in cash equal to the outstanding Obligations as of such date.

Section 2.2 Nature of Guaranty. The Guarantor guarantees that, subject to the demand provisions set forth in Section 2.01, the Obligations will be paid in accordance with the terms of the Note. The liability of the Guarantor under this Guaranty to the fullest extent permitted by law shall be absolute and unconditional, irrespective of:

(a) any change in the time, manner or place of performance or payment of, or in any other term of, all or any of the Obligations, or any other amendment, extension of maturity or waiver of or any consent or departure from the Note;

(b) the existence of, or any release or amendment or waiver of or consent to departure from, any other guaranty for all or any of the Obligations;

(c) any change in the existence, structure or ownership of the Borrower, the Guarantor or the Bank or any insolvency, bankruptcy, reorganization or other similar proceeding affecting any of them or their respective assets or any defense that may arise as a result of any such proceeding;

(d) any other act, omission to act or delay of any kind by any party hereto or any other person, or any other circumstance whatsoever that might, but for the provisions of this Section, constitute a legal or equitable discharge of the obligations of a guarantor or surety;

(e) any lack of validity or enforceability of the Note or any other agreement or instrument relating thereto;

(f) any law or legal requirement now or hereafter in effect in any jurisdiction affecting any of the terms of the Note or the rights of the Bank with respect thereto; or

(g) the failure of the Bank to assert any claim or demand or to enforce any right or remedy under the Note.

The Guaranty made by the Guarantor hereunder shall continue to be effective or be reinstated, as the case may be, if at any time any payment of any of the Obligations is rescinded or must otherwise be returned by the Bank for any reason, including the bankruptcy, insolvency or reorganization of the Borrower or otherwise, all as though such payment had not been made, and, in such event, the Guarantor will pay to the Bank an amount equal to the payment that has been rescinded or returned. This Guaranty shall be absolute and unconditional notwithstanding the occurrence of any event or the existence of any other circumstance which might constitute a defense available to the Guarantor or the Borrower or a legal or equitable discharge of a surety or the Guarantor except indefeasible payment in full of the Obligations and all other amounts owed hereunder. The provisions of this paragraph will survive any release or termination of this Guaranty. If and to the extent that the Guarantor makes any payment to the Bank pursuant to this Guaranty, any claim which the Guarantor may have against the Borrower by reason thereof shall be subject and subordinate to the prior indefeasible payment in full of the Obligations. The obligations of the Guarantor hereunder are independent of the obligations of the Borrower and separate action or actions may be brought and prosecuted against the Guarantor to enforce this Guaranty, irrespective of whether any action is brought against the Borrower or whether the Borrower is joined in any such action or actions.

2.3 Waiver. Except as otherwise set forth herein, the Guarantor waives promptness, diligence, notice of acceptance and any other notice with respect to any of the Obligations and this Guaranty and any requirement that the Bank protect, secure, perfect or insure any collateral or exhaust any right or take any action against the Borrower or any other Person or any collateral.

ARTICLE III

REPRESENTATIONS, WARRANTIES

Section 3.1 Representations and Warranties. The Guarantor hereby represents and warrants as follows:

(a) The Guarantor and each Principal Subsidiary are duly organized or validly formed, validly existing and (if applicable) in good standing in each case under the laws of its jurisdiction of incorporation or formation. The Guarantor and each Principal Subsidiary have all requisite powers and all material governmental licenses, authorizations, consents and approvals required in each case to carry on its business as now conducted.

(b) The execution, delivery and performance by the Guarantor of this Guaranty are within the Guarantor's corporate powers, have been duly authorized by all necessary corporate action of the Guarantor, require, in respect of the Guarantor, no action by or in respect of, or filing with, any governmental body, agency or official and do not contravene, or constitute a default under, any provision of law or regulation (including, without limitation, Regulation X issued by the Federal Reserve Board) applicable to the Guarantor or Regulation U issued by the Federal Reserve Board or the articles of incorporation or by-laws of the Guarantor or any judgment, injunction, order, decree or material ("material" for the purposes of this representation meaning creating a liability of $50,000,000 or more) agreement binding upon the Guarantor or result in the creation or imposition of any lien, security interest or other charge or encumbrance on any asset of the Guarantor or any of its Subsidiaries.

(c) This Guaranty has been duly executed and delivered by the Guarantor and is the legal, valid and binding obligation of the Guarantor enforceable against the Guarantor in accordance with its terms, except as the enforceability thereof may be limited by the effect of any applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally and by general principles of equity.

(d) The audited consolidated balance sheet of the Guarantor and its Subsidiaries as of December 31, 1996 and the related audited consolidated statements of income, cash flows and changes in stockholders' equity accounts for the fiscal year then ended and the unaudited consolidated balance sheet of the Guarantor and its Subsidiaries as of June 30, 1997 and the related unaudited consolidated statements of income, cash flows and changes in stockholders' equity accounts for the six months then ended, certified by the chief financial or accounting officer of the Guarantor, copies of which have been delivered to the Bank, fairly present, in conformity with GAAP except as otherwise expressly noted therein, the consolidated financial position of the Guarantor and its Subsidiaries as of such dates and their consolidated results of operations and changes in financial position for such fiscal periods, subject (in the case of the unaudited balance sheet and statements) to changes resulting from audit and normal year-end adjustments. Since December 31, 1996 through the date hereof, there has been no material adverse change in the business, consolidated financial position or consolidated results of operations of the Guarantor and its Subsidiaries, considered as a whole.

(e) Except as disclosed in the Guarantor's Form 10-K for the year ended December 31, 1996 or the Guarantor's Forms 10-Q for the quarters ended March 31, 1997 or June 30, 1997, there is no action, suit or proceeding pending against the Guarantor or any of its Subsidiaries, or to the knowledge of the Guarantor threatened against the Guarantor or any of its Subsidiaries, before any court or arbitrator or any governmental body, agency or official in which there is a reasonable possibility of an adverse decision which could materially adversely affect the business, consolidated financial position or consolidated results of operations of the Guarantor and its Subsidiaries, taken as a whole, or which in any manner draws into question the validity of this Guaranty.

(f) No Termination Event has occurred or is reasonably expected to occur with respect to any Plan for which an Insufficiency in excess of $50,000,000 exists. Neither the Guarantor nor any ERISA Affiliate has received any notification (or has knowledge of any reason to expect) that any Multiemployer Plan is in reorganization or has been terminated, within the meaning of Title IV of ERISA, for which a Withdrawal Liability in excess of $50,000,000 exists.

(g) United States federal income tax returns of the Guarantor and its Subsidiaries have been examined and closed through the fiscal year ended December 31, 1991. The Guarantor and its Subsidiaries have filed or caused to be filed all United States federal income tax returns and all other material domestic tax returns which to the knowledge of the Guarantor are required to be filed by them and have paid or provided for the payment, before the same become delinquent, of all taxes due pursuant to such returns or pursuant to any assessment received by the Guarantor or any Subsidiary, other than those taxes contested in good faith by appropriate proceedings. The charges, accruals and reserves on the books of the Guarantor and its Subsidiaries in respect of taxes are, in the opinion of the Guarantor, adequate to the extent required by GAAP.

(h) Neither the Guarantor nor any of its Subsidiaries is an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

(i) Each of the Borrower and the Principal Subsidiaries is not subject to, or is exempt from, regulation as a "holding company", a "subsidiary company" of a "holding company", an "affiliate" of a "holding company", or an "affiliate" of a "subsidiary company" of a "holding company", in each case as such terms are defined in the Public Utility Holding Company Act of 1935, as amended.

(j) Not more than 25 percent of the value of the assets (either of the Guarantor only or of the Guarantor and its Subsidiaries on a consolidated basis), which are subject to any arrangement with the Bank (herein or otherwise) whereby the Guarantor's or any Subsidiary's right or ability to sell, pledge or otherwise dispose of assets is in any way restricted, will be margin stock (within the meaning of Regulation U issued by the Federal Reserve Board).

ARTICLE IV

COVENANTS

Section 4.1 Affirmative Covenants. The Guarantor hereby covenants and agrees that, until the Obligations and all other amounts owed hereunder are paid in full, the Guarantor shall:

(a) Reporting Requirements. Furnish to the Bank:

(i) (1) promptly after the sending or filing thereof, a copy of each of the Guarantor's reports on Form 8-K (or any comparable form), (2) promptly after the filing or sending thereof, and in any event within 75 days after the end of each of the first three fiscal quarters of each fiscal year of the Guarantor, a copy of the Guarantor's report on Form 10-Q (or any comparable form) for such quarter, which report will include the Guarantor's quarterly unaudited consolidated financial statements as of the end of and for such quarter, and (3) promptly after the filing or sending thereof, and in any event within 135 days after the end of each fiscal year of the Guarantor, a copy of the Guarantor's annual report which it sends to its public security holders, and a copy of the Guarantor's report on Form 10-K (or any comparable form) for such year, which annual report will include the Guarantor's annual audited consolidated financial statements as of the end of and for such year;

(ii) simultaneously with the delivery of each of the annual or quarterly reports referred to in clause (i) above, a certificate of the chief financial officer or the chief accounting officer of the Guarantor in a form acceptable to the Bank (x) setting forth in reasonable detail the calculations required to establish whether the Guarantor was in compliance with the requirements of Sections 4.02(b) and (c) on the date of the financial statements contained in such report, and (y) stating whether there exists on the date of such certificate any Event of Default or event which, with the giving of notice or lapse of time, or both, would constitute an Event of Default, and, if so, setting forth the details thereof and the action which the Guarantor has taken and proposes to take with respect thereto;

(iii) as soon as possible and in any event within five days after an executive officer of the Guarantor having obtained knowledge thereof, notice of the occurrence of any Event of

Default or any event which, with the giving of notice or lapse of time, or both, would constitute an Event of Default, continuing on the date of such notice, and a statement of the chief financial officer of the Guarantor setting forth details of such Event of Default or event and the action which the Guarantor has taken and proposes to take with respect thereto;

(iv) as soon as possible and in any event (A) within 30 Business Days after the Guarantor or any ERISA Affiliate knows or has reason to know that any Termination Event described in clause (i) of the definition of Termination Event with respect to any Plan for which an Insufficiency in excess of $50,000,000 exists, has occurred and (B) within 10 Business Days after the Guarantor or any ERISA Affiliate knows or has reason to know that any other Termination Event with respect to any Plan for which an Insufficiency in excess of $50,000,000 exists, has occurred or is reasonably expected to occur, a statement of the chief financial officer or chief accounting officer of the Guarantor describing such Termination Event and the action, if any, which the Guarantor or such ERISA Affiliate proposes to take with respect thereto;

(v) promptly and in any event within five Business Days after receipt thereof by the Guarantor or any ERISA Affiliate, copies of each notice received by the Guarantor or any ERISA Affiliate from the PBGC stating its intention to terminate any Plan for which an Insufficiency in excess of $50,000,000 exists or to have a trustee appointed to administer any Plan for which an Insufficiency in excess of $50,000,000 exists;

(vi) promptly and in any event within five Business Days after receipt thereof by the Guarantor or any ERISA Affiliate from the sponsor of a Multiemployer Plan, a copy of each notice received by the Guarantor or any ERISA Affiliate indicating liability in excess of $50,000,000 incurred or expected to be incurred by the Guarantor or any ERISA Affiliate in connection with (A) the imposition of a Withdrawal Liability by a Multiemployer Plan, (B) the determination that a Multiemployer Plan is, or is expected to be, in reorganization within the meaning of Title IV of ERISA, or (C) the termination of a Multiemployer Plan within the meaning of Title IV of ERISA; and

(vii) such other information respecting the condition or operations, financial or otherwise (including an annual report or reports on oil and gas reserves of the Guarantor and its Subsidiaries), of the Guarantor or any of its Subsidiaries as the Bank may from time to time reasonably request.

(b) Compliance with Laws, Etc. Comply, and cause each of its Subsidiaries to comply, with all applicable laws, rules, regulations and orders to the extent noncompliance therewith would have a material adverse effect on the Guarantor and its Subsidiaries taken as a whole, such compliance to include, without limitation, compliance with environmental laws and paying before the same become delinquent all taxes, assessments and governmental charges imposed upon it or upon its property except to the extent contested in good faith.

(c) Preservation of Corporate Existence, Etc. Preserve and maintain, and cause each of the Principal Subsidiaries to preserve and maintain, its legal existence, rights (charter, if applicable, and statutory) and franchises; provided, however, that this Section 4.01(c) shall not apply to any transactions or matters permitted by Section 4.02(d) or (e) and shall not prevent the termination of existence, rights and franchises of any Principal Subsidiary pursuant to any merger or consolidation to which such Principal Subsidiary is a party or pursuant to lease, sale, transfer or other disposition of assets by a Principal Subsidiary, and provided, further, that the Guarantor or any Principal Subsidiary shall not be required to preserve any right or franchise if the Guarantor or such Principal Subsidiary shall determine that the preservation thereof is no longer desirable in the conduct of the business of the Guarantor or such Principal Subsidiary, as the case may be, and that the loss thereof is not disadvantageous in any material respect to the Bank.

(d) Maintenance of Insurance. Maintain, and cause each of the Principal Subsidiaries to maintain, insurance with responsible and reputable insurance companies or associations in such amounts and covering such risks as is usually carried by companies engaged in similar businesses and owning similar properties as the Guarantor or such Principal Subsidiary, provided, that self-insurance by the Guarantor or any such Principal Subsidiary shall not be deemed a violation of this covenant to the extent that companies engaged in similar businesses and owning similar properties as the Guarantor or such Principal Subsidiary self-insure. The Guarantor may maintain its Principal Subsidiaries' insurance on behalf of them.

(e) Visitation Rights. At any reasonable time and from time to time, after reasonable notice, permit the Bank or any agents or representatives thereof, to examine the records and books of account of, and visit the properties of, the Guarantor or any of its Principal Subsidiaries, and to discuss the affairs, finances and accounts of the Guarantor and any of its Principal Subsidiaries with any of their respective officers or directors.

Section 4.2 Negative Covenants. The Guarantor hereby covenants and agrees that, until the Obligations and all other amounts owed hereunder are paid in full, the Guarantor will not, unless the Bank shall otherwise consent in writing:

(a) Negative Pledge. Fail to perform and observe any term, covenant or agreement contained in Section 1007 of the Enron Indenture (as modified for purposes hereof as set forth in the proviso to the next sentence hereof). For the purposes of this Section 4.02(a), Section 1007, and the definitions of all terms defined in the Enron Indenture and used in or otherwise applicable to such Section 1007, are hereby incorporated in this Guaranty by reference as if such provisions and definitions were set forth in full herein; provided, however, that solely for the purposes of this Section 4.02(a) the word "Securities" as used in the Enron Indenture shall mean the obligations of the Guarantor now or hereafter existing under this Guaranty, the word "Company" used therein shall mean the Guarantor, the phrase "this Section 1007" used therein shall mean this Section 4.02(a), the word "Trustee" used therein shall mean the Bank, and the phrase "So long as any of the Securities are outstanding" used therein shall mean so long as any Obligation or other amount owed hereunder shall remain unpaid.

(b) Senior Debt to Capitalization.. Have a ratio of (i) Total Senior Debt (other than Debt of the EOG Group) to (ii) Total Capitalization greater than 65%.

(c) Tangible Net Worth. Have a Consolidated Tangible Net Worth of less than $1,500,000,000.

(d) Disposition of Assets. Lease, sell, transfer or otherwise dispose of, voluntarily or involuntarily, all or substantially all of its assets.

(e) Mergers, Etc.. Merge or consolidate with or into, any Person, unless (i) the Guarantor is the survivor or (ii) the surviving Person, if not the Guarantor, is organized under the laws of the United States or a state thereof and assumes all obligations of the Guarantor under the Guaranty, provided, in each case that immediately after giving effect to such proposed transaction, no Guarantor Default or event which, with the giving of notice or the lapse of time, or both, would constitute an Guarantor Default would exist or result.

(f) Compliance with ERISA. (i) Terminate, or permit any ERISA Affiliate to terminate, any Plan so as to result in any liability in excess of $50,000,000 of the Guarantor or any ERISA Affiliate to the PBGC, or (ii) permit circumstances which give rise to a Termination Event described in clause (ii), (iv) or (v) of the definition of Termination Event with respect to a Plan so as to result in any liability in excess of $50,000,000 of the Guarantor or any ERISA Affiliate to the PBGC.

ARTICLE V

GUARANTOR DEFAULT

Section 5.1 Guarantor Default. Any of the following specified events shall be considered a "Guarantor Default" hereunder:

(a) The Guarantor shall fail to perform or observe any term, covenant or agreement contained in Section 2.01, or shall fail to perform or observe any other term, covenant or agreement contained in this Guaranty on its part to be performed or observed if, in the case of such other term, covenant or agreement, such failure shall remain unremedied for 30 days after written notice thereof shall have been given to the Guarantor by the Bank (provided that such grace period shall not apply to the Guarantor's payment obligations under Section 2.01); or

(b) Any representation or warranty made by the Guarantor (or any of its officers) under or in connection with this Guaranty shall prove to have been incorrect in any material respect when made and such materiality is continuing; or

(c) The Guarantor or any of its Principal Subsidiaries shall generally not pay its debts as such debts become due, or shall admit in writing its inability to pay its debts generally, or shall make a general assignment for the benefit of creditors; or any proceeding shall be instituted by or against the Guarantor or any of its Principal Subsidiaries seeking to adjudicate it as bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief, or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors, or seeking the entry of an order for relief or the appointment of a receiver, trustee, or other similar official for it or for any substantial part of its property and, in the case of any such proceeding instituted against it (but not instituted by it), shall remain undismissed or unstayed for a period of 60 days; or the Guarantor or any of its Principal Subsidiaries shall take any action to authorize any of the actions set forth above in this subsection (c); or

(d) Any provision of this Guaranty for any reason is not or ceases to be valid and binding on the Guarantor, or the Guarantor shall so state in writing; or

(e) The Guarantor or any of its Principal Subsidiaries shall (i) fail to pay any principal of or premium or interest on any Debt (other than Debt described in clause (iii) of the definition of Debt) which is outstanding in the principal amount of at least $50,000,000 in the aggregate, of the Guarantor or such Principal Subsidiary (as the case may be), when the same becomes due and payable (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise), and such failure shall continue after the applicable grace period, if any, specified in the agreement or instrument relating to such Debt; or any other event shall occur or condition shall exist under any agreement or instrument relating to any such Debt and shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such event or condition is to accelerate the maturity of such Debt; or any such Debt shall be declared to be due and payable, or require to be prepaid (other than by a regularly scheduled required prepayment or as a result of the giving of notice of a voluntary prepayment), prior to the stated maturity thereof, or (ii) with respect to Debt described in clause (iii) of the definition of Debt, fail to pay any such Debt which is outstanding in the principal amount of at least $50,000,000 in the aggregate, of the Guarantor or such Principal Subsidiary (as the case may be), when the same becomes due and payable and such failure shall continue after the applicable grace period, if any, specified in the agreement or instrument relating to such Debt; or

(f) Any judgment, decree or order for the payment of money in excess of $50,000,000 shall be rendered against the Guarantor or any of its Principal Subsidiaries and remains unsatisfied and either (i) enforcement proceedings shall have been commenced by any creditor upon such judgment, decree or order or (ii) there shall be any period of 60 consecutive days during which a stay of enforcement of such judgment, decree or order, by reason of a pending appeal or otherwise, shall not be in effect; or

(g) Any Termination Event as defined in clause (ii), (iv) or (v) of the definition thereof with respect to a Plan shall have occurred and, 30 days after notice thereof shall have been given to the Guarantor by the Bank, (i) such Termination Event shall still exist and (ii) the sum (determined as of the date of occurrence of such Termination Event) of the liabilities to the PBGC resulting from all such Termination Events is equal to or greater than $100,000,000; or

(h) The Guarantor or any ERISA Affiliate shall have been notified by the sponsor of a Multiemployer Plan that it has incurred Withdrawal Liability to such Multiemployer Plan in an amount which, when aggregated with all other amounts required to be paid to Multiemployer Plans in connection with Withdrawal Liabilities (determined as of the date of such notification), exceeds $100,000,000 or requires payments exceeding $50,000,000 in any year; or

(i) The Guarantor or any ERISA Affiliate shall have been notified by the sponsor of a Multiemployer Plan that such Multiemployer Plan is in reorganization or is being terminated, within the meaning of Title IV of ERISA, if as a result of such reorganization or termination the aggregate annual contributions of the Guarantor and its ERISA Affiliates to all Multiemployer Plans which are then in reorganization or being terminated have been or will be increased over the amounts contributed to such

Multiemployer Plans for the respective plan years which include the date hereof by an amount exceeding $50,000,000 in the aggregate.

ARTICLE VI

MISCELLANEOUS

Section 6.1 Notice. Any demand, notice, request, instruction, correspondence or other document to be given hereunder by any party to another (herein collectively called "Notice") shall be in writing and delivered personally or mailed by certified mail, postage prepaid and return receipt requested, or by telegram or telecopier, as follows:

if to the Guarantor:

Enron Corp.
1400 Smith Street
Houston, Texas 77002
Attention: Treasurer
Facsimile: (713) 646-3422

if to the Bank, at its address or telecopier number set forth below:

Barclays Bank PLC
222 Broadway
New York, New York 10038
Attention: Richard Williams/Sal Esposito

Telecopier No.: (212) 412-7588

Notice given by personal delivery or mail shall be effective upon actual receipt. Notice given by telegram or telecopier shall be effective upon actual receipt if received during the recipient's normal business hours, or at the beginning of the recipient's next business day after receipt if not received during the recipient's normal business hours. All Notices by telegram or telecopier shall be confirmed promptly after transmission in writing by certified mail or personal delivery. Any party may change any address to which Notice is to be given to it by giving notice as provided above of such change of address.

Section 6.2 Amendment or Waiver. Neither this Guaranty nor any terms hereof may be changed, waived, discharged or terminated unless such change, waiver, discharge or termination is in writing signed by the Guarantor and the Bank.

Section 6.3 Successors and Assigns. This Guaranty shall be binding upon and inure to the benefit of the Guarantor and the Bank, and their respective successors and assigns, except that the Guarantor may not assign or transfer any of its rights or obligations under this Guaranty without the prior written consent of the Bank. This Guaranty shall also be binding upon, inure to the benefit of and be enforceable by any Person which acquires an interest in the Note by assignment or participation.

Section 6.4 No Waiver; Remedies Cumulative. No course of dealing between the Guarantor and the Bank shall operate as a waiver of any right, power or privilege hereunder; nor shall any single or partial exercise of any right, power or privilege hereunder or under the Note preclude any other or further exercise thereof or the exercise of any other right, power or privilege hereunder or thereunder; nor shall any failure to exercise or delay in exercising any right, power or privilege hereunder operate as a waiver of any right, power or privilege. The rights, powers and remedies hereunder or in the Note expressly provided are cumulative and not exclusive of any rights, power or remedies which the Bank shall otherwise have. No notice to or demand on the Guarantor shall in any case entitle the Guarantor to any other or further notice or demand in similar or other circumstances or constitute a waiver of the rights of the Bank to any other or further action in any circumstances with notice or demand. At the option of the Bank, the Guarantor may be joined in any action or proceeding commenced by the Bank in connection with or based on the Note, and recovery may be had against the Guarantor in such action or proceeding or in any independent action or proceeding against the Guarantor, without any requirement that the Bank first assert, prosecute or exhaust any remedy or claim against the Borrower or any other Person.

Section 6.5 Severability. In case any provision in or obligation under this Guaranty shall be invalid, illegal or unenforceable in any jurisdiction, then the validity, legality and enforceability of the remaining provisions or obligations, or such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

Section 6.6 Final Agreement. THIS WRITTEN AGREEMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE GUARANTOR AND THE BANK AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS BETWEEN GUARANTOR AND THE BANK. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN GUARANTOR AND THE BANK.

Section 6.7 Governing Law. THIS GUARANTY AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER AND OTHERWISE ARISING FROM OR RELATING TO THE SUBJECT MATTER OF THIS GUARANTY OR THE TRANSACTIONS CONTEMPLATED HEREBY SHALL BE CONSTRUED IN ACCORDANCE WITH AND BE GOVERNED BY THE LAWS OF THE STATE OF NEW YORK.

Section 6.8 Right of Set-Off. Upon the occurrence and during the continuance of any Guarantor Default, the Bank is hereby authorized at any time and from time to time, to the fullest extent permitted by law, to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by the Bank to or for the credit or the account of the Guarantor against any and all of the obligations of the Guarantor under this Guaranty which are then liquidated, matured and past due. The Bank agrees promptly to notify the Guarantor after any such set-off and application made by it, provided that the failure to give such notice shall not affect the validity of such set-off and application. The right of the Bank under this Section is in addition to other rights and remedies (including other rights of set-off) which the Bank may have.

IN WITNESS WHEREOF, the Guarantor has caused its duly authorized officer to execute and deliver this Guaranty as of the date hereof.

ENRON CORP.

By: William D. Gathmann cca
William D. Gathmann
Vice President, Finance and Treasurer

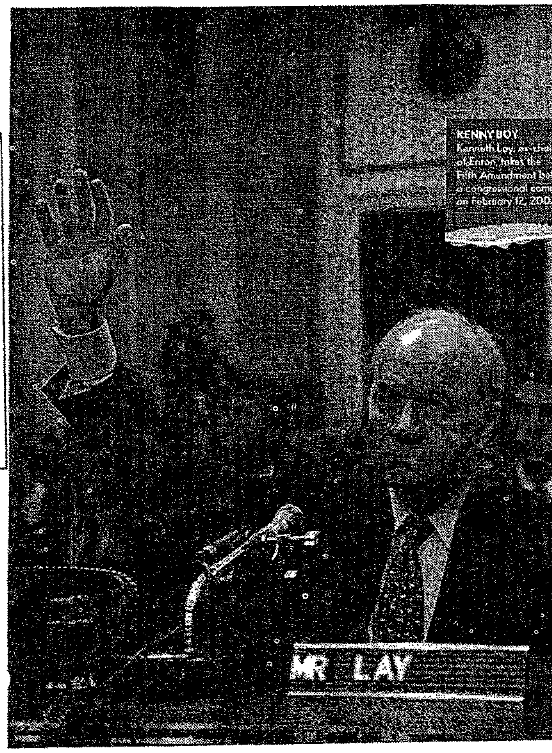
VE 00867

ADVANCE COPY

# THE ENRON WARS 26

If there was one thing Jan Avery knew when she joined Enron in 1993, it was numbers. But nothing added up. New evidence reveals that the seeds of Ken Lay's pattern of hiding losses went back even further—all the way to 1987

BY MARIE BRENNER



KENNY BOY
Kenneth Lay, ex-chairman of Enron, takes the Fifth Amendment before a congressional committee on February 12, 2002

It was at first inconceivable to Jan Avery that her position at the Enron Corporation could make her a valuable witness in the largest bankruptcy case in American history. On the morning of January 25, when former Enron vice-chairman Cliff Baxter was found dead in his Mercedes with a suicide note and a bullet wound in his head, Avery was home sifting through proxy statements and S.E.C. filings she had kept in storage. Like Baxter, she had been interviewed by lawyers and investigators who were convinced that her testimony could illuminate what had led to Enron's collapse. Shortly before his death, Baxter told colleagues that he had become a pivotal figure in the scandal, and that he stood between Ken Lay and Jeff Skilling (former C.E.O.'s of Enron) going to jail. Avery was apprehensive as well. For eight years she had consulted on the myriad complex structures that fueled the Enron delusion. "The pattern began very early," she said, "much earlier than anyone has reported. It started in the gray area of what was acceptable in accounting principles and, in my opinion, later turned into a clear case of fraud."

The mystery of Enron presented itself to Avery in 1993, during her earliest days in the company's tax department. Trained as an accountant—what Enron called a "middle person"—she placed confidentiality at a premium. Avery's special expertise was in oil-and-gas tax procedures, used to compute state and federal taxes. From her days as a young woman going to night school, she had been taken by the simple beauty of accounting, balancing credits and debits. She had even run her own marketing company, jockeying to buy and move gas on the newly deregulated pipelines that criss-crossed Texas and New Mexico. In an Enron that would soon fill up with young M.B.A.'s in polo shirts and khakis, Avery was an anomaly. She dressed in blazers and suits and always kept flowers in her office. Her paternal grandmother had been born on a plantation in Alabama, and good breeding showed on Avery's face, but the family had lost everything, so a determination was there as well. In the wild, optimistic days of Enron's romance with the opening energy markets, Jan Avery was a perfect hire. The Soviet Union had fallen, and the idea of privatizing electricity, natural gas, and other commodities was sweeping the world.

**THE WITNESS**
Jan Avery, an accountant at Enron for eight years, with her daughter, Katherine, photographed in Houston on January 26, 2002.

Like FedEx, Enron seemed poised to be in the vanguard of the newest frontier of American business.

Avery's first assignment, in 1993, seemed routine. She was to compute a schedule of amended state tax returns for Enron Oil, a former subsidiary of the company. Enron Oil had shown a loss on its books, her boss told her, and Avery was supposed to calculate the carryback on the company records. She had worked at such major accounting firms as Arthur Young, Arthur Andersen, and Touche Ross, so she knew what to expect: a thick file with a schedule of tax depreciations. It was standard stuff—years of book-value depletion for oil and gas, company officers' life insurance, liabilities of all kinds. She waited for the file to be delivered, but it didn't appear. "Where is the file?" she asked her colleagues, and they gave vague answers, as if they hadn't understood what she was talking about. Days passed, and still no file arrived. Finally, she says, she was given a thin manila folder containing three sheets, on one of which was a number: $142 million. This was

> "Where are the books for Enron Oil? How am I supposed to justify a $142 million loss?," Avery asked.

no routine loss; it was a staggering amount for a young company. Avery assumed it was a mistake; she scoured the storage room next to her cubicle and continued to ask her co-workers, "Where are the books for Enron Oil? How am I supposed to justify a $142 million loss for state-tax purposes?" No one could answer her.

"It made no sense to me," she said. "You do not have an entire file of financials disappear." Enron Oil had gone out of business; there had to be officers you could track down. Since she had no data, she refused to sign off on the $142 million figure. "I questioned it and questioned it. I went to the financial office. Finally I wrote a research report, trying to come up with some kind of basis, but it was impossible to do the research without the facts," she said.

Soon after that Avery's boss walked into her office and said, "Here is your answer. We had a little problem." He paused and said, "Rogue traders." That was the first Avery heard of a bizarre case that had disappeared without much notice. For a moment she thought he was joking. She wondered if certain files were kept in his office so that Enron could claim that they were protected under attorney-client privilege and could not be subpoenaed. Finally he let Avery see the Enron Oil file, but it yielded no data to clarify what had really gone on. "This was the clear beginning for me, when I realized that they were trying to hide all the losses," she later said.

Jan Avery had arrived early in the Enron Corporation's drama of willful blindness, during an attempt to perfume a disaster Kenneth Lay, Enron's architect, had inherited in 1985 when he merged his company, Houston Natural Gas, with InterNorth, an Omaha-based concern. In December 1993, Arthur Andersen would become the in-house auditors. Enron Oil was an overture to thousands of off-the-books partnerships which would subsequently dizzy readers trying to figure out what the Enron debacle was really about. It was a harbinger of the future Enron pattern of hiding losses, no matter what. Avery's initial confusion over accounting discrepancies and missing documents only presaged the bafflement of the battalion of bankruptcy lawyers who would be assigned to unravel the morass, of the

STYLING … JR., AND MAKEUP BY NANCEY CHAPMAN


PHOTOGRAPH BY MARY ELLEN MARK

thousands of Enron employees who would find that their 401(k) plans were nearly worthless, and of all the congressmen—71 in the Senate and 187 in the House—who had received campaign contributions from Enron. The taint of the energy giant would soon permeate the White House and the president's men as George W. Bush and Dick Cheney, close friends and associates of Ken and Linda Lay for years, stonewalled requests from the General Accounting Office for documents, issued new terrorist warnings, and gave lengthy interviews to *The Washington Post* in which Bush talked about being choked with emotion in the days after September 11. To many these actions appeared to be a full-out legal-defense and public-relations campaign, a smoke screen to keep the political leaders' web of Enron connections from scrutiny. They overwhelmed the footage on the nightly news shows of former Enron employees in T-shirts dragging ficus trees from their offices down the steps of the two gleaming corporate skyscrapers on Houston's Smith Street.

Avery had been hired to work on tax collages, researching case law and the tax code and briefing executives on Enron's interests in deals. "We take an aggressive position on losses," she was told, but that policy sounded benign. The enigma of the Enron Oil loss confounded her because it seemed to be constructed to cover up a criminal fiasco. In October 1985 the heads of a trading operation—soon to be renamed Enron Oil—based in Valhalla, New York, had set up a scam: using two sets of financial books, they ran hundreds of millions of dollars of phony trades through four sham Cayman Island partnerships. Masterminded by Louis Borget and Thomas Mastroeni, the president and vice president, the trades glided into the Enron Corporation's machinery, and in the swirl of the start-up the bogus trading operation continued smoothly for two years. One former executive remembered the day Enron got an urgent phone call from the Treasury Department questioning the enormousness of one Enron Oil trade.

In fact, the future Ken Lay business model started with Enron Oil, a flourishing petroleum-marketing operation with 28 employees and offices in New York, London, and Singapore. Enron Oil seemed to be the one bright spot in the sea of debt incurred in the Houston Natural Gas and InterNorth merger. On the books, it looked like a success story, earning $50 million over the two and a half years before its collapse. Months before federal prosecutors targeted the crime, an in-house Enron auditor began to keep a meticulous and lengthy file on the episode. Later, there was talk in the company that the auditor was so frustrated that he took 50 cartons of evidence and spirited them away in his attic.

Borget and Mastroeni pleaded guilty to conspiracy to defraud and to filing false tax returns, and Borget went to prison. The minor scandal hardly registered a blip in the financial press. Ken Lay told *The New York Times* that the loss was "an expensive embarrassment." The Enron board quickly voted to disband Enron Oil, and the loss almost tanked the new company. Enron had to liquidate assets, including a portion of a new power business, to cover it.

There remained, however, a larger question: How much of a loss had the company actually sustained? Enron gave the *Times* a figure of $85 million. Avery's file with no backup data said $142 million. No explanation for the loss ever appeared in subsequent annual reports, according to London's *Financial Times*. Avery became obsessed with trying to solve that first accounting puzzle. "It was clear to me, even then, that the management wanted as few people as possible to have any access to the records. It was the beginning of management's attempt to hide records from the S.E.C. and the shareholders."

Studying S.E.C. documents, Avery discovered that in an 8-K filing for 1987 the loss showed up as $85 million. This number appeared to her to have been computed using a standard that would become applicable only the following year. "This was a huge discrepancy," she later said. I asked Avery to explain what the numbers meant. She faxed several pages photocopied from 8-K's and Enron financials, and wrote, "It appears that management convinced Arthur Andersen to sign off on showing the loss and provides the first hint of Enron's ability to persuade Andersen to see things in Enron's best light."

Jan Avery and I met in early January for the first of many conversations. Like most people I interviewed during weeks of traveling back and forth between New York and Houston, she radiated anxiety about being seen with a reporter. A divorcée with a daughter who is a college freshman, Avery was concerned that she would be recognized in River Oaks by friends in the oil-and-gas business. In her years at Enron, she had participated in a heady world of ego and manipulation, dealing with an array of Cayman Island partnerships charted on whiteboards in conference rooms, jimmying utilities contracts during the California brownouts, bundling energy for Safeway stores, and creating a nationwide energy program for Citigroup. She supervised teams building power plants in Nicaragua and spent nine months in Europe, traveling often to the United Arab Emirates, where she was closing the $3 billion creation of the Dolphin pipeline.

For days I remained at the St. Regis Hotel in Houston as frightened Enron managers, lawyers, deal originators, and vice presidents—most of them women—came through the lobby, past the holiday gingerbread house that seemed frozen in the air-conditioning. It was the women of Enron, I soon discovered, who had detected the web of intrigue, predicted the fall, written futile letters to board members, tipped financial analysts, and tried to avert the final collapse.

Cynthia Harkness, an Enron lawyer, still at the company, described the moment when chief financial officer Andrew Fastow introduced her to a concept of monetization in which future revenue is booked immediately. The lawyer was baffled by the nerve behind Fastow's logic. She told him, "Andy, it seems to me that if you do a 10-year deal, and suck all the earnings out in one year, you will then have to keep the profit coming through years 4, 5, 6, and all the way to 10, by doing more of these deals.... How are you going to do that if the market changes? Book more deals?" It looked to Harkness like a pyramid scheme, but she knew that the accounting department had signed off on it. She recalled Fastow looking at her and saying, "Yes, you have to keep doing more of these deals each year."

It was Harkness's first week in Enron's global finance group, and she had yet to parse the world within the world that was Enron. Harkness had come to Houston from a large French investment bank, and she asked her new colleagues about partnerships called LJM, which were controlled by Fastow. (The name came from the initials for Fastow's wife and children.) "Isn't there a conflict here?" she asked. "Their answer always was 'This has been approved by the board.' They said, 'It's dicey, but it has been carefully scrubbed. They have put in extra hoops and procedures to make sure they're all right.'"

The language of the culture was borrowed from ornithology, with partnerships called Osprey, Raptor, and Condor as created vehicles to hide debts and losses. A special fiefdom was arranged for Fastow, with names taken from George Lucas films: JEDI, Chewco. It was a sign of status to have earned a life-size, furry Chewbacca head as a token of having worked on the Chewco deal. "At first we believed there was nothing wrong with this," Shirley Hudler, the manager of the JEDI I partnership, said, as friends of Fastow's walked away with huge profits.

Hudler, like Harkness, worked with Fastow and understood the mechanism of the partnership deals. "They would say, 'O.K., we need to get these assets off the books. We can either put it in Osprey or, if Osprey is full right now, we can sell it to LJM, which can hold it. And *then* we can move it.'" Years before that, the future whistle-blower Sherron Watkins would sit in meetings and say openly, "This is a circle jerk." Hudler said, "There was so much pressure on us to make earnings, and the Arthur Andersen staff we worked with would never challenge these structures. We could always bully them into getting what we wanted. We made them push the envelope. If they had questions, they would call Chicago—their headquarters. I don't think they were doing their job." (Arthur Andersen lays the entire blame for Enron's difficulties on Enron's board and management.)

Enron, many of the women said, was a hotbed of hormones, a testosterone culture. A vice president openly displayed a "hottie board," on which he ranked the sexual allure of Enron women. There was occasional violence. One trader, learning that his annual bonus was a mere $500,000, was said to have thrown his plasma screen across the trading floor. Another, fearing he would be a victim of an upcoming performance review, slammed his boss up against a wall, accusing him of lying about the trader's performance. "Forget you saw that," the man's boss told the woman who later described the event. "He's having a bad day."

**A vice president openly displayed a "hottie board," on which he ranked the sexual allure of Enron women.**

Arriving at the St. Regis Hotel on a Sunday morning, Avery wore a black pantsuit and high-heeled boots and carried a slim folder of documents, as if she were on her way to a deposition. She had driven from her house near West University, a neighborhood formerly inhabited by Rice University professors which had been taken over by the young Enron crowd. Many of the brick cottages had been expanded into mini-mansions, and S.U.V.'s and Porsches circled the area. At former chief financial officer Andrew Fastow's house, a guard stood in the winter fog. There was an atmosphere of impending catastrophe in the city.

I had first noticed Avery a month earlier at an Enron hearing in federal court. She was seated directly behind me in the press section, scribbling in a black ledger. She wore a vivid purple suit and had the put-together look of a woman who knew her way around Neiman Marcus. It was impossible not to notice her in the press seats, because she did not join in the easy conversation of the reporters seated around her. She had an aura of vulnerability underneath her good looks, a sadness around the edges. I guessed she might work for a law firm, but before I could speak to her she had vanished. Later, Avery told me she was actually trying to look like a reporter. It was her first time inside federal court, and before the hearing she had sat in the empty courtroom and watched a flotilla of lawyers wheel in seven carts of documents. To calm herself, she started counting the attorneys arriving in Judge Lee Rosenthal's court; she stopped at 30. Fearing that she would be caught in the background by one of the camera crews outside, she left during a break.

Avery had come to court to watch William Lerach in action. Lerach and his firm, Milberg Weiss Bershad Hynes & Lerach, were vying for a share of the billions of dollars in potential awards claimed by the hundreds of corporate creditors and pension funds that had seen their investments in Enron become worthless. The University of California retirement system alone had lost $145 million; Florida claimed $335 million. The total loss to state pension funds was $2.9 billion. Lerach's assistant worked the press row, passing out an oversize color chart. It was the first time I had ever seen a lawyer employ a public-relations intern at a routine hearing. The chart appeared to show the astonishing profits made by 29 Enron officials who had sold off $1.1 billion of company shares.

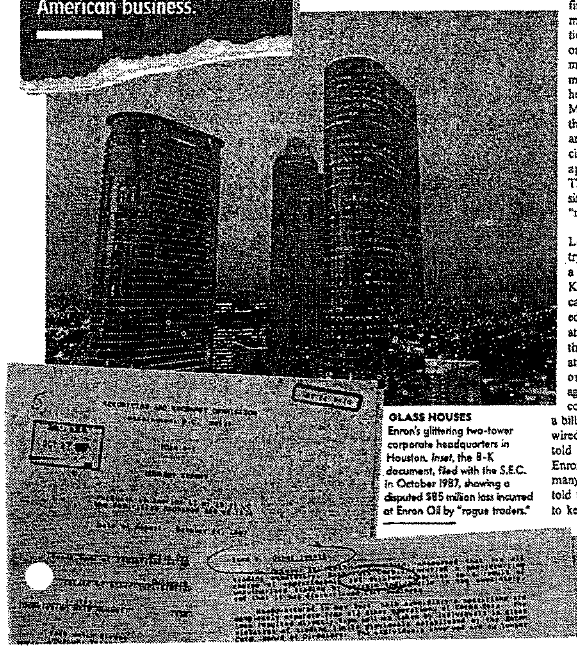
> **Like FedEx, Enron seemed poised to be in the vanguard of the newest frontier of American business.**

This was early in December, and the narrative of Enron as corporate Antichrist had yet to grip the networks. There was no mob of shouting bankrupt employees outside the courthouse, no Jesse Jackson, no CNN tent in front of the chrome Enron headquarters, no Linda Lay dragging NBC across an emerald lawn and declaring that the Lay family was impoverished. Lerach was attempting to freeze the assets of the 29 officials, but he was also selling his story, attempting to launch a fusillade into the national media.

"This is fraud at the top," Lerach declared in a booming voice with the thick sound of his native Pittsburgh. "Enron's goal ... was to keep these debts off the balance sheet so the rating agencies would not be able to see them." Lerach's task was to convince Judge Rosenthal that a group of Houston's finest citizens, whom she saw socially in River Oaks, had morphed into this decade's Robert Vesco and Marc Rich, global money launderers, and might be attempting to evade prosecution. "We know that the other night [Andrew Fastow] pre-cleared customs in Houston ... and had booked passage to Tel Aviv on three separate flights! ... Skilling has been in Brazil for the last couple of weeks! ... One top executive named McMahon, the treasurer, was known for going around the company after he met with Skilling, Lay, and Fastow, and they directed him to do some bogus deal and say, 'Well, we've all got to go drink the Kool-Aid.'" Lerach tossed out unfamiliar terms like grenades—"costless collars," "derivative trades."

Lerach, the scourge of the tort-reform anti-lawsuit lobby in Washington for his championing of class-action suits, from tobacco cases to those involving nursing homes, has a passion for theatrics, and his unruly hair looks as if he had stuck his finger into an electrical outlet. Standing in front of a chart of what he called "the Mike Milken model"—a reference to the Drexel Burnham Lambert architect of junk-bond finance in the 80s, who ultimately went to jail for securities fraud—Lerach pounded on the board with his black marker and then drew an immense daisy. "[Milken] was here in the middle ... so what Milken used to do is trade the bonds around.... It goes around and around in a big circle ... it creates the phony appearance of a market." Then Lerach threw out more sinister phrases—"dark swaps," "massive insider trading."

Judge Rosenthal studied Lerach coolly, as if she were trying to come to terms with a new set of variables for the Ken Lay who had chaired a campaign for the local United Way, who went to dinners at the White House, and who threw out the first baseball at Enron Field. Lerach, who once directed a civil case against Milken and others that collected damages of almost a billion dollars, appeared hard-wired with moral outrage as he told the court, "A member of Enron's tax group who structured many of these transactions has told us he was told his job was to keep Fastow out of jail!" At that moment, I turned in my seat and saw the woman in purple behind me blanch. Later, I would learn that the remark had been made to her as a joke by



**GLASS HOUSES**
Enron's glittering two-tower corporate headquarters in Houston. *Inset,* the 8-K document, filed with the S.E.C. in October 1987, showing a disputed $85 million loss incurred at Enron Oil by "rogue traders."

TOP, BY JAMES NIELSEN

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[illegible] Mintz, an Enron senior attorney who in February would testify before the House of Representatives that he had attempted to warn Jeff Skilling in May 2001 that his off-the-books partnerships were questionable. "I am keeping all my papers in a salt dome," Mintz had told a friend.

Lerach, who calls himself a private attorney general, is a connoisseur of criminal schmutz. He and his partner Mel Weiss run a thriving class-action firm which employs about 200 lawyers from San Diego to New York and 12 private investigators. They target savings banks, drug companies, and offshore scams. Their specialty is securities fraud, a form of

"This is nothing but a Ponzi scheme!," Lerach said outside the courtroom. "There it all was: *You have to drink the Kool-Aid!"*

**THE SCOURGE**
The attorney William Lerach follows a chart showing the demise of Enron Corporation stock. Lerach and his firm, Milberg Weiss Bershad Hynes & Lerach, have the leader position in the class-action suits against Enron.

plaintiff law that has been stymied by the 1995 tort-reform act, which was pushed through Congress by a group led primarily by Chris Dodd, senator from Connecticut, with the financial backing of the powerful insurance lobby. Tort-reform advocates insist that it lessens the ambulance chasing that used to clog the legal system; trial lawyers rail that it punishes victims and allows large corporations to get away with outrageous financial manipulations. The act put a stop to virtual automatic discovery of legal documents in class-action cases; because of that, lawyers like Lerach say, the standard of proof for legal pleadings has become onerous, and the investigations needed to file airtight complaints have become unduly expensive.

William Lerach is one of the foremost practitioners of aggressive research, and his investigators scour the world for witnesses and class members, an activity that is questionable under the new law, which prohibits lawyers from trolling for victims. Lerach is also criticized for his public displays. Last fall he chose an unusual strategy to win the Enron case. He decided to feed the media openly and ignore the barrage of legal moralists who would take him to task for it. He reasoned correctly that the bigger the story became, the sooner Enron whistle-blowers and witnesses would come out of hiding. Under tort reform, plaintiff firms must compete for the ultimate stake of being the assigned class leader. "I see it as a $3 billion case," Lerach told a partner, meaning the aggregate of all the claims. The class leader could reportedly earn between 10 and 30 percent of that.

By the time I saw Lerach in court, he was competing with law firms representing Florida and Illinois. Outside in the hall that day, he held forth with fiery indignation. "This is nothing but a Ponzi scheme! There it all was: *You have to drink the Kool-Aid!"* Within weeks Lerach's accusations proved to be accurate and made the leads of national news stories. His strategy—called "Leraching" by his detractors—had worked perfectly. According to one of his partners, "After that hearing we went back to the Four Seasons and for two days did not leave the room, there were so many Enron former employees who wanted to talk to us." (In February, Milberg Weiss won the class-leader position.)

In the early days of the scandal, Houston reverberated with the social and legal conflicts arising out of all the possible Enron prosecutions. Judge Rosenthal's husband, Gary, is an attorney who used to work at Vinson & Elkins, Enron's lawyers, and the *Houston Press* would later report that Ken Lay had once lobbied unsuccessfully to get Lee Rosenthal a circuit judgeship. Within weeks, Judge Rosenthal recused herself from the case, as did the entire Houston U.S. Attorney's Office. By the time I arrived in the city, fear verging on panic was spreading through the River Oaks set. As a South Texas native, I had a modest acquaintance with the folkways of Houston, but Enron had turned the village of oil into an almost unrecognizable society. One truism remained: the city has never been neutral about the poetry of money. The collapse of Enron had caused the cave dwellers to begin to reconsider their friendships with Ken and Linda Lay. Lay had ascended into an orbit so rarefied in Houston that his very presence at parties could change the atmosphere. He would stand in one place, as a king might, and allow himself to be greeted with fulsome praise. He brought a new persona to Houston, appearing to be a kindly naïf, in contrast to Oscar Wyatt, the former head of Coastal Corporation, the energy company. Houston has long tolerated the foibles of Wyatt, who revels in his flamboyant reputation for buying oil from Saddam Hussein.

By early December the easy hyperbole of Texans swearing eternal loyalty to friends who are potential felons was sounding thin. Ken Lay and chief officers Jeff Skilling, who had left the company abruptly in August, and Andrew Fastow, who had been fired by October, were at ground zero in the Texas endgame, victims of the "tall poppy" syndrome, the phrase Australian Enron traders used for unspeakable hubris.

On my first night in town, at a grand dinner in the Huntingdon, a luxurious River Oaks high-rise, several floors away from the Lays' 13,000-square-foot, $7 million spread, Ken Lay's friends were speaking in code about the loss of his fortune. "Ken went to see Fayez to ask him for help," one said. "Fayez told him no way." In the Houston big-money world, this haiku spoke volumes. Fayez Sarofim, the secretive Egyptian money manager with multiple mansions, Rolls-Royces, and wives—one of whom died after collapsing mysteriously on Mount Kilimanjaro two years ago—could have delayed Lay's fate with a single call, but he dismissed him peremptorily. "I wouldn't dream of recommending Enron," he said. His remark circulated quickly through the Tudor mansions of River Oaks and Shadyside, many of whose owners are Sarofim clients. That same week Lay appeared pink-cheeked and cheerful to have lunch at the Coronado Club, implying in the casual tone he had learned to use that he was in communication with the president and Laura. But, as

MARIO TAMA

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Lay's intimates could tell you, their friend was out selling. It was known that Ken's fervent phone calls to "the Oval" were not being returned.

"Hi, I'm Jan Avery, the president of Southwest Reserves and their only employee. I am a WMBE—a woman in a minority business enterprise—trying to move MM B.T.U.'s from the Permian Basin to the California border." That's how Jan Avery would cajole representatives from the pipeline companies who worked the booths at gas trade shows and energy conventions in New Mexico and Oklahoma. It was 1990. Avery had invested $250 to start her one-woman corporation, taking advantage of a new regulation which gave women and minorities special advantages. She had the legs of a model and did not play down her good looks, but she was also adept at fending off advances at a time when a subtext of sexual favors permeated the wildcatter atmosphere. Avery was struggling with a vicious divorce. She had run away from a grueling marriage to a rich lawyer from Arkansas and was living with her seven-year-old daughter, Kay, short for Katherine,

**As Lay's intimates could tell you, Ken's fervent phone calls to "the Oval" were not being returned.**

in a small rented house in Santa Fe. The only telephone was in the hallway, and all day long she would make calls on it, pretending she was in an office, trying to get people to buy her brokered gas.

When Jan Avery talks about her history, she tends to skip over difficult periods. She grew up in Leeds, Alabama, outside Birmingham. Her father was a sheet-metal worker, the son of an heiress whose only remaining legacy was her insistence on fine linens, good manners, and a full-time housekeeper. She taught her granddaughter to appreciate finery and to excel in school. After attending a junior college, Jan worked as a receptionist for a forklift company. She also helped out with the books and became so intrigued with accounting that she enrolled in night school. In 1974 she married her first husband, Gary Kirsch, and soon followed him to Houston, where at 29 she got a job at Arthur Andersen. In the office she met Bob Avery, who worked near her in the tax department. Her marriage broke up, but she and Kirsch remained friends. Avery moved to Tulsa, and Jan followed, getting a job at Arthur Young, just when oil was moving toward $60 a barrel. There she had her first view of the sea of criminality surrounding the wildcatter crowd. When she came to believe that one of her clients was defrauding investors, she and Arthur Young walked away from the account.

Avery and Jan went out for three years before they married. Avery's wealthy father owned an oil-field-machinery company. The couple moved to the Avery-family plantation in Eudora, Arkansas, but when the marriage crumbled, Jan took her baby daughter and fled. She struggled over custody issues while trying to maintain a relationship with Avery. "I loved him," she said, "and I wanted Kay to have a father." When Kay was five, Jan moved to Santa Fe, where she worked part-time as an accountant and sold gas on the phone in the hall. A neighbor recalls that Jan said she was terrified of Avery.

Through cold-calling Jan met the chairman of Gas Mark in Houston, and he agreed to back her on her first deal to move gas on Enron's pipeline to Southern California. Then the market changed, and only big players could stay in the business. Jan became clinically depressed and for a time followed a doctor's advice and took lithium, a fact she confided to Bob Avery. That year Kay went to see her father and his new wife and children over spring vacation, and Avery, a part-time district attorney, filed a motion for custody. According to Jan, he refused to allow his daughter to return home, using the fact that Jan had once fled as a way to convince the court that she was an unfit mother.

Jan finally had to agree to an onerous custody situation; she could visit Kay four weekends a year and have her for summer vacations and alternating holidays. They were allowed to talk on the phone once a week for 15 minutes. Jan always spoke to her daughter as if she were an adult. "I am going to fight for you, but it is going to be very expensive," she told her. "You know how much I love you, and I will do everything in my power to get you back." (Robert Avery rejects Jan's version of events.)

Avery moved to Houston in order to be closer to her daughter. Through friends at Arthur Andersen, she started working part-time at Enron. She became married to her job, spending long hours working on the tax aspects of the multiplying partnerships—there would be about 3,000 by the time the company imploded. She was often sharp with her colleagues, quick to assert herself: "I am the only person who can work on that deal. I know how they work," she would say. Her bonuses depended on the earnings value of the deals she structured. The more money I make, she thought, the sooner I can afford the legal fees to fight for Kay.

When Jan Avery arrived at Enron, she already possessed an understanding of the arrogance of the company's culture. Of all the energy companies she knew, only Enron didn't deal with businesses owned by women. "I could never get them to give me the time of day," she told me. "And they controlled the best pipelines." By 1993, Ken Lay had established his system of rivalries. Forrest Hoglund ran the oil-and-gas division, Stan Horton was in place at the staid and traditional pipeline company, Jeff Skilling had arrived to set up a trading operation, and Rich Kinder, the chief operating officer, kept a brake on the financials, discouraging Lay's grandiose schemes with a droll Texas remark, "Let's not drink our own whiskey, Ken." From time to time Kinder would lose his temper. "Goddamn it, how can we be doing all this?" He was uncomfortable with the rapid expansion, and Lay would say teasingly, "I'll die with a lot of friends, and Rich will have all the money."

And then there was Rebecca Mark, a young banker who in 1982 moved to what would become, in 1985, Enron's treasury department. With her blond hair and gold earrings, she looked like a Texas sun queen. Her mentor at the time was John Wing, a West Point graduate and canny negotiator, whom she reported to. She and Wing went to work opening power plants, but her division was partially sold to help cover the debt incurred by the rogue-trading scandal. In 1988 she took time off, bundled up her toddler twin boys, and entered Harvard Business School. She negotiated the contracts for a power plant for Enron outside Boston, and after she earned her M.B.A. she returned to the company full-time. Soon she was setting up power plants and pipelines in England, India, and the Philippines. Mark would ultimately spar with Jeff Skilling, who had been a Baker Scholar at Harvard Business School and a consultant at McKinsey & Company before joining Enron. "Jeff may have been the single best student I ever had, and he did not suffer fools," said Chip Bupp, a professor of Skilling's at Harvard. Bupp likened Skilling's personality to the icy capability of Robert McNamara, President Kennedy's secretary of defense.

Skilling thrived on confrontation and had a perfect command of the minutiae of deals. In interviews he could stun financial writers with his grasp of details, but that same superiority made corporate vision was messianic. Skilling kept a sign on his desk: I.R.I.S., which stood for: "First they Ignore you, then Ridicule you, then Imitate you, and then Steal your idea." From the beginning, colleagues say, Skilling's pattern was to scapegoat others without leaving a trail that could lead back to him. In meetings that Ken Lay chaired, Skilling was often silent, letting Lay believe that he was completely in control. But at other times Skilling could be very volatile. He was divorced, and his office was a shrine to his children; on long plane rides with colleagues he might spend hours talking about them. He would often blurt out astonishing remarks in public—he once, famously, called a stock analyst an asshole during a conference call—and the public-relations staff worried each time he gave an interview.

Andrew Fastow, a Skilling protégé, was recruited early on in Skilling's first fiefdom, Enron Capital & Trade. As Skilling consolidated his power, he and Fastow allegedly designed the partnerships that were constructed to hide losses and maximize profits. Testifying before Congress, tax lawyer Jordan Mintz recalled sending a memo and leaving messages for Skilling asking him to sign off on crucial legal documents. Skilling testified that he had no memory of that. Last December, *The New York Times* had Skilling saying that the partnerships were Fastow's idea. Bupp, who remained close to Skilling, is now confounded. "I can't believe he did not know what was going on, yet I can't believe Jeff would lie.... [The partnerships are] a clear black-and-white conflict of interest. Holy smokes!"

One day in 1995, Jan Avery sat in a conference room and watched Andrew Fastow, standing in front of a whiteboard, grapple with how to deal with a coming loss on the books of his group's investment in an M.T.B.E. fuel-additive plant outside Houston. Fastow and Skilling had gambled on the toxic additive used in gasoline, but, as a result of a steady attack from the media and environmentalists, the market for M.T.B.E. had virtually disappeared. Fastow exuded anxiety, Avery remembered, raising his voice, barking orders. "We have to be able to come up with something! We have to construct a structure where the loss could be camouflaged." Most of Enron's now notorious partnerships were still in the future, but Fastow had already seen the possibilities they offered. There were already roughly 300 in place. "Losses were never allowed at Enron, even then," Avery said. "You did not recognize losses." She remembered that the meeting stretched on for much of the day, and Fastow became increasingly agitated. Avery recalled thinking, This has gone too far.

"We sat there and bounced it around," she said, while Fastow frantically drew circles representing subsidiary corporations all over the board—partnerships within partnerships—to suggest how to move the loss. Fastow also asked them for ideas on how to maintain the value. "That was our language for hiding a loss. We called it 'maintaining value,'" Avery said. "I knew that this was something that was ultimately going to drag the company down, because you could not maintain this level of loss. It was hundreds of millions of dollars, never acknowledged on the books." Isn't that fraud?, I asked. "It was still within the realm of accounting rules, but they were way out in the gray zone. It became criminal when they continued it to such a degree that it put all the shareholders at risk." Did anyone raise an objection? "All the time. We called it house-of-cards accounting and would openly discuss how crazy it was. In meetings, we were always told the same thing: 'You have to be able to come up with a solution.' There was no alternative."

**Jeff Skilling kept a sign on his desk with the initials I.R.I.S.: "First they Ignore you, then Ridicule you, then Imitate you, and then Steal your idea."**

Fastow's wife, Lea Weingarten, was in the room; she too worked at Enron, which was not unusual in the culture. Fastow had met Weingarten, the daughter of one of Houston's prominent Jewish families, when they were at Tufts. The Weingartens' fortune had come from a chain of grocery stores. Around town the couple was thought of as a study in opposites; Lea Weingarten was low-key, with the casual style of old-money Texas.

Enron was hermetic and pulsing with sexuality. Ken Lay had married his secretary; Jeff Skilling had left his wife and taken up with Rebecca Carter, whom he promoted to company secretary and who earned more than $600,000 last year.

People who know Kenneth Lay well insist that his destruction can be understood by looking at his longtime attraction to ruthless, brainy alter egos such as Jeff Skilling and Andrew Fastow, who could act out Lay's ambitions while he played Mr. Congeniality. The aura of fraud permeated Enron from its inception in 1985, when the legacy and corporate style of Michael Milken were imprinted on Lay and his company. It was Michael Milken and Drexel Burnham that helped raise the $2.3 billion needed for the InterNorth–Houston Natural Gas merger. A little-known fact is that Enron stock was one ingredient of the scandal that brought down Michael Milken and Dennis Levine. Tipped off by a banker at Lazard Frères, Levine and his group of insider traders profiteered on the merger, as James B. Stewart has reported in *Den of Thieves*. They later went to prison.

Lay thrived in a culture of rivalries. He was a man of parts, a winner of awards and member of committees, generous with young associates, serving them himself when they traveled with him on one of the many Enron planes. "All these planes give my C.E.O.'s something to aspire to," Lay said to an ABC news reporter just months before Enron crashed. Inside the company, Lay overlooked, even encouraged, all the vicious infighting that went on. Lay came from a modest background, had a cheerful salesman's façade, and wore a Mr. Magoo mask of disconnection. He was a Gatsby of the pipelines, a minister's son from Missouri fueled with the desire for grandiose status. He earned a Ph.D. in economics at the University of Houston, was a navy officer, and clocked time in Washington as an undersecretary in the Department of the Interior. He was attracted to Houston by the hope of staggering returns in the oil-and-gas world.

When Lay became allied with Milken in 1985, the junk-bond king's reputation as the genius of inventive financial structures was at its peak. Not long before Drexel Burnham chief executive Frederick Joseph denounced the press for its "outrageous" allegations linking Milken to insider trading and the unsavory affairs of arbitrageur Ivan Boesky, Lay arrived in Beverly Hills in search of the financing he needed to realize his dream. The steady drumbeat of allegations in 1986 concerning Milken's honesty would have alarmed a more prudent C.E.O. In a 1987 interview, Milken went as far as to defend his business practices by boasting that he was helping Enron increase the size of its debt offering by an additional $225 million. Lay never cut his ties with Milken, and would later talk about him as a vi-

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ed. After Milken got out of jail, Lay invited him to speak at an Enron conference, despite a vocal protest from lawyers inside the company. "Ken always thought Mike was an out-of-the-box thinker who deserved sympathy," an Enron executive said.

In one magazine spread, Lay was portrayed as the wizard of energy, his body a glowing electric-power line. As for the Kool-Aid, it was the elixir of money. Young traders just out of school were tantalized with promises of $500,000 in bonuses within a year. The Enron car of choice was a silver Porsche; the parking garage in Houston was full of them. Vice presidents and managers preparing to make a budget presentation in front of Lay, Skilling, and Fastow were told, "Here is your number." The numbers—always larger than what was feasible to demand on a contract—would have to be reached or, the vice presidents and managers knew, they could be "re-deployed," Enron language for being switched to another department, often before being forced out in a vicious biannual performance review. These performance reviews, referred to as "rank and yanks," were a variation on the old English Star Chamber. Your picture was displayed, and your colleagues blasted your job performance, knowing that their own advancement depended on your demise. Originators of deals might find that their numbers had been tampered with so that in the performance review their deal structures no longer made sense. "Because of the complexity of the math, it could take you weeks to figure out what had been changed, and by that time your deal was shot down or you were fired," one former associate recalled. Skilling would be very blunt with vice presidents who questioned these methods: *Change your assumptions. You can always refinance! You can always get the deal done!* In addition, the public-relations staff had to keep Lay's competing division heads from getting too many cover stories in *Fortune* and *Forbes*. "Ken didn't like it," one told me. "He wanted the coverage for himself."

By the mid-90s, Fastow was the whiz kid of Enron's financial structuring, always ready with sophisticated accounting arcana such as the "costless collar"—a complex financial instrument which allowed an investor to sell a stock in partnership with a bank at a guaranteed trigger price and yet ... have it reported to the S.E.C. Jan Avery, for one, grew more and more alarmed ... of the accounting tricks required to support Skilling's and Fastow's bookkeeping. She used the term "feeding the monster" to describe the process.

As the Enron tentacles spread, it became increasingly difficult for Fastow and Skilling to disguise their ambitions. The deal structures became more and more byzantine. At the broadband division, which trafficked in the fiber-optic cable used in high-speed Internet connections, trades called "Barney deals"—meaning "I love you, you love me"—were constructed. Enron would sometimes swap control of its fiber lines with those of another company, only to undo the transaction a few days later, so as to create the appearance of volume. Other maneuvers pushed hundreds of millions of dollars of trading equity around in a circle, a practice employed by such companies as Qwest, Cisco, and Global Crossing, which was headed by Gary Winnick, who had trained at Drexel Burnham. When Global Crossing went bankrupt in January, Winnick was able to walk away with a reported $735 million. At the broadband group, Fastow used the lawyer Kristina Mordaunt, who represented the group in its dealings with the separate partnership of LJM2, which was run by Fastow. In March 2000, Mordaunt was invited into a Fastow venture called Southampton Place. She put down $5,800. She heard a few weeks later that the deal was winding down. Opening her bank statement the next month, she saw a deposit of $1 million. Another friend of Fastow's, managing director of Enron Global Finance Michael Kopper, would make more than

**Skilling and Fastow allegedly designed the private partnerships that were constructed to hide losses and maximize profits.**

**DREAM MERCHANTS**
Linda and Ken Lay, below, at a major-contributor reception for the Alexis de Tocqueville Society in Houston, March 2001. *Above:* convicted junk-bond tycoon Michael Milken, *left,* who helped Lay finance the Enron merger; Andrew Fastow, *right,* an architect of Enron's "house-of-cards accounting."

TOP LEFT, BY ADAM STOLTMAN; BOTTOM, BY DAVE ROSSMAN in Chewco, according to the report released by Enron directors in February.

"There is someone you should talk to," Alex Conn told Milberg Weiss partner David Walton in a surprise telephone call. Conn, an Austin software entrepreneur, had met Jan Avery when he negotiated with Enron, and he was impressed by her. Several weeks after Enron collapsed, he reached out to the people at Milberg Weiss to let them know what a valuable witness she could be. It was November 2001, and Walton, the Milberg forensic accountant, arranged a conference call with Paul Howes, who is the Milberg partner in charge of day-to-day operations for the Enron investigation. Howes has thick blond hair, a former athlete's build, and the empathic conversational style of the Southwest; in his years as a Washington-based assistant U.S. attorney, he radiated such useful kindness that he could get drug lords to confess. After his conversation with Avery, in which she talked about her experience at Enron International, which ran the company's projects overseas, Howes got on a plane to Houston. From then on, in his research reports Avery was referred to only as "confidential witness." He had yet to determine whether her information would check out.

By 1996, Avery had been transferred to Enron International and was therefore in the middle of the drama that would define the fall of Enron. It involved assets versus trading, and a rivalry between Rebecca Mark and Jeff Skilling, which led to the demise of Enron International, frequently referred to as "the purge." The war was fought over "paper gas," as the executives at Enron International called Skilling's ruthless consolidation of his power on the trading side. Skilling's traders occupied three floors in the Enron headquarters, and the trading room had more plasma screens than any other office in America. The atmosphere, according to one former Enron manager, was "the Royalton Hotel meets the Death Star." At the height of Skilling's power, the company was moving toward a peak moment, when the partnership structures would enable price-earnings ratios of 60, and the stock would surge in 2000 to $90.

**Lay would say of his lieutenant Rich Kinder, "I'll die with a lot of friends, and Rich will have all the money."**

A[illegible] Enron International on the tax side and soon began working 18-hour days. She kept a picture in her office of Kay, now 11 with long blond hair, but when people asked her, "Who is that?," Avery would reply only, "My daughter." She rarely talked about her private life, but during the last weeks of each summer, as Kay got ready to return to her father, Avery was clearly under strain. Kay would lie in bed, crying, "Please let me stay." By 1999, Avery was earning more than most vice presidents, almost $300,000 a year with her bonus. She was angry that Enron refused to give her the title, and was convinced that, at 49, she was a victim of ageism. She took on an onerous amount of work in order to blot out her anger over her custody problems. Exploring the foreign-tax implications for Enron dealmakers negotiating for pipelines and power plants in Brazil, Bolivia, Peru, Eastern Europe, and Africa, Avery had to learn the tax code for each country. By then "the Skilling atmosphere," as it is often called, had begun to permeate the department. Avery recalled, "We were told constantly, 'Keep the debt off the balance sheets.'" This was done not only through off-the-books partnerships but also through loopholes in the tax laws of the foreign countries. Tax meetings would go on for hours, but Avery rarely complained.

Sent to Rio, she stayed for months in Copacabana, mastering the Brazilian tax code in order to facilitate negotiations for a pipeline between Brazil and Bolivia. She also began an affair with a member of the Enron team and for the first time in years felt it was possible to have an emotional life. She then went to Bolivia and Peru, spent weeks in Warsaw, returned to Houston, and flew to Africa, attempting to explain to Kay why it was often 9 or 10 hours later where she was calling from.

During this period, she was searching for lawyers in the counties around Eudora, Arkansas, hoping to find a talented attorney who would take on the Avery family. She knew she could not defend her travel schedule in a courtroom; she was on constant call, and, as she confided to her friends, the strain was becoming unbearable. How could she put an 11-year-old through the hell of an ugly custody battle?

In 1997 she was invited to the Enron International executive retreat in Beaver Creek, Colorado. At lunch during a ski break, she was joined at an outdoor table by Rebecca Mark, who was there with her 12-year-old twins. Mark was also divorced, and they talked about the constant emotional pull exerted on single working mothers. That day Avery resolved that she would try to become a deal originator in order to make more creative use of her time. At the bar, she sought out Mark's co-C.E.O., Joseph Sutton, a former brigadier general who resembled Burt Lancaster. Taking power and American investments around the world had made Mark and Sutton well known in developing countries, but also, at times, the targets of scathing criticism for supporting the alleged imperial exploitation of local workers. In India they were accused of pushing through a $2 billion energy plant at Dabhol with bribes and threats, and of manhandling laborers. The Indian press is notorious for libel, and Enron officials vigorously denied the charges, which were never proved. Sutton was intrigued when Avery told him she had once set up her own pipeline-marketing business, and he suggested that she write a letter to Mark.

I went to Houston determined to meet Rebecca Mark. For the last decade Mark had been a template of female achievement for the business press—named twice to *Fortune*'s list of the 50 top women C.E.O.'s. Her style had become famous—the size-6 Armani skirts, the stiletto heels. As the head of Enron International, she had early on taken part, with John Wing, in negotiating the billion-dollar power plant in England called Teesside, and had structured the deals for the Indian facility at Dabhol and the Brazilian pipeline. She and Henry Kissinger dealt with the Chinese premier, Israeli prime minister Ariel Sharon took her calls, Indian taxi drivers in Delhi would ask Enron executives, "Do you know the famous Miss Mark?" Back in Houston, she would work the phone late into the night in her flannel pajamas as her twins complained, "Mother, get off the phone!" She was an absence in the Houston social firmament; her ambitions were global, at the greatest remove from the Houston Country Club. As with Jan Avery, her job was her life, and her attractiveness and her ability to draw crowds in such places as Brazil and Vietnam helped to establish Ken Lay's political bona fides and extend the Enron brand.

The day I went to see her, her houseman was hanging Christmas boughs on the front gates of her mansion. Mark lives palatially behind a high wall in River Oaks. As I walked toward the house, two large dogs came bounding up to me, followed by a tall blonde with a distinct Texas-rich-girl look, a [illegible] of hair, and the skintight pale-blue stonewashed jeans that Houston and Hollywood power women pair with a $1,000 blazer and a white Gap T-shirt. Estimates of Mark's personal fortune vary wildly, from $30 million to $80 million. She married for the second time two years ago to Michael Jusbasche, who was born in Bolivia and owns a chemical company.

Like Ken Lay, Mark came from a small town in Missouri, one of four children in a farm family with deep fundamentalist beliefs. Her conversational style has been polished in Texas, and she is a master of "hillbillying," the trick of playing up one's humble origins. "Sometimes it was so cold in our farmhouse that frost was on the quilt," Mark told me as we sat in her vast drawing room with a grand piano in it and looked out on the garden. Within Enron International, Mark presented herself with the same down-home attitude, along with a rapier-sharp skill in marshaling rigorous arguments for deals. She was a booster of talent, particularly in women, and she created an atmosphere that felt familial. She would throw Christmas parties for as many as 900 people at her house, with carolers, clowns, and rides for the children. As a C.E.O. operating under terrible tension, she told me, she taught herself to conceal her anger behind a midwestern sorority-girl smile, particularly as she felt the Enron culture turning increasingly ruthless. She had a trick: when other executives excoriated her in meetings for not producing enough profits, she would not fight back but would simply tell herself that she was the smartest person in the room. "I was looking at them but it wasn't real," she said. "It was like an out-of-body experience."

At the time I met Mark, she was angry about an ongoing attack on her abilities in the business press. Moreover, she was bound by a confidentiality agreement and had been named as one of the 29 officials who are potential defendants in the class-action cases against Enron. As she told me later, "I am prepared for two stories: the 'I had sex with everyone in the universe' story and 'Rebecca's assets stink.' If they have a reason to try to destroy me, it will be over the quality of my business and what they will make up about my love life. The sole reason will be to put less credibility on the side of the asset business I built up."

There appear to be few people in Houston who do not hold strong opinions about Mark's investments. One economist who knows her well described her as "a bundle of energy ... but she and John Wing figured out a way to take a juicy bite of the apple with their power-plant development, and the credulous banks went along with them ... loaning 95 percent financing on the basis of pro formas that no fool would believe.... The poor Indian and Chinese residential electricity consumers would have been spending half their disposable annual income on electricity." A prominent money manager who shorted Enron stock in 2000 said, "Almost everything that Mark touched at Enron was catastrophic in terms of investment return. The company had to either recognize the losses or cover them up. To Skilling's detriment, he chose to cover them up." When I asked Mark about this, she said, "None of the money managers have ever read the contracts backing up these businesses. The companies we created around the world are not bankrupt."

Some insiders theorized that Mark's "special relationship" with Ken Lay may have given her carte blanche to operate with no checks and balances. It was commonly thought that Rebecca Mark and Jeff Skilling had had an affair; they were both divorced, had children the same ages, and often went to school sporting events together. Mark's detractors suggest that she also had relationships with several members of her development team. Mark has become used to hearing this type of sexual branding, and believes it is a classic attempt to diminish her tenacity and achievement. "These were people outside the international arena who did not know how we worked," she said. "I used to make jokes about this in speeches and say, 'I had no idea I was so staggeringly attractive.' And how in the world would I ever have time, when I have passports so thick they look like volumes of the Bible."

For years, Mark operated under the protection of Ken Lay and Rich Kinder. She represented the assets-based side of Enron, which went back to the early days of the company, when Lay realized that gas could be traded as a commodity. By then the government had forced the utilities to accept the notion of unregulated power. Mark's great skill as a C.E.O. was always in presentation, her colleagues say, not in operation, which was routinely handled by other executives. Mark was able to persuade the Indian government to change its policies and reverse its course on the power plant at Dabhol, and she negotiated ironclad agreements protecting the assets in the event the government should change. She understood that her ability to survive at the highest level required her to project certitude, a sense that she was comfortable in her own skin.

In the early days of Enron International, Mark was told repeatedly, "You eat what you kill," and initially she and her team worked without bonuses. However, she was able to come up with a lucrative contract-value-percentage arrangement that ultimately earned her close to $80 million in stock

"I think they gave us this deal because they were convinced we couldn't get anything done," she said. She and Joe Sutton operated on sheer nerve. Sutton would tell her, "Act like we've already won," as they went into meetings with foreign leaders.

A former executive at Shell Oil described Mark in Bolivia, determined to sell the government on the idea of giving Enron the contract to assist in building a billion-dollar pipeline between Brazil and Bolivia, a project so politically problematic that even industry leaders such as Shell and Mobil wouldn't touch it. Mark sailed into one presentation and spoke for hours without notes to 300 officials, dazzling them with her command of the area's problems and stimulating them with her assurances of what Enron could bring to the table. She was less

One day Rebecca Mark confronted Lay in a meeting. "You are being snookered, Ken," she told him.

**OVERSEAS ASSET**
**Rebecca Mark, then C.E.O. of Enron International, parts a crowd of journalists in India, 1995.**

successful in dealing with complexities in the Middle East. The Enron team arrived in Qatar to set up a three-country development deal for the richest supply of natural gas in the world. "No one tells us how to negotiate—we are Enron," Mark allegedly said to one diplomat representing the emir. Moreover, the Enron bids were couched in very aggressive language. "They told us they were doing us a public-relations favor, letting our negotiation be a model for good relations with Israel," the diplomat said, startled at the team's lack of understanding of the re- [illegible] told me, she had inherited this deal from another division of the company and found herself locked in a negotiating struggle with two governments. "We walked into a mess, and the Qataris were angry," she said. "But we felt we could not leave a billion dollars on the ground." Two years later the emir was said to be offended by the low price Enron bid for the gas. Ken Lay tried to smooth out the difficulties and renegotiate. "Not if you send in the same group," the emir said sternly, according to an official who was in the room.

In 1998, Jan Avery was in Nicaragua as a project developer, supervising the building of a $75 million barge power plant, one of Enron International's last enterprises. The night before the final approvals, she was on a conference call with Skilling's aide Rick Buy and the Enron International executive who was presenting the Nicaraguan barge plant to the board. "They were screaming at each other," Avery recalled. "It was clear how Skilling and his group were out to put a stop to all assets being developed. They were trying to make us lower the assessments, although the numbers had already been presented." By then Skilling had turned against Mark, telling her in meetings, according to one of her associates, that her assets were a disaster, the worst investments Enron had ever made.

Nine months after Avery moved to Managua, she developed a persistent cough. The working conditions were filthy, she recalled, and the air was full of smoke and pollution. The barge project had caused a political firestorm. The president of Nicaragua was demanding a payment of $2 million to allow the company to finish the work, and a warrant was put out by the Nicaraguan government for the arrest of Enron executives. "You have a spot on your lung," her doctor told her. "You have to go home immediately." In Houston she was diagnosed with a rare bacterial disease. She spent the next five months in the hospital, and several times her blood pressure climbed so high that she was close to death.

At the top of Enron International, the pressure on Rebecca Mark was increasing. She confided to friends that Skilling's approach was like Chinese water torture, a subtle, continual bombardment of what she was doing. He was attempting to consolidate his power, moving Enron into a future where it was asset-light, as he said. He was still an icon of the business magazines, celebrated for his Gas Bank innovation, which moved Enron into a new world where it created a market in gas. His elliptical phrases, such as "vertical integration," became koans of the dot-com era. One day Mark sat him down and asked him how his business worked. She was curious, she told colleagues, about Broadband and the emerging energy markets. "I wanted a sense of comparison," she said. "Are we that bad? Or are they that good?" Mark was operating in a closed system. Enron International had separate accounting and was in a different building. At the height of this internal war, Rich Kinder, who for years had kept a brake on the company's exponential expansion, was passed over for C.E.O. Later, Ken Lay reportedly ran into Rich Kinder's wife and told her that none of Enron's problems would have happened if Kinder were still at the company. After Kinder left Enron, he started a new energy company, Kinder Morgan, which is traded publicly; he is said to be a billionaire.

One day Rebecca Mark confronted Lay in a meeting. "You are being snookered, Ken," she told her old friend. "These are profits from the sale of assets. These are not trading profits." Their conversation was about their European business, and Lay's response, Mark told someone close to her, was to look at her kindly, condescendingly, as if to indicate that her lack of vision made her a dinosaur. Her assets, at best, could return 14 percent, but she was planning for the long run with equity investments, a strategy designed to hold an investment for decades, and the company had veered inexorably toward the culture of traders, where profits now soared to close to 30 percent every year.

It became clear, Mark told a few intimate friends, that Skilling was trying to shove her out. She began to negotiate a partnership agreement with Shell to sell half of Enron International's assets, which would have brought $3.2 billion of equity to the company. They negotiated for seven months, a Shell executive remembered. Inside Enron International, it was generally assumed that Mark's position as a C.E.O. of the new company would ensure that the fluctuating stock price made the deal impossible to close. Mark was made a vice-chairman—a position known as "the ejector seat"—and allowed to take a bold gamble and explore treating water as a commodity in the international markets. The board approved the $2.3 billion purchase of an English water company called Wessex Water, which would become the backbone of Enron's global water company, Azurix, and which looked to be a great source of profit, but which turned into a disaster when Britain changed its water rates. Soon the whole water business changed, and Azurix was losing so much money that it was affecting the price of Enron's stock. When asked to respond, Mark said, "It wasn't a disaster. We couldn't survive as a public company because we didn't have earnings sufficient to support the growth of the stock."

As Skilling moved against Mark, Cliff Baxter found himself in an increasingly untenable position. He was a lieutenant with a conflict, whose responsibility it was to enforce the new Skilling culture, and his loyalty, many believe, was what would ultimately drive him to suicide. By 1997, Skilling had consolidated his power and had assembled his own team, which included Fastow and Baxter. The group was known as "the beautiful people" or "the seven dwarfs." One day the accounting staff at Enron International learned that Skilling's team had reaudited Mark's assets and was planning to sabotage her in front of the board. She arrived at the meeting to hear Skilling say, "These assets are a disaster. Not just Azurix—everything. They are returning 3 percent, not 14 percent." Mark tried to remain calm and responded, "I take issue with these numbers. My analysis is there for anyone to see." According to an associate of Mark's, however, Lay conveyed a few days later that it made no difference to him what her analysis said about the assets; he wanted no debate about getting rid of all of them, because he wanted the cash for the trading operation. In August 2000, Mark was asked to leave the company she had helped start. She immediately sold all of her Enron stock.

For Jan Avery, Enron had become incomprehensible; nothing she had experienced since Nicaragua had prepared her for the internal chaos she found. Sent to Abu Dhabi in October 1999, Avery watched Skilling torpedo nine months of negotiations on the $3 billion Dolphin pipeline. The projected pipeline would link the United Arab Emirates with Qatar in a deal so innovative that Conoco, Amoco, ... were all vying for it. The pipeline business had once been the very basis of Enron's financial strength, and this deal—which required Enron to invest $300 million—was projected to return tenfold profits to the company.

In Abu Dhabi, Avery supervised a 10-person team through months of due diligence and negotiations. The Dolphin pipeline became a symbol of the Middle East's emergence into the 21st century and a staple in the European press. Surrounded by computer models and sheikhs in robes, Avery was oblivious to what was going on in Houston. Skilling was directing his attention to Broadband, to which he had pledged $3 billion. Three days before the press conference announcing the successful acquisition of the Dolphin contract, Avery received an agitated phone call from Joe Sutton, who was now sitting in the ejector seat as vice-chair. "Stop the press conference," he told her. "This cannot go through. Skilling has put a stop to it." But it was too late. The Dolphin pipeline had been announced throughout Europe and the Middle East. Nevertheless, within months Skilling had walked away from the deal. "I don't want any assets," he announced.

In Houston, Avery went to Broadband Services, and during her interview there she was asked to take a look at the projected trading models. It would be her job to help determine the pricing for the Broadband swaps—trades that would later provide the basis of Bill Lerach's invective in court, when he would compare them to Michael Milken's fraudulent operations.

Avery studied the models and told the head of the division, "There is no way that these can work." She then walked away from the job and was moved to the international group, where she worked on a deal to create a trading hub for liquid gas in Malaysia. Skilling's purge had now infected the entire company, and there were waves of firings. While in Kuala Lumpur to negotiate with the local oil-and-gas company, Avery learned of the "ethnic cleansing" being used to close down her division. "Don't worry, they are keeping the best people and re-deploying them," she was told.

She was next assigned to Enron Energy Services (E.E.S.), the playground of Lou Pai, who had set up a division to trade energy in California. The move meant changing buildings and giving up her large office for a trading desk. E.E.S. sold "bundled energy" to customers such as Starwood Hotels, J. C. Penney, Quaker Oats, and Owens-Illinois, the glass company. The "bundle" was a promise of future service—meaning air-conditioning replaced, lightbulbs changed, wiring fixed. In her first weeks, Avery approached a commodity analyst who was proposing a price that would absolutely guarantee a loss to Enron. "We can't do this," Avery told him. "How can you be selling something that is a negative?" The commodity analyst replied belligerently, "Just do it. We sell negatives all the time."

**"There are unusual cash transactions from the Isle of Guernsey," the bank officer said. "They're coming into my bank from Enron in $100,000 increments!"**

That was during last year's California brownouts, and Avery made a startling discovery. Enron had sold contracts to retail customers, including the University of California and the Simon Property Group, which owned malls in San Francisco. As the cost of power soared, Enron returned the power to the utilities, employing a loophole the Enron salesmen had cleverly provided. The resulting cost to the state of California by one estimate was close to $500 million, but within Enron there was no acknowledgment of the larger meaning. Avery remembers that the press releases were still rosy. No mention was made of Enron's reduction of a buying price from $1,500 per megawatt to $10. "This was disguised as normal business procedure," Avery said. "What it meant was that all their contracts were under water."

"Margaret, this is insane," Avery said to Margaret Ceconi, who sat next to her at the trading desk. Like Avery, Ceconi was new to the department, having been hired from G.E. Capital with the promise of annual bonuses as high as $1 million. Ceconi was voluble and freewheeling, a person who would throw pool parties and invite several boyfriends only to describe their reactions with bursts of laughter the next day at work. "We have to find some new men for *you*, Jan!" she told Avery, and soon they were spending time together. "This place is

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we have to get off the ship." They talked about financial analysts they could tip off, finally settling on Carol Coale at Prudential, who for months had been cautioning that Enron was not sound.

One day in the summer of 2001, Skilling arrived at the E.E.S. floor and jumped on a desk. By then the new-business developers were frequently logging on to thomsonFN.com, which tracks insider trading. "Why are you selling your stock, Jeff?" someone shouted at him. According to Ceconi, Skilling, after citing a list of dubious reasons for unloading his shares, reassured the developers that "life was good" and that they should keep buying Enron stock. After that, Ceconi said to Avery, "You and I are going to write a letter to the board, Jan." Avery was wary. Two weeks before Skilling's abrupt departure, both women lost their jobs. It was early August, shortly before Kay Avery, finally in her mother's custody, was to leave for Baylor University. Without a job, Jan could no longer afford the $20,000-a-year tuition.

"You don't know me," said Margaret Ceconi in a phone call to Carol Coale, "but I'm a friend who wants to tell you what's really going on at Enron." Ceconi, who didn't reveal her identity at first, began writing to Coale from an E-mail account with the address Enron-truth. "We are sending you a lengthy letter that we have sent to the Enron board," Ceconi wrote. The letter, like Sherron Watkins's now famous warning to Ken Lay, spelled out $500 million in false profits Enron had claimed in the last year. Unlike Watkins's straightforward, cogent criticism, Ceconi's letter began with a litany of complaints about the company. More reasoned analysis of the financials was buried on subsequent pages.

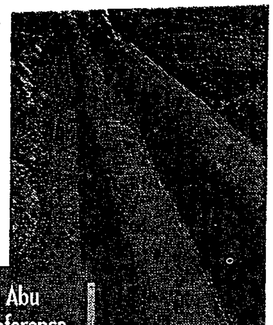
The S.E.C. opened its inquiry into Enron's accounting on October 22. Ken Lay continued to tout his company's stock in a conference call the following day. On October 24, Carol Coale, fed up with Enron's rosy predictions, downgraded the stock to a "sell." The company filed for bankruptcy six weeks later. Ceconi's letter was given to Apache Oil, an Enron competitor. It ultimately found its way to the congressional committees working on the investigation into Enron. The day Ceconi's letter was published in the *Houston Chronicle,* 65 news organizations contacted her. She was on *Good Morning America,* being interviewed by Diane Sawyer, at the same time Linda Lay was telling NBC's Lisa My-

... in, everything we own is for sale."

'Good God, it's a Rorschach test," Paul Howes said to Jan Avery during one session in Houston as he studied a diagram of an Enron partnership. It was the first time the lawyer had ever seen the circles and boxes that would soon confound even the most sophisticated economists. "It is simple to understand," Avery told him. "The more circles and boxes, the bigger the bonuses, and the more the customer is confused." Howes had weighed Avery's unhappiness over her treatment by Enron with her expertise on the financials and had decided to use her as a consultant. He was working on the Enron case with a team of investigators and Frank Karam, a partner from the New York office, as well as with Lynn Hodges, whose California firm, L. R. Hodges & Associates, specializes in "witness development."

In January, Howes and his team were fielding more than 100 calls and E-mails a day. "This is the most exhausting case I have ever done," Hodges told me. "All I am doing at the moment is reacting." She had received that morning an E-mail with a photograph of a shredding-company truck parked outside the Enron building. One Saturday, Howes spent eight hours in a hotel room with an auditor from Enron International, another "confidential witness." He and another auditor told Howes that Robert Jaedicke—then dean of the Graduate Business School at Stanford and the head of the Enron audit committee—visited the internal-audit staff in March 1989. "How do you view your role as an independent director?," Jaedicke was asked. "I'm here to support management. I'm here to support Ken Lay," he replied. The two auditors took this remark as an indication of where Jaedicke's loyalties lay. Later, they told Howes, Enron International developers in pursuit of bonuses put through projects rife with engineering problems, which later became budget nightmares. They had been disgusted to be outsourced to Arthur Andersen. "Jeff Skilling ran a casino for a business side and a day-care center for junior auditors," one said.

**Joe Sutton called Avery in Abu Dhabi: "Stop the press conference. This cannot go through. Skilling has put a stop to it."**



**WORLD POWER**
Two workers stand on pipelines at the Dabhol power plant in Maharashtra, India, one of Enron's major energy properties, 1999.

STEVE MCCURLEY

In early February, Howes told me he had finally tracked down Herb Perry, the auditor who 15 years earlier had gathered an investigative file on the rogue-trading operation at Enron Oil that had so mystified Jan Avery in her first months on the job. Avery had told Howes about the missing file, and Howes finally persuaded Perry, who had just retired, to see him. The day before Sherron Watkins testified in Congress, Howes flew to New Orleans and drove for an hour to a house near the water. A 10-year-old sheltie came out to greet him, and Howes, who is passionate about dogs, played with her before he said hello to Perry and his wife. "Well, if our dog likes you, you must be all right," Perry's wife said.

The men drove to a nearby café and shared a shrimp po'boy sandwich. To an investigator, Perry's background was impeccable. Before going to Enron in June 1986, he had spent 17 years at Shell on internal audits and fraud investigation. His specialty was white-collar crime. He found Enron's accounting department in disarray, he later told me; the new corporation was still trying to integrate InterNorth and Houston Natural Gas. The board had six members from each, and the group was fraught with tension, because the Houston executives had profited in the merger, and the InterNorth members had not. Ken Lay and

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Florida Gas, were running the new company, with Kinder as general counsel.

On January 23, 1987, Perry says, his boss, David Woytek, the vice president of audit, got a call from a security officer at Apple Bank on 42nd Street in New York. "Hey, something interesting happened. You should know about it. There are unusual cash transactions from the Isle of Guernsey coming into my bank from Enron in $100,000 increments!" the officer said. The approvals of the transactions, he went on, were not coming from authorized corporate treasurers but from two executives in Valhalla, New York, named Louis Borget and Thomas Mastroeni. "Borget and Mastroeni appear to be writing checks to themselves," the bank officer said.

Woytek called Rich Kinder and then spoke to an aide of Enron's John Harding. The news of the suspected fraud rocked the audit staff. Enron Oil appeared to be a great source of profit for Enron, and Harding had personally appeared before the board, one auditor told me, describing in detail the connections to the Saudi royals and Kuwait that had enabled his executives to make such vast trading profits. All the midwesterners at Enron, including Ken Lay,

> "You don't know me," Ceconi said to Coale. "I'm a friend o wants to tell you what's really going on at Enron."

understood pipelines and their rich, dependable cash flow, but Harding's description of the potential bonanza to be made in trading money thrilled them. "They swallowed it hook, line, and sinker," the auditor said. Lay was told that the amount at issue in Valhalla was no more than $2 to $4 million, a relatively small amount since Enron Oil was reporting profits of more than $30 million a year—one-third of the earnings of the company at that time. "Lay told us, 'Just go up there and get the money back,'" Perry said. By then the audit department had gotten statements from the Apple Bank and suspected that Borget and Mastroeni were keeping double books. Perry, who went with Woytek to Valhalla, was sternly warned, "Whatever you do, do not upset Borget."

Before Perry left Houston, he made a t list of 19 items, which included "..ing the system down, getting a war-

... because that was how the deals were confirmed in those days."

Arriving in New York, Perry and Woytek discovered that the trading operation was controlled completely by Borget and Mastroeni. To go there, you had to be picked up in a limo, Perry recalled. "I don't want the competition to get close to my staff," Borget told him to explain the quirky privacy procedures. The Houston employees were not allowed to interview anyone on the staff. One member of the Houston team was an Arthur Andersen partner and an expert in oil-and-gas trading. "Everything is proper," Borget told Perry. "We've just had an audit done."

Perry and Woytek sat in an octagonal trading room with John Beard, another Enron auditor, trying to unravel the fraud. Two days later a call came from Houston; Perry remembers distinctly that the caller was Rich Kinder. "I am hearing one side of it," he said. "Woytek was just beside himself. He carried on with Kinder, getting quite aggressive. He was saying, 'I can't believe you are going to ask us to do this.' Kinder told Woytek, 'Get out of the building and come back to Houston. You are off the case.'" The reason? "They were all scared," one auditor told me, "that the traders would get upset and they would lose the income." He is not sure whether the call came from Kinder or John Seidl, the president of Enron, but he said that Perry's memory is "sharp" and he kept perfect notes.

Perry remembered Kinder saying, "We are turning the investigation over to Arthur Andersen." Soon a flotilla of Arthur Andersen auditors arrived from Houston; among them was the young Jeffrey McMahon, who in 2002 would replace Andrew Fastow as Enron's chief financial officer.

The Houston auditors appeared before the audit committee in April 1987 and reported on what the Enron staff and Arthur Andersen had found in Valhalla. The two groups were in complete agreement. Woytek had managed to retrieve the millions that Borget and Mastroeni had misappropriated, but one auditor recalls Woytek telling Lay and the committee that they had to get rid of the two men. They were adamant; they should have been gone in February, they said. Borget had told the auditors that he was keeping the money in a personal account but that it would soon come back to Enron. One auditor said, "If the Apple Bank had not called, this money might never have been recovered."

I asked the auditor to read me the minutes from the April 29, 1987, meeting. "Dr. Jaedicke called upon management for a matter that involved Enron Oil Corporation that was investigated by the company and subsequently investigated by Arthur Andersen.... After a full discussion, management ['This was Ken Lay,' the auditor said] recommended the person involved be kept on the payroll but relieved of financial responsibility, and a new chief financial officer of Enron Oil Corp. be appointed. The committee agreed with reservations.... Mr. Orloff [the future general counsel, who is now at Bracewell & Patterson] reported on possible legal consequences. He stated that all legal work for Enron Oil Corp. would now be done in Houston by an attorney reporting to him."

Fifteen years later, the auditor is still upset. "And when they say 'management,' I can remember Ken Lay sitting there saying, 'I have made the decision!' ... What can I say? He was the C.E.O., and he felt that they could put controls in place and that he needed those earnings. That was his call.... We all knew those people were crooks! We told him that."

He became solemn as he read out the names of the people gathered in the room, several of them now familiar players in the Enron drama, who would maintain their silence and remain aligned with Kenneth Lay right up until the corporation collapsed. Robert Jaedicke, the distinguished accounting professor, would appear before the congressional subcommittee this year. Herbert Winokur Jr., a Harvard overseer, would also testify as the chief of the finance committee who in the wake of the scandal finally ordered an investigation. Arthur Belfer's family would lose about $2 billion of Enron stock. Steve Goddard of Arthur Andersen would be relieved of his management responsibilities.

At least two people in the room that day questioned Lay's judgment. One was Ronald Roskens, then the president of the University of Nebraska, who would leave the board two years later to join the government. The other was Carolyn Kee, from Arthur Andersen. "When we walked out of the room, Carolyn Kee turned to me and said, 'I am just sick about this,'" one auditor remembered. Kee was concerned about the lack of internal controls and would spend months dealing with the fallout from future shareholder suits and the S.E.C. inquiry. Within three years she left Enron and is now in private practice in Arkansas.

For the Enron auditors, the April board meeting was prophetic. "It was obvious to us and to Arthur Andersen that [Borget and Mastroeni] had opened fraudulent bank accounts, and we felt that they were going

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[illegible] one auditor told me. "Lay read the report and he read his budget, and estimated how much they made and if they were fired what he could lose.... My conclusion was that this is a guy who puts earnings before scruples, rather than reacting to the dishonesty right in front of him."

Does that establish a pattern of fraud?, I asked Herb Perry, a question I had often asked Jan Avery. "It is certainly the indicator that there is significant collusion between the executives at Enron and the senior people at Arthur Andersen. They were willing to tolerate improprieties."

Lay's designated watchdog was delayed in getting to Valhalla in 1987, and soon Borget and Mastroeni had spun out of control. They bet long on oil as the prices dropped and shorted when the prices rose. Borget called Houston and said, "There is going to be a huge loss. About a billion dollars."

I asked one auditor what it was like around Enron when that staggering figure was revealed. "Bad," he said. "We were all concerned because we thought that someone would be made a scapegoat." According to the auditor, the in-house lawyer Gary Orloff asked for the files. "They came to us and said, 'We want all of your files. We want everything.... Kinder was the chief operating officer and ... Orloff seemed to be protecting Lay in this thing." When Jan Avery went to work at Enron, she could hardly have known that the files on Enron Oil she tried so hard to find had vanished six years earlier.

By the autumn of 1987, federal prosecutors in New York working under then U.S. attorney Rudolph Giuliani had detected the crime. The prosecutor who ran the case, James Comey, now has Giuliani's former job. Lay's inability to operate within the strict rules of corporate propriety had left his company close to collapse. What had started as "an expensive embarrassment" had become herculean. Lay had had to dispatch an Enron team, led by Mike Muckleroy, from Enron Oil Trade & Transportation, to unwind many of the deals. Muckleroy was able to reduce the loss to $185 million, a figure closer to the number Jan Avery first saw.

In September 1993, the year Jan Avery went to work for Enron, Perry learned that Arthur Andersen would be taking over all of Enron's auditing functions at the end of that year. The company said it was a cost-saving measure, but Perry believes that the real significance of the change was that internal investigation of off-shore partnerships and off-balance-sheet partnerships were no longer pursued. The new Arthur Andersen model, Perry was told, would be used as an exemplar for the rest of the industry. Perry remained on assignment for Enron Oil & Gas, a subsidiary of Enron which had gone public and had a separate accounting staff.

**One Enron executive watching on TV said, "Now Jeff will say, 'I don't recall,'" and 27 times Skilling did not disappoint him.**

**ZERO RECALL**
Jeffrey Skilling takes the oath to tell the truth at a hearing of the House energy-and-commerce oversight subcommittee in Washington, D.C., on February 7, 2002.

On February 8, a week before Howes went to New Orleans, Jeff Skilling appeared before the House energy-and-commerce oversight subcommittee, one of a dozen government panels investigating the Enron debacle. Executives still working at the corporate headquarters in Houston watched him on television. One of them recalls hearing Andrew Fastow on any number of occasions mention his conversations with Skilling about the off-the-books partnerships Skilling was now telling congres[illegible] he knew very little about. Earlier that day, Skilling had sat with cold eyes and an odd smirk on his face and told the committee, "I was not aware of any financing arrangements designed to conceal liabilities or inflate profitability.... I did not believe that the company was in any imminent financial peril." At that, several financial officers screamed at the set, "Bullshit!" One kept saying during Skilling's testimony, "Now Jeff will say, 'I don't recall,'" and 27 times Skilling did not disappoint him. These Enron executives, who had cheered Skilling when he was named C.E.O., now studied him on the screen with contempt.

Congressman Ed Markey of Massachusetts, who had been the chairman of the House telecommunications-and-finance subcommittee that investigated Michael Milken in the 1980s, said of Jeff Skilling, "He testified like he was a guest on *I've Got a Secret*. He was treating Congress like he had treated his shareholders."

In Louisiana, Herb Perry spent Valentin Day in his La-Z-Bo[illegible] armchair watching Sherron Watkins testify before Congress. After the criminal investigation of Borget and Mastroeni began, Perry had turned over a copy of his Valhalla file to his boss, David Woytek. What happened to Perry's 50 cartons of documents about Enron's dealings over the years? "I shredded those," he said. "I did not want to carry them around, and I certainly did not want to be dragged into legal issues with Arthur Andersen." Watching Watkins in front of the committee, Perry was at first impressed with her stolid manner and muted outrage, but he began to revise his opinion as Watkins mused about Ken Lay's personal culpability. Watkins described a moment where she had tried to explain the cascade of partnership accounting fantasies to Lay. "He did not seem to understand," she said. Sitting with his wife and his dog, Perry laughed out loud. "I said a lot of language I can't repeat," he told me. He said he was mystified that an intelligent woman could have made such an assertion without fully understanding the history of the company. I asked Perry what he thought when Watkins asserted, "Mr. Lay was duped." He laughed. "Ken Lay duped? Well, I guess now you know better, don't you?" ◻

**DRAFT:** October 23, 2001 (2:45PM)
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MEMORANDUM

27

TO: Enron general file (re: Accounting Issues)

FROM: Max Hendrick, III

DATE: October 22, 2001

RE: Telephone Interview with Jeffrey McMahon on October 18, 2001

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On October 18, 2001, Joe Dilg and the author interviewed Jeffrey McMahon ("McMahon") by telephone. McMahon had previously been interviewed in connection with the investigation into the allegations contained in an anonymous letter and supplemental materials authored by Sherron Watkins. The supplemental interview was occasioned because of information relayed by Steve Kean ("Kean") to the effect that McMahon had made several statements regarding the LJM transactions that seemed inconsistent with statements he had previously made in his interview. The focus of the supplemental telephone interview was to clarify those points on which there was potential inconsistency.

Leaving the Office of Treasurer under Duress

McMahon initially stated that his comments to Kean were made immediately after learning Enron had been sued in a derivative lawsuit regarding the LJM transactions. He wanted Kean to know that there were certain areas of concern that would, no doubt, come under scrutiny as a result of the lawsuit or further legal or SEC inquiry.

By way of history, McMahon stated that he had approached Andy Fastow ("Fastow") many times about how the LJM issue was being treated. Fastow was wearing two hats but still in charge of and superior to people negotiating for Enron. Employees subordinate to Fastow were charged with responsibility for working on LJM matters; Enron and LJM were operating out of the same space. Reference to Fastow's ownership in LJM was used as a subtle stick in negotiations against Enron. All of these factors (previously discussed in the initial interview) contributed to McMahon's view that there was a conflict of interest.

Fastow never addressed these problems, whereupon McMahon felt compelled to discuss the issues with Jeffrey Skilling ("Skilling"), Enron's then President and Chief Operations Officer. McMahon advised Skilling that there were major conflicts of interest, but that those conflicts could be resolved. The people involved in the LJM conflicts were not responding well, and it was a

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stressful situation. McMahon did not present an ultimatum to Skilling (he volunteered that presenting ultimatums was not the way one could deal successfully with Skilling). He simply presented the fact that he could not compromise his position in light of the existing conflict of interest. Either some changes had to be made to resolve the conflict of interest or Skilling needed to find McMahon a new position. Several weeks later Skilling encouraged McMahon to take the job with Enron Networks, but Skilling did not link this to the conflict of interest with LJM.

McMahon believes that there are lots of people who know about his position and complaints about the conflict of interest. There may be a general perception that McMahon was "forced out" of the Treasurer's position as a result of this, and McMahon thought that Kean should be aware of this potential problem.

Pressure on Enron's Bankers to Invest in LJM

McMahon believes that a lot of the adverse publicity may be coming from bankers who believe they were pressured to invest in LJM. Several bankers came to McMahon and inquired whether an investment in LJM gets them an inside position for Enron business. McMahon consistently responded, "Not as far as I'm concerned." At later points in time, at least two bankers came to McMahon and said that they were promised business in turn for their investment in LJM.

McMahon recounted that First Union Bank's Paul Riddle called and complained about not getting a bond deal. He stated that he was promised the next bond deal for investing in LJM. McMahon's response was to the effect, "Not by me, you're talking to the wrong guy."

Merrill Lynch (no name given) commented, not by way of sour grapes, but simply as fact that it was felt linkage existed between investment in LJM and Enron business.

Deutsche Bank did not invest in LJM, but thought there was a linkage and felt it was improper.

Chase Bank felt there was a linkage between an investment in LJM and Enron business.

McMahon made clear that he had no first-hand knowledge – he was not present when any pressure was put on a bank to invest in LJM. He is concerned, however, how other Enron officers may have to testify on this subject. McMahon identified the following Enron employees as having had discussions with banks and who can comment more directly on the possibility of pressure being put on them to invest in LJM: Ben Glisan, Tim Despain, _____ Brown, Ray Bowen and Kelly Boots.

After he left the Treasurer position, McMahon never saw anything fishy about the way bank business was given out, but he was totally out of the loop. While he was Treasurer, he never saw anything about giving business to banks that he thought was improper or he would have "pulled the red chain."

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Buy-out of Michael Koppers' Equity in JEDI-1

McMahon recounted that when Calpers was bought out as an equity owner in JEDI-1, Michael Koppers ("Koppers"), an Enron employee who worked for Fastow, was used as a replacement equity owner. The JEDI-1 structure was administrative burdensome and McMahon thought the equity (then owned by Koppers) should be bought out. He understood that Koppers had invested approximately $100,000 a year before. He discussed the possible buy-out with Fastow and felt Koppers could easily be bought out at a modest profit. Fastow said that he would handle the negotiations with Koppers.

There was actually a formula built into the JEDI investment whereby Enron could effect the buy-out. Going by the formula, Koppers would be entitled to approximately $22 million. McMahon felt like Koppers should not even get $1 million. As McMahon understands it, Koppers was to get $10-12 million as a result of the final negotiations. McMahon's discussions with Fastow on this subject were in January-February of 2000, shortly before he left as Treasurer. He thinks the deal did not close until early 2001.

McMahon's concern about this buy-out of Koppers in JEDI-1 was based on rumors that Koppers used the money from JEDI-1 to buy out Fastow's position in LJM. Many people assume that this was the case, but McMahon again has no personal knowledge. He thinks the same financial executives named above plus Kevin Howard would either have knowledge or a view of this situation.

Pressure on Enron Representatives Negotiating with LJM

McMahon believes that the lawsuits and related inquiries are going to look for all leakage out of Enron to LJM. People who negotiated for Enron against LJM will probably testify that they felt pressure. One example, which he gave in his prior interview, was Doug McDonald negotiating on behalf of Enron against Koppers. McMahon was at home, received a call from Fastow, who complained about McDonald negotiating too hard. As it turned out, Fastow had the facts wrong and ultimately backed off.

McMahon has no personal knowledge of deals that were against Enron's interest or well-being, but he is concerned about this subject. He gave the following names of individuals and situations that indicate that they may be the source of information unfavorable to Enron's position in this regard:

Kevin Howard – a good person to talk to about pressure exerted on Enron professionals negotiating against LJM;

Ray Bowen – another guy who got chewed out for negative comments about the LJM situation;

Cliff Baxter – frequently in Skilling's office complaining about LJM and Fastow's conflict of interest;



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Ken Rice – same story;
Paul Chivens – an ex-Enron London guy now with Credit Agricole in Paris; and
Mike Jakgbic – hired by McMahon to set up a private equity fund. McMahon wanted a friendly source of capital to do deals. By the time Jakgbic arrived for work, Fastow had set up LJM, which was exactly the same concept. Jakgbic felt that Fastow stole his concept. He is now the relationship person for Enron with Deutsche Bank.

As a final note, McMahon stated that the Bloomberg release has lots of information concerning the derivative lawsuit filed against Enron.

MHHI

c: Joseph C. Dilg

Houston 690086.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Jeffrey McMahon, August 30, 2001

On Thursday, August 30, 2001, Joe Dilg and the author interviewed Jeffrey McMahon ("McMahon"), President and Chief Executive Officer of Enron Industrial Markets ("EIM"), to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures.

McMahon was in Enron's London office as Chief Financial Officer of Enron Europe until mid-1998. From mid-1998 until March 2000, McMahon was Treasurer of Enron Corp., reporting to Andy Fastow ("Fastow"), Enron's Chief Financial Officer. In March 2000, McMahon moved to a business position with Enron Networks which later evolved into EIM.

When McMahon came on as Treasurer in mid-1998, the NightHawk structure, a predecessor to Condor/Whitewing was already in place. Condor/Whitewing was set up after he came, as a structured finance project and was managed by Michael Kopper ("Kopper"), who reported directly to Fastow. Although McMahon had no direct responsibility for or involvement in Condor/Whitewing, he understood it was set up as a temporary holding facility for assets Enron wanted to sell. Condor/Whitewing was capitalized, bought assets that Enron wanted to sell; then Condor/Whitewing would sell off the assets either individually or in packages as time and circumstances allowed.

Both LJM1 and LJM2 were set up during McMahon's tenure as Treasurer, but he was not familiar with the exact structure. He knew that Fastow would be the general partner of the entity. Although he tried to find out who the investors were, and felt he should know about them because his job was dealing with banks with whom Enron transacts business, he was never told who the investors were. LJM was likewise handled as a special project by Kopper. The Raptor vehicles came along after McMahon left as Treasurer, although he understood that Raptor was a vehicle established so that Enron could protect the value of certain of its merchant assets.

McMahon does not recall reasons being given for the secrecy or confidentiality of LJM, although it was perhaps because he never asked. The widely held perception was that LJM presented an inherent conflict. McMahon was vocal with Fastow and Skilling on this point. His issue was not with the fairness or valuation of transactions that were placed in LJM but rather the potential conflict of interest.

McMahon explained that the conflict arose because employees under his supervision negotiated on Enron's behalf with other Enron employees representing LJM on the value of assets to be sold. Enron employees he supervised were instructed to get the best deal for Enron; he assumes that those acting for LJM were similarly instructed to get the best deal for LJM. The perception to employees he supervised was that when Fastow got involved, the guys negotiating for Enron might shrink from their expected vigorous negotiations. Fastow, after all, had the final say on their evaluations for salary and bonus purposes.

McMahon and Fastow went round and round on this issue. McMahon thought there was a conflict and thought it needed to be fixed. He proposed several options that would avoid or lessen the conflict:

(1) Fastow could resign from LJM (McMahon did not view this as a realistic alternative because he did not think Fastow would voluntarily resign);

(2) Fastow could remove himself from the evaluation process for salaries and bonuses of those Enron employees other than McMahon representing Enron in negotiations with LJM (*i.e.*, let McMahon deal with the conflict);

(3) Enron and LJM could be separated by (a) eliminating dual employees and (b) establishing separate office space for LJM.

Fastow never acted to implement any of these options (to which McMahon attributes no bad motive or intent), so he discussed the conflict with Jeffrey Skilling ("Skilling") to the effect that the conflict needs to be fixed or McMahon should be moved. This discussion took place in the February-March 2000 time frame and Skilling said that he would look into it.

Coincidentally, McMahon was being recruited by Greg Whalley to join Enron Networks in a business position. While in the process of making his decision on this possible move, Skilling encouraged him to take the new job, emphasizing that it was Enron's core business and his talents were needed. McMahon did so and commented that it was the best move he ever made. Enron Networks ultimately developed into EIM.

McMahon is confident that the conflict issue, as he viewed it, was brought to the attention of Skilling because he discussed it with him personally. He doubts that Ken Lay was aware of this specific conflict that was his concern.

Although McMahon said he was unaware of Fastow intervening directly in the negotiations between Enron and LJM, he cited one situation in which Doug McDowell ("McDowell") was negotiating from Enron's standpoint with Kopper on a deal near year-end 1999. Fastow called McMahon at home and complained that McDowell was negotiating too hard and that they should get the deal done. As it turned out, there was a communications problem and Fastow did not have the right information about the deal terms. The deal was later consummated in favor of the points being argued by McDowell. McMahon has no examples of a deal having been struck that was unfair to Enron. His concern was that the Enron guys may not be negotiating the same way they would have with a truly independent third party.

McMahon stated that the approval procedure was put in place after he left as Treasurer. He believes that this was started as a result of one of his complaints. He was aware that Rick Buy, Risk Management Manager, and Rick Causey, Chief Accounting Officer, are part of the approval process. He noted that Rick Buy would be an interesting person to talk to, because he believes that the approval procedure shifted the conflicts issue from the Treasurer to Buy.

McMahon emphasized he had no problem with Fastow's motive or intent in the LJM vehicle. His issue was the inherent conflict in appearance only. The impact of this conflict was on the junior people negotiating for Enron under those circumstances.

McMahon commented that a lot of transactions that were done with LJM were highly beneficial to Enron. Without this form of friendly equity vehicle, a lot of these deals would not have gotten done.

Since becoming CEO of EIM, McMahon has had no dealings with LJM or the Raptor vehicles. Those vehicles were used to monetize assets or protect the value of assets and EIM has no assets that require those services.

McMahon also pointed out that the anonymous letter addressed accounting issues, and that accounting issues have never been the subject of his concern. He was not involved with and is not competent in those areas of accounting issues and is further confident that Causey and Arthur Andersen & Co. make sure that things are done properly.

McMahon viewed the individual who wrote the anonymous letter to have a concern about how the structure/transactions with LJM would stand up to public scrutiny. He personally thinks not very well, although he is confident that everything was done in a technically correct way.

If the conflict issues were cured, McMahon believes it was good to have a friendly equity investor available. Fastow simply did not need to be the general partner.

As Treasurer, McMahon received inquiries from bankers about whether continued banking relationships with Enron were dependent on investing in LJM. McMahon believes that Fastow solicited the ten or so key banks with which Enron did business to be investors in LJM, and McMahon heard from at least half of them. This possibly presented another area of conflict. Fastow had the final say on bank selections; some he picked alone on special projects, but most requests

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would be originated by the Treasurer. McMahon consistently informed the banks that there was no linkage between Enron banking business and investments in LJM.

McMahon agrees that the anonymous letter raises no new information. As he walks through the letter, he cannot believe that the accounting is not absolutely perfect. It has been carefully reviewed.

During the course of the interview, McMahon indicated that the person who wrote the anonymous letter came to visit him directly, so he is aware of the person's identity. He believes some information she provided may have overstated or misstated the nature of his concerns, as his concerns were not related to accounting issues.

c: Joseph C. Dilg
Houston 644816.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 18, 2001

RE: Interview with Sherron Watkins, September 10, 2001

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On Monday, September 10, 2001, Joe Dilg and the author interviewed Sherron Watkins ("Watkins") to obtain information relevant to the inquiries contained in her anonymous letter to Ken Lay regarding the propriety of the Condor/Whitewing and Raptor structures. The interview was somewhat disjointed because it was felt better to let Watkins discuss issues she wanted to address initially before questioning in any particular areas. As a result, the following memorandum, which attempts to track the general flow of discussion, is repetitious in certain areas.

By way of her personal employment background, Watkins advised that she spent eight years with Arthur Andersen L.L.P. ("AA"), five in the audit department in Houston (auditing primarily energy clients) and three in the New York office in litigation support. She then spent three years with MG Trade Finance in New York City before returning to Houston and joining Enron Corp. ("Enron") in October, 1993. She took a job working for Andy Fastow ("Fastow") (apparently in the corporate finance area) and was a manager for the JEDI, Cactus and related projects. During the three year period in that position, she reported variously to Fastow and/or Rick Causey. Over the next 3-4 years, Watkins apparently had several different positions with Enron's materials and metals operations and Enron International. She joined Enron Broadband in early 2000 but left in the spring of 2001 as a result of the downsize movement. In the spring of 2001, she was considering positions in corporate relations or again working for Fastow. She took the position working for Fastow, and in June, 2001, commenced a project of listing and gathering information on assets Enron may want to consider selling off. Watkins current business card indicates she is Vice President, Corporate Development.

Watkins stated that her concern about the Condor and Raptor vehicles arose during the process of her listing of various assets that Enron may want to consider selling. She noted the following particular assets sold to Raptor on which a theoretical gain or revenues were reflected: NewPower Co., AVICI, and Hanover. She notes that these assets are all hedged in an investment vehicle in which LJM is an equity participant, but LJM has pulled out approximately $39 million, constituting more than its equity contribution. The Raptor entities owe Enron approximately $700

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million, but those entities have no ability to pay Enron back and LJM has no obligation to put up additional equity.

Watkins understands that, because of value appreciation in Enron stock held in another entity, it was used to support these Raptor investments with LJM. She noted a progressive aggressiveness in Enron's accounting practices, beginning in 1996 when Enron began its mark to market evaluation. At first these were less aggressive, but by 1998-1999, Enron began pushing the edge.

Watkins' concern is that the Raptor transactions look bad. Each of the aforementioned three investments were pegged at their peak. No truly independent third party would have bought these assets at their then market value. Although Raptor provided a vehicle for Enron to hedge against declines in those values, Raptor couldn't hedge. Watkins' point is that in the Raptor transactions you can't find an equity or debt investor who will ultimately have to pay Enron back. Watkins commented that the initial bad appearance got even worse. Both the Enron stock values and the asset value of the assets in Raptor went down. In the first quarter of 2001, the Raptor vehicles had to be enhanced to avoid a write-down. In looking at the overall value of the credit, the Raptor vehicles simply had to be enhanced.

Watkins likewise commented on the inherent conflict of interest of Fastow being the managing partner of LJM. In fact, Jeff McMahon ("McMahon") told Jeff Skilling ("Skilling") of five options that were needed to fix the conflict in order for McMahon to stay on as Treasurer of Enron. Three days later, without addressing the five points, Skilling offered McMahon a position in Enron Networks, a new start-up business. She thinks it is highly unusual for a person to go from Treasurer to the business head of a start-up business. She viewed this as coercion and intimidation.

Watkins stated that she was upset by the situation she found in the Condor and Raptor structures. She decided to leave the company and thought she would tell Skilling all that she had found wrong on her last day of work. But Skilling announced his resignation and departed immediately. Accordingly, she put her concerns in the anonymous letter in advance of the Enron employee meeting to express her concerns to Ken Lay.

Another aspect of the inherent conflict in interest, according to Watkins, was Fastow in effect blackmailing banks to become investors in LJM. She stated that she had friends/acquaintances who worked for Chase, Bank of America and CreditSuisse First Boston who had told her as much during cocktail conversations.

Watkins stated that she had studied the Waste Management accounting problems. Waste Management had depreciated a landfill on a more aggressive schedule than was permitted by the SEC. In that context – which did not seem so bad to her – Waste Management executives and board of directors were removed; they were required to return bonuses and the company had to pay tremendous fines. She viewed Enron's actions as being much more horrific.

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Watkins pointed out that Rick Buy's group, which was responsible for assuring the Raptor entities were creditworthy, put together various information which was shared with her. Rick Buy and his group did not get involved in accounting issues and from their standpoint, all they could do was push on the creditworthiness issue. She views some of the materials out of Rick Buy's group to be "smoking guns" if ever they fell into the hands of the wrong parties.

Watkins also identified Enron's activities in Entertainment on Demand, a FAS125 transaction, a total return swap with a bank, as a transaction that will come back to haunt Enron.

On several occasions Watkins mentioned that she felt Enron had no choice but to restate its financial statements and take its lumps. Skilling's departure has brought additional attention to Enron and its accounting practices, and she feels that the Condor and Raptor transactions will become public knowledge . Watkins has no information, however, that there was any causal relationship between these vehicles and Skilling's departure.

Watkins feels that efforts to enhance the Raptor vehicles again on Ken Lay's watch would come back to haunt him. She is concerned about this because of her understanding of a $250 million fix that will need to be made during the third quarter of 2001. Potential publicity may come from 100-200 employees who have been "redeployed" from Enron. She believes there is a risk of these employees providing information to journalists, analysts and authorities.

To reiterate her point that the Raptor transaction does not look good, she expressed concern about what a good plaintiff's lawyer could do with the facts of locking in of asset values at their highest point, expert witness testimony that this value is unrealistic and no one would pay that much, a loss of $700 million which no one has to pay and which Enron shareholders will have to absorb through dilution of their shares. Watkins stated that if the Raptor transactions are not arms length transactions, they have to be accounted for differently. She also points out that on a disclosure issue, Wall Street Journal articles and others are already writing stories about Enron's unclear financials.

Watkins admitted that she had not seen the legal documents on the Raptor transaction. She does not know how the deals were negotiated as to value for the AVICI, Hanover and NewPower assets. Her point, nevertheless, is that in hindsight, it looks bad.

On several occasions, Watkins pointed out possible sources of corroboration for her concern about Enron's accounting practices. She referenced an employee survey that was done in advance of the senior management retreat held September 6-7, 2001, which was summarized for Ken Lay's benefit and use by Cindy Olsen. Watkins heard two Enron employees – Jeff Donaghey, a managing director on the cultural committee, and Tim Detmiring, also a managing director – state, in effect, that questions regarding accounting issues were not reflected in that summary. Watkins did not know how many people commented on accounting issues, but felt that a legal assistant could plow through the surveys and make a determination. Watkins also identified people in Rick Buy's group as being sufficiently removed and knowledgeable about the accounting problems. These included Vince Kaminski, Rudi Zipter and Ding Yuan.



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Insofar as the references in her anonymous letter to the unwinding in 2002-2003. Watkins stated her understanding that Condor has debt coming due in 2003, or otherwise has a time period by which Enron has to do something about that vehicle. Insofar as Raptor, she understands that the derivative contracts must be settled in 2002. At that point, something will have to be done to Enron's accounting.

When asked if she had specific instances in the Condor vehicles that the accounting was handled contrary to accounting rules or literature, Watkins' response was simply that the transaction would not play well in court. Although the asset was purportedly sold by Enron to Condor, Enron's business units are still managing the asset. Enron booked cash flow on the sale of the asset but is still running it. She acknowledged, however, that Condor was a cash flow and off-balance sheet tool, and not an earnings management tool.

Watkins points out that the mere fact that Fastow has sold his interest in LJM may help cure the inherent conflict of interest, but it does not cure the problem of dealing with a "friend of Enron." Dealing with any friend of Enron raises two issues:

- No one will do transactions of this kind unless they know that payment will be made by Enron stock or they will otherwise be made whole;
- The issue is not just valuation at the time; the ongoing value of assets placed in Raptor is an important factor.

Watkins' understanding of the first quarter of 2001 enhancement of Raptor with Enron stock was that it was done so Raptor's credit would not be restricted. Something had to be done to avoid credit write-downs. She thinks this looks bad from a possible "coverup" exposé, but she is not sure how the enhancement was accomplished. She thinks it is one thing to have the Raptor transactions in the first place, but worse to enhance Raptor with Enron stock after the Raptor asset value declines. In the third quarter she understands $250 million credit deficiency will exist in Raptor. She thinks there will be another effort to enhance Raptor but that Ken Lay will be making a mistake to do it.

The comments in Watkins' letter about executives selling Enron stock at high prices is not related to her concerns about the Condor and Raptor structures. It is just another bad circumstance that will not play well in court. She does not have any facts linking these stock sales to the Condor/Raptor transactions.

Watkins does not necessarily know how LJM got its money out of the Raptor transactions. In her letter, she referred to a cash fee but all she knows is that LJM has received distributions that more than repaid its initial investment in the Raptor transactions.

The $250 million third quarter problem is known to her through casual conversations. She has had a number of conversations with representatives of Enron Global Markets who have innocently told her the information about Raptor and the $250 million problem.

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Watkins believes that AA has not been kept from information relating to the Condor Raptor transactions. She thinks that AA has let the transactions go too far and that AA is as "guilty" as Enron. She also points out that Enron is AA's largest customer world wide.

Watkins thinks that taking assets placed in Raptor at the highest market value was merely a coincidence; she has no indication that there was any backdating to achieve high market value for these assets.

Watkins explained the evolution of the various papers she had made available to Ken Lay. She initially wrote the anonymous letter. She then advised Cindy Olsen that she was the letter writer and wished to speak to Ken Lay. She was provided a copy of Rick Causey's e-mail addressing one of her concerns. She thinks that it is far too simplistic to respond that the contingent shares are included in the calculation of fully diluted earnings per share. She then wrote additional explanations of her points, and finally made an outline of topics she wished to discuss with Ken Lay. The last item was prepared after her discussion with McMahon, who suggested she needed to be organized and use her 30 minutes with Ken Lay wisely if the objective was get Jim Derrick to look at the issue closer.

Questions about Enron's accounting practices are not limited to Condor and Raptor. Watkins knows that Jeff Donaghey thinks that the sale of the MTE plant to EOTT on a mark to market basis is questionable. He did not like the mark to market treatment.

Watkins stated she was trying to give Ken Lay the impression that she was not a voice in the wilderness and that other employees were very concerned about this issue. She believes that a review of the employee survey would support her position in this regard.

Watkins suggested that Cliff Baxter and Jeff Donaghey would be good additional people to talk to regarding her criticism of accounting practices in the Condor/Raptor vehicles.

Insofar as determining how valuation was determined in the Raptor transactions, Watkins identified Vince Kaminski as a good person to talk to. She does not know exactly how the valuation matters were negotiated.

Watkins pointed out that it would also be useful to look at what happens in 2002 and 2003. Enron can't write off its Raptor investment because it would admit that it was not dealing with a real entity in arm's length transactions. She thinks Enron has to restate its financials and take its lumps.

c: Joseph C. Dilg
Houston 652950.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: August 30, 2001

RE: Interview with Jordan H. Mintz, August 24, 2001

On Friday, August 24, 2001, Joe Dilg and the author interviewed Jordan H. Mintz ("Mintz"), Vice President and General Counsel of Enron Global Finance ("EGF") to obtain background information regarding the Raptor transactions and, more particularly, the entity known as "LJM." Mintz has been General Counsel of EGF for approximately one year. In that capacity, his boss is Andy Fastow ("Fastow"), Chairman of EGF and Chief Financial Officer of Enron Corp. ("Enron"). Mintz initially indicated that when he became General Counsel of EGF, he was concerned about LJM, not because of any impropriety, but because of the ugly cosmetics. LJM created morale problems among senior management within EGF because there was uncertainty as to the fairness of the compensation of those participating in LJM.

According to Mintz, the impetus for LJM was created by Enron's acquisition of Portland General Electric ("PGE"). Because that acquisition would make Enron a utility, Enron was forced to divest itself of several "Qualifying Facilities" under certain federal regulatory statutes. The idea was to find a "friend of Enron" which would get a return on its investment, which would look to Enron to make it whole, and which would be easy for Enron to work with in the event Enron wanted to reacquire the assets. The structure requires sufficient third party equity so that it will not be an Enron affiliate for financial accounting purposes. Arthur Andersen & Co. ("AA")'s view was that 3% of the equity must come from the non-affiliated party. Enron also conferred with AA on the issue of booking assets on a mark to market basis. According to Mintz, Enron was looking for a structure in which to place mark to market assets and assure that any loss on those assets would be deferred until their disposition.

According to Mintz, Fastow created a private investment company in which he acted as manager of the general partner and various banks participated as limited partners. These banks were the same as those who ordinarily did business with Enron. Fastow (or perhaps more properly LJM) would earn a management fee based on the total funds raised. For instance, if the funds raised amounted to $200 million, LJM would earn 1% in fees regardless of any activities. Under the structure, the limited partners would get the return of their investment and a 30% return on their investment. Within the initial LJM fund (which Mintz referred to as "LJM1," the full name of which is LJM Cayman, L.P.), there were two deals. One was RhythmsNet and another was an interest in Cuiba, a pipeline project in Argentina (Brazil?).

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There was later formed an LJM2 (LJM2 Co-Investment L.P.), which Mintz described as a larger fund with limited partners possibly including Credit Suisse First Boston and CitiBanc. Mintz indicated that the creation of these funds involved private placement memoranda and disclosure information, and he agreed to collect and provide a package of materials that would include these items reflecting information provided to the limited partners of LJM.

According to Mintz, after the formation of LJM2, the entity took on a life of its own. From Enron's standpoint, the transactions with LJM were funded with Enron shares of common stock that had built up considerable market value. (Later in the interview, Mintz indicated that these shares primarily came available with the dismantling of JEDI into which Enron had previously contributed shares of its common stock. At least some of this stock, once it became available from the termination of the JEDI vehicle, was used to fund transactions with LJM.) According to Mintz, there was lots of history of the Enron-LJM relationship reflected by Enron board of director resolutions and presentations. Deal sheets were also developed that reflected negotiations and approvals at various stages by appropriate Enron and LJM representatives.

At one point, Mintz indicated that the LJM vehicle accomplished several things:

(1) generate funds with which to purchase assets from Enron;
(2) generate revenues to Enron;
(3) move Enron assets off balance sheet; and
(4) hedge assets (also characterized as a subset of (1) above).

LJM was a third party with whom Enron could close deals quickly and could work easily. Mintz believes that Jeff Skilling liked the vehicle for that reason and was glad to have it around without regard of the personal profit to LJM and Fastow. To the extent this structure was criticized because Enron shares of common stock were used as currency, those shares were always used in calculating Enron's earnings per share on a fully diluted basis (that is, Enron shares committed to transactions with LJM were included in the denominator in the calculation of Enron's earnings per share).

Mintz observed the awkwardness and disfunctionality that was brought about by the LJM structure. Some employees of EGF also had roles with LJM. LJM was operated out of Enron's office space, although it was separate space in a separate building. Employees working for LJM received their salaries from Enron, but their bonuses were paid by LJM. Enron analysts and associates were routinely rotated through LJM. Certain Enron employees were likewise profiting from LJM. For instance, on the RhythmsNet deal, Fastow implied that his personal profit was in the \$10-15 million range. At some point, according to Mintz, Fastow carved out a piece of his interest in LJM and conveyed it to Michael Koppers, also an Enron employee. Finally, effective July 31, 2001, Koppers left Enron and Fastow either sold all of his interest in LJM to Koppers. There were only two transactions between Enron and LJM in the first half of July, 2001, and the sale of Fastow's interest to Koppers was structured so that Fastow would realize no income from LJM transactions with Enron during 2001. Under the sale transaction as currently structured, LJM will lease office space from Enron in Three Allen Center, but Koppers will retain an office in Enron's premises through September, 2001.

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According to Mintz, the relationship between Enron and LJM was reviewed by both the audit committee and finance committee of Enron's board of directors. The review is done on a transaction by transaction basis and there was a discussion of (1) the deal, (2) the purposes, and (3) the benefits to Enron. Mintz does not believe this review process delved into the profits received by Fastow (or any other Enron employee) from LJM.

The deals between Enron and LJM, at the time they were entered into, were likewise signed off by appropriate business personnel, including representatives from legal (Mintz himself), Risk Management (Rick Buy), Enron Accounting (Rick Causey), among others. Although Mintz attempted to secure Skilling's signature to sign off on these deals, he was not able to accomplish this.

According to Mintz, AA would also review deals to assure appropriate accounting treatment. Primarily, AA was looking at the LJM side to make sure the deals had sufficient third party equity in the party. Mintz indicated that the deals were negotiated and reviewed from the LJM side as well, which used Kirkland & Ellis as its counsel and Coopers/Price Waterhouse as its accountants.

Mintz indicated that a third fund, LJM3, was in the works earlier this year, but the project did not go forward. Although Mintz did not so state, the scrapping of LJM3 was apparently done about the time it was determined that Fastow should divest himself of all ownership interest in LJM entities.

**Possible Follow Up Activities**

During the course of the interview described above, Mintz indicated he would provide a package of information relating to LJM which will include, at a minimum, private placement memorandum issued by LJM to its investing limited partners. If the package does not contain additional information, possible consideration should be given to requesting the following items for further background review:

(1) Resolutions and minutes of the board of directors of Enron Corp., and the audit committee and finance committee thereof, with respect to transactions between Enron and LJM (this has been provided);

(2) All written presentations to the Enron board of directors, audit committee or finance committee regarding LJM or transactions between Enron and LJM (this has been provided in part, but should be confirmed for completeness); and

(3) All "deal sheets" showing the nature and approval of transactions between Enron and LJM (this has not been provided).

c: Joseph C. Dilg
Houston 639760.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: August 30, 2001

RE: Interview with Andrew S. Fastow, August 27, 2001

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On Monday, August 27, 2001, Joe Dilg and the author interviewed Andy Fastow ("Fastow"), Chief Financial Officer of Enron Corp. ("Enron") and Chairman of Enron Global Finance ("EGF") to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures.

Fastow expressed some irritation with the implication of the employee's letter referring to the Condor/Whitewing and Raptor structures, because all transactions were reviewed with the Office of the Chairman. This is also true of NightHawk, a predecessor to Condor/Whitewing. These were all stock deals (*i.e.*, Enron stock was issued to support the transactions) which required approval of the full board of directors. The full board of directors also approved any restructuring of these transactions. In addition, Arthur Andersen & Co. ("AA") reviewed every transaction under the auspices of Rick Causey, Enron's Chief Accounting Officer. Standard procedure was to review each transaction from a technical basis, and AA's technical specialists (specialists in accounting rules) were involved in this process. AA likewise reviewed legal documents utilized in each transaction and commented to counsel. Vinson & Elkins ("V&E") also reviewed documents and made comments. Moreover, the transactions were disclosed. V&E and AA worked diligently on the necessary disclosure reports.

Fastow noted that the Condor/Whitewing and Raptor structures were similar in that they were supported by the issuance of Enron stock, but that Raptor was different in that in each of the four Raptor transactions, LJM provided the equity for the deal. Fastow recused himself from the Enron part of the equation and represented LJM in those transactions.

The board of directors' approval was of the initial structure of the vehicles (Condor/Whitewing and Raptor). The audit committee of the board of directors performed an annual review of all LJM transactions, including the Raptor transactions.

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Fastow interpreted the employee's letter to have two primary implications:

(1) AA made a mistake when they determined that Enron could book earnings from Raptor; and

(2) There was not full disclosure of the issuance of Enron stock to support these transactions.

In Fastow's view, the employee is simply "second guessing" AA's determination as to the first implication and is factually wrong on the disclosure issue. Fastow believes that Enron's issuance of shares to support these transactions has been fully disclosed in its public filings.

Fastow pointed out the primary difference between the Condor/Whitewing structure and the Raptor vehicles is that no earnings are booked by Enron from the Condor/Whitewing vehicles. These vehicles were intended to accomplish two things:

(1) Move assets and related debt off Enron's balance sheet; and
(2) Record funds flow when assets are sold by Enron to Whitewing.

Because Whitewing is an affiliate of Enron, Enron cannot book earnings from it. LJM is not an affiliate of Enron; therefore, Enron can book earnings from the vehicles in which LJM provides the equity.

Fastow speculates that the employee who wrote the letter would argue something as follows:

- contingent Enron stock associated with Whitewing vehicle was pledged to the Raptor entities
- Enron entered into derivative transactions with Raptor running in Enron's favor
- because of the decline in value of the assets placed in the Raptor entities, Enron will have to issue more stock to support these transactions, which would ultimately be dilutive of the earnings per share of Enron stock.

In response, Fastow would argue that Enron had been able to avoid write-downs on its assets because of its transaction with Raptor. Assets are sold to Raptor, Enron gets the benefit of derivatives from Raptor, and Enron has the benefit of a buffer on its P&L statement. AA says that this situation works perfectly under the accounting rules. Although the structure may be in a gray area, it is fully approved by AA and is fully disclosed.

Fastow offered the following simplified example of how the Raptor vehicles work: LJM2, as a non-Enron affiliated entity, would invest $30 million in a Raptor entity. Enron committed to contribute stock (initially dedicated to Whitewing which had excess value) to Raptor in exchange for which Raptor would issue a promissory note payable to Enron. Enron also took back a special limited partnership interest in Raptor. Enron would then enter into a series of derivative transactions with Raptor to hedge against a decline in value of the assets.

For example, Enron might invest in an IPO. Assuming the IPO had a market value of $100 million, Enron would then put the asset to Raptor for $100 million and enter into derivative hedging transactions. If the asset declined in value, the value of the derivative would increase. This would be a wash on Enron's balance sheet.

There are a number of merchant banking investments that could be placed in a Raptor vehicle and a number of derivative transactions that could be made as hedges. An ongoing test was made to assure Raptor's credit-worthiness to support these transactions. At some point in time, the derivative transactions would have to settle.

Insofar as the equity in Raptor, there was a formula providing a return to LJM. (Fastow further stated that this formula was reviewed this board of directors, board committees and office of the chairman). If cash was left over in Raptor after settlement of the derivative transactions, LJM would get it. Fastow thinks this was a unique structure which was developed not by himself, but by Ben Gilsan, now Treasurer of Enron.

Assuming the value of all assets contributed to Raptor increased, the following scenario would occur:

- Enron wrote up the value of those assets on its balance sheet
- Enron would settle its derivative transaction by paying cash to Raptor
- Cash goes to LJM in payment of its fee pursuant to the formula
- All excess cash flows back to Enron through its special limited partnership interests

The "train wreck" under this structure (according to the employee who wrote the letter) would occur if all contingent stock had to be issued. Assuming that Enron would have to issue new stock to fulfill its obligation, it would dilute the earnings per share of Enron stock. The answer, according to Fastow, is that all contingent stock that might be needed to satisfy Enron's obligations to Raptor was included in the earnings per share calculation – thus, no dilution will occur.

Fastow stated that, on the one hand, he applauded the employee who wrote the letter because it takes fortitude to stand up and complain, even on an anonymous basis. He questions the employee's motives, however, because the person is smart enough to know that the structure and all transactions within the structure were reviewed by AA and found to be appropriate. [Fastow also stated his belief that this employee is acting in conjunction with a person who wants his job.]

When LJM was first brought up as an entity to provide equity in Raptor (or similar transactions), the primary issue discussed was the potential "Wall Street Journal risk" – *i.e.*, the bad

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cosmetics being aired publicly. LJM1 was created in June of 1999. It was put together to form a non-affiliated third party for Enron to enter into derivative transactions to hedge its investment in RhythmsNet stock. The Enron stock contributed to make LJM a credit-worthy counter party came from "UBS forwards" created several years earlier by Ed Segnor. Enron shares were issued to UBS and Enron entered into a contract to repurchase those shares in the future at a specified price. The shares held by UBS increased in value and after Enron repurchased them, the excess value was pledged to the RhythmsNet transaction.

LJM1 was capitalized by $1 million from Fastow and $7.5 million each from two separate banks. On its $20 million investment in RhythmsNet, Enron ultimately booked $400 million.

In returning to the "Wall Street Journal risk" that was discussed at the outset, Fastow was asked why the "friend of Enron" was not selected from some totally third party – a Goldman Sachs or other investment banker. According to Fastow, the reasons were (a) complexity, (b) speed of closing, and (c) confidentiality. By way of example, a bank typically wants to repackage and market products in which it invests, which would jeopardize confidentiality. New deals also came up quickly and banks could not move with the required speed.

The limited partners in LJM1 were two commercial/investment banks. The limited partners in LJM2 included banks, pension funds, insurance companies and high net worth individuals; a total of thirty different investors, none with relations to Enron. The LJM limited partnerships were marketed as unrestricted deals (*i.e.*, not limited to Enron transactions). All materials, including offering circulars, subscription agreements, etc. were reviewed by AA and V&E. AA made comments to LJM partnership agreement to assure that it was not an affiliated entity. LJM had its own attorneys (Kirkland & Ellis) and other limited partners had counsel, which reviewed and commented on the LJM documents. The limited partners were also given extraordinary rights, including the power to remove Fastow as manager of LJM without cause. An advisory committee of limited partners was also established to review transactions.

LJM1 had very little equity ($16 million) and was set up specifically for the RhythmsNet deal. LJM1 actually did a second deal involving a portion of Enron's investment in the Cuiba Power Plant project in Brazil which enabled Enron to book future earnings on natural gas supply contract. Enron sold an $11 million dollar interest in the power plant, thereby dropping Enron's ownership to below 50%. This made the plant a deconsolidated asset and would permit Enron to value the gas supply contract on a mark to market basis. The future income under the gas contract could therefore be booked as revenue.

LJM2 was much larger fund which was closed in early December, 1999, and raised $349 million in equity, 1% from Fastow and the remainder from limited partners. By the end of 1999, seven different transactions occurred between Enron and LJM2. In total, LJM2 engaged in 24 transactions, three of which were non-Enron transactions, and four of which were Raptor structures.



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Fastow re-emphasized that the LJM vehicle was approved on several levels. First, LJM was set up with knowledge of the board of directors, its committees, and the office of the chairman. Second, on a transactional basis, Causey was designated to represent Enron. Causey negotiated and approved all transactions. Audit committees of the board of directors were to review all transactions with LJM on an annual basis, and have done so for two years. Scott Sefton, General Counsel of EGF, prepared Causey for the first review and Jordan Mintz, presently General Counsel of EGF, prepped Causey for the second review.

Insofar as the separateness of LJM and Enron, Fastow indicated that this took many different forms. Each employee of Enron who was also working for LJM was covered by a Services Agreement pursuant to which, in effect, LJM reimbursed Enron for the cost of that employee providing services to LJM. Michael Koppers, for instance, had his salary paid by Enron but his bonus was paid by LJM. For another employee, Cathy Lynn, LJM reimbursed Enron for her entire salary and bonus. LJM also had some employees who were not employed by Enron. The rationale for dual employees, according to Fastow, were two: (1) Enron employees could keep their benefits, such as stock options, insurance and the like; and (2) dual employees would be knowledgeable about Enron and work with Enron easily.

Fastow made several comments to indicate that the LJM-Enron relationship had adequate oversight and safeguards. Christina Mordant was General Counsel of EGF at the time LJM1 was formed and the RhythmsNet transaction occurred. Scott Sefion was General Counsel of EGF who prepared Causey for his first audit committee review and was further present when LJM2 was created and many of the transactions with LJM2 occurred. More recently, Jordan Mintz has been General Counsel of EGF for approximately a year and has participated in the oversight of transactions occurring during that time period as well as preparing Causey for his second presentation to the audit committee. Rick Causey has been the primary Enron officer scrutinizing transactions with LJM from the Enron standpoint.

Fastow also pointed out that Enron had no obligation to enter into any transactions with LJM. LJM was set up this way so that there would be no complaints that Enron was required to deal with LJM on any of the four Raptor entities or other transactions.

According to Fastow, the Condor/Whitewing structures have third party investors, some equity interests by Enron, but are subject to the special purpose accounting rules. These entities began in 1997 with NightHawk and then progressed into Condor/Whitewing and Ospray.

Fastow viewed the LJM-Enron relationship as good for LJM and great for Enron. He pointed out that LJM had, however, lost money on some of the transactions it had engaged in with Enron.

c: Joseph C. Dilg
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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 18, 2001

RE: Interview with Richard Causey, August 31, 2001

On Wednesday, August 31, 2001, Joe Dilg and the author interviewed Rick Causey ("Causey"), Executive Vice President and Chief Accounting Officer of Enron Corp. ("Enron"), to obtain information relevant to an employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures.

Causey stated that he received the employee's anonymous letter from Jim Derrick. He made a brief response to the letter by e-mail and later visited with Ken Lay on this subject. Causey then launched into a narrative description of what he believed to be the relevant events, after which there were follow-up questions in specific areas.

According to Causey, years ago a minority interest financing structure was developed called NightHawk. Enron common stock was supplied to the structure. During that time period the stock appreciated in value, adding value to the NightHawk structure. This structure eventually led to Condor/Whitewing. The structure was carried forward, leveraging off the increased value in Enron stock. This created a larger equity base, together with outside equity, but was still supported by Enron stock. This structure permitted the management of off-balance sheet assets and cash flow.

Causey stated that the value of the Enron stock in the Whitewing structure kept going up. This led to the idea of putting the excess stock value in a Raptor vehicle (of which there were four) to take advantage of this equity. The structure was conceptualized by Ben Glisan. The structure was to use the equity shares – *i.e.*, Enron shares in the Whitewing structure that would be used to support the Raptor vehicles. The value in the Raptor vehicles was to cover losses on swaps.

The Enron stock then started dropping. Raptor may not have enough equity to pay its derivative obligations to Enron. In the first quarter of 2001, contingent shares were issued and Raptor gave back a note. Raptor is restricted from selling for a period of time so the shares were not sold, but the full value of those contingent shares was considered in calculating Enron's earnings per share. At the end of the day, this structure will do its job, but it may be in a more noisy fashion.

Raptor was created to withstand volatility. It was not created to withstand declining asset values of the magnitude that have been experienced.

Insofar as the impact of these transactions on Enron's earnings, the current target for earnings per share include all contingent share commitments. By reason of recent securities law rules, there is a maximum number of shares that can be delivered in these vehicles. These rules place practical limits on the number of shares that can be delivered that would begin to have an impact if Enron stock goes to $20 per share or below. Below this level, the consequences of this structure would hit Enron's income statement. All these consequences were known to Jeff Skilling and Ken Lay through discussions of this structure.

According to Causey, the logical windup of the situation would be for Enron to deliver shares to Raptor, Raptor to sell shares in the market, and cash to be paid to Enron in satisfaction of its derivative contract. According to Causey, there is not much use in keeping the Raptor structures in place. There are no more derivative trades that can be conducted with Raptor and those vehicles have reached their limits.

Causey pointed out that Raptor-3 did not involve Enron stock. It involved a hedge with NewPower stock. The NewPower stock price dropped significantly. The receivable hit a high point because of the derivative transaction, but the collateral shrunk. This transaction was not supported at all by Enron stock; however, there is now cross-collateralization of all Raptor structures.

Causey explained the Raptor vehicles and Arthur Andersen L.L.P.'s ("AA") role in approving the structure. LJM is a general partner in the Raptor vehicles; Enron is a special limited partner. AA never provided written approval as to the overall Raptor structure. Causey's approach is to include AA early and consult often on all projects. AA gets all documents and they walk down the path with Enron all the way. Ultimately, AA signs off with an audit opinion and reports to Enron's audit committee. The audit committee has definitely heard reports of hedging with Enron stock.

Causey states that AA has its own documentation of various Enron transactions. Dave Duncan is aware of the anonymous inquiry and went back and looked at the issues and advised Causey that he felt comfortable. AA used its Chicago-based technical group in passing on the Raptor structures. This is all done internally at AA.

Enron also has its own accounting documentation. The anonymous inquiry has made Causey more sensitive and he wants to look back at the documentation to see that it is in good shape.

Causey pointed out that an unfortunate error will require an adjustment to the third quarter statements. In the contingent fee/cross-collateralization transaction that occurred in the first quarter of 2001, the note taken by Enron was booked as a note receivable (an asset) and not a charge against equity. The note should have been booked as a charge against equity and this may have to be corrected in the third quarter statements. This amounts to approximately $800 million, and together with an expected $200 million in additional contingent share commitment that will be required in

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the third quarter, will amount to a $1 billion charge against equity. Causey characterizes this as a simple mistake that now requires correction.

Causey discussed the structural challenge in the Raptor transactions that required outside equity to be at risk. It was known that the Raptor structure would be used to hedge against volatile assets. A "put" on the Enron stock was negotiated with Raptor. The hope was that a put would result in equity being placed in Raptor. AA was well aware of this vehicle and the key issue was whether the third party money was really at risk. The negotiation of the put with LJM was the key factor in this structure.

There are other deals with LJM and business reps at Enron. These people would do the negotiations, then Rick Buy and Causey would review the deal.

Causey points out that there was always a review process in the LJM transactions with Enron. These transactions may not have been subject to independent evaluations, but he considered whether other transactions were considered, looked at the fairness of the transaction and the propriety of the accounting.

Generally, AA looked at any material dealing with LJM – AA needed to do so for purposes of disclosure. The amount of time spent by AA on deals depended on their complexity. AA was involved heavily in the Raptor transactions.

Deals would originate by the business unit looking for earnings opportunities and also monetizing assets to hit their cash flow targets. The decision to involve LJM on a deal was for speed and efficiency – some consideration was given to non-affiliate counterparties, but speed and efficiency normally sent the deal to LJM.

AA had the opportunity to look at and comment on LJM's structure – basically looking at the outside equity in LJM. Causey did not know if AA participated in comments to the partnership agreement, but it may have. AA said it was okay with the structure, but must have known that the structure would be considered unusual.

Causey noted that there were some caveats to a full board of directors approval. The review of the LJM transaction was done with the audit committee. Causey gave two such reports to the audit committee. The finance committee also got involved; he gave them a report at a year-end meeting. Causey identified the document entitled "Related Party Transactions – LJM 2000" as the document used to make a presentation to the audit committee.

According to Causey, Ken Lay and Jeff Skilling would normally be in the finance committee meetings because this was one of the company's most substantive business meetings. Lay and Skilling were possibly there when LJM transactions were reported. There are five meetings/presentations a year with the committee, and perhaps some special meetings.



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The audit committee meeting involved a discussion of the structure of transactions with LJM and they were given a general status of the LJM activities.

Causey explained that the finance committee has approval authority at certain levels of expenditures – capital projects primarily, but not so much interested in the divestment of assets.

Dave Duncan was AA's engagement partner of the Enron account and works primarily with Causey. Depending on the deal and subject matter involved, specific AA partners would be assigned to work with the Enron business unit. If issues ever arose from that work, Causey and Duncan conferred to resolve them.

Causey commented that the Raptor presented a vehicle that permitted the booking of significant revenues. Some new accounting/securities rules came out after Raptor was formed which now diminish the value of the vehicle. The Raptor vehicles were used to hedge a group of volatile investments. Raptor 1 was the start. Raptor 2 and 4 were started because the Raptor 1 vehicle was not large enough. Raptor 3 was a special purpose vehicle in which the NewPower stock was used.

Causey stated that Whitewing is not a "revenue-generating vehicle." It was a structure for placing assets off balance sheet and generating cash flow.

In Whitewing, Enron stock in the vehicle is significant because they are share settleable derivatives. There will be some contingent obligation to deliver shares to satisfy these debts.

The contingent share commitment graph contained in the investor relations booklet reflects a dilution from the Whitewing and Raptor transactions, but it does not discuss those vehicles specifically.

The impact on a $20 per share price for Enron stock would cause losses to occur in income. Above the $20 floor, there is sufficient value in the vehicle.

Causey states that there were not many questions on these vehicles by equity analysts until the stock price fell precipitously; now, the news media has focused on the entities, but it is old news to the equity analysts. Causey states that there have been discussions about various risks involved in these vehicles. AA included these risks in its audit issues. Causey has discussed these risks with Skilling and Lay. Causey questions whether someone else might take a different view of these structures? Possibly, and that risk has long been known.

Causey commented that the anonymous employee who wrote the letter is correct that a decline in stock will require more shares to be delivered. These shares, however, are already being considered in calculating fully diluted earnings per share.



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Causey identified Bob Butts, a senior accountant in Enron, and Rodney Feldun as additional Enron employees who might be knowledgeable about accounting and possibly valuation issues now under discussion.

According to Causey, there will be no hit to income as contemplated in the wind down of the Raptor scenario set forth in the letter from the anonymous employee. The impact would be on the capital portion of Enron's balance sheet (*i.e.*, a decline in equity).

c: Joseph C. Dilg
Houston 657378.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 14, 2001

RE: Interview with Rick Buy, September 5, 2001

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On Wednesday, September 5, 2001, Joe Dilg and the author interviewed Rick Buy ("Buy"). Executive Vice President and Chief Risk Officer of Enron Corp. ("Enron"), to obtain information relevant to an employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures.

Before joining Enron in 1994, Buy had ten years experience with Bankers Trust Company in the derivative finance area focused on the energy industry. He has held his current position for 3-4 years and is responsible for the Risk Assessment & Control Group ("RAC") which functions similar to a bank credit committee. This group reviews proposed transactions by Enron and affiliates for the soundness of assumptions, the reality of projections, and identification of underwriting risks. As a result of this analysis, his group will either recommend that a transaction be approved or not be approved.

Typically, Buy's group did not review the structured financing vehicles like Condor/Whitewing – those transactions are largely a repackaging of assets already in Enron, on which no new risks are being taken.

Buy gave examples of the normal type of transaction that his group would assess:

- the purchase of a pulp and paper company in Canada;
- acquisition of an oil and gas exploration company in West Texas; and
- various derivative transactions.

In assessing transactions of this type, the group would function much like a credit committee of a bank in that it would:

- identify the risks;
- assess the financing required and the ability for repayment; and
- assess profit potential.

This would include a review of the financials to determine what the deal would look like based on various projections. This process would be documented in a Deal Approval Sheet ("DASH") which would present a summary of the transaction, its basic parameters, and the approval of a financial analyst and various supervisors. Andy Fastow's group would also look at and approve these transactions from the securitization standpoint.

In Enron's business, there arose a need for outside equity which led to the formation of LJM. Buy had no involvement in the structure of LJM but was involved in the governance issues and deals in which LJM was an investor. There had to be a process whereby deals with LJM would be assured to be in the best interest of Enron. This process was established from the outset of the Enron-LJM relationship.

Transaction approval for normal deals is detailed and specific. Andy Fastow is normally in the approval chain for those deals. Because of his ownership of LJM, Fastow had a conflict of interest in transactions in which LJM participated with Enron. The process therefore required that Buy and Causey sign off on all LJM deals. This process was in place from the outset and was presented to and approved by Enron's board of directors.

Buy regularly attends finance committee meetings of the board of directors and, in his view, there was lots of information presented about LJM and the finance committee signed off on LJM and the procedure that would be followed for the approval of deals done with LJM. This procedure was derived through discussions among Jeff Skilling, Fastow, Causey and himself (Rick Buy), and then submitted to the finance committee of the board.

Buy described a hypothetical non-Raptor transaction with LJM. A business group would originate the deal, LJM would buy an equity sliver, provide debt financing or the like, and approval would be sought. The review process by Buy's group would not be as rigorous as a normal transaction because the numbers and economics had already been run; this was just LJM taking a piece of the deal. Dave Gorde in the underwriting group would normally review transactions and the underlying detail and would pass on his recommendation to Buy.

According to Buy, Causey would also review the proposed transaction for a "smell test" of the commercial terms and would review the accounting.

Buy commented that the structure was beneficial to Fastow financially, but also beneficial to Enron and Causey to permit the generation of revenues to meet targets at the end of calendar quarters. It was a good vehicle but it needed to be managed carefully.

The deals done with LJM were relatively small – LJM would take a piece of a larger deal done by Enron. Speed of doing the deal with LJM was a key factor; the people knew the deal, the structure, and flexibility was very high. The approval process was not as tight on these deals as in the normal transaction approval process. There was not as great a concern with these deals because all knew it was highly structured.

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Fastow's group would prepare the Enron Investment Summary form. It would be provided to Buy's group and the Deal Approval Sheet (DASH) would be prepared and executed.

The Raptor vehicles in which LJM participated were different because they involved derivative transactions. The credit capacity of the Raptor vehicles changed with the value of Enron stock and the value of the assets in the vehicle. Enron had contributed stock to some prior structured transaction; the stock appreciated in value and there was no good way for Enron to use this increased value in the prior vehicle. Accordingly, Enron shares were contributed to Raptor and Raptor could use the shares as its equity base. This vehicle could be used to hedge Enron's merchant banking assets. At this time, asset values were bouncing around like crazy. RhythmsNet was cited by Buy as an example.

According to Buy, Raptor provided a means to lock up an asset at a certain level. If the asset declined in value, it would eat up Enron equity, not Enron earnings. The problems with the vehicle arose when Buy's group conducted its check on the counter-party's credit worthiness. The equity base in the Raptor vehicles deteriorated to the point where the equity was negative. This posed a problem and Buy picked up the phone and called Skilling to discuss what to do about the structure so that Raptor would be a credit worthy counter-party. Skilling's solution was to wait for a while. Finally the situation got worse and in the third quarter of 2000, supplemental shares of Enron stock were dedicated that would assure credit worthiness of the Raptor vehicles, at least so long as Enron stock was traded above $20 per share.

Buy stated that his group received daily statements that would show the value of assets in the Raptor vehicles so that its credit worthiness could be traced. The $20 per share may be slightly tenuous if the asset value placed in the Raptor entities has declined. For instance, NewPower stock has gone down drastically, and some fix may need to be made in the Raptor entity which holds the NewPower stock.

The fix that was done in the second/third quarter of 2000 was the contingent share commitment/cross-collateralization among all Raptor vehicles. [This actually occurred in the first quarter of 2001.]

Buy stated that he (his group) did not spend a lot of time on valuing the Raptor assets. They mostly look at spreadsheets. He views the legal and accounting issues to be more significant than the valuation issue. He views the accounting as aggressive, but that is not his role. The accounting ramifications are under the control of Causey and AA.

Buy is not familiar with the unwind procedures for Raptor. He guesses that Raptor will be shored up with additional Enron stock. The Raptor vehicles need to be capitalized sufficiently to cover the credit exposure from the derivative contracts which fluctuate over time.

Buy stated he was not concerned about the Raptor structure -- he thinks it is a clever structure to put to work the excess value of Enron stock (held in a prior vehicle) and to minimize the volatility of the merchant bank assets conveyed to Raptor. He thinks Enron's accounting is aggressive, but not over the line.

Buy believes that valuation is a key factor, but not just today's valuation. It was not necessary for Raptor to be unwound, and those vehicles can be kept as long as they are credit worthy.

Buy commented that had Enron stock stayed high and the value of assets placed in Raptor not fallen sharply, there would be excess capacity in the Raptor vehicles. But these scenarios simply did not happen.

Buy sees no eminent "train wreck" arising from the Raptor vehicles, but he needs to check on the present value of NewPower stock. If the value of NewPower stock – held in one Raptor vehicle – becomes low enough, and the Enron stock has declined as well, that Raptor vehicle may be in an uncreditworthy position.

Buy concluded the interview by stating he will be available to address any follow up questions we might have.

c: Joseph C. Dilg
Houston 649549.1

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Mark E. Koenig and Paula H. Rieker, August 29, 2001

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On Wednesday, August 29, 2001, Joe Dilg and the author interviewed Mark E. Koenig ("Koenig"), Executive Vice President Investor Relations, and Paula H. Rieker ("Rieker") Managing Director of Investor Relations, to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures. Also present during the interview was Rex Rogers, Assistant General Counsel of Enron Corp.

At the outset, Koenig and Rieker questioned the use of Condor and Raptor terms. They pointed out that those were simply internal code names within the Enron business groups, and the disclosures to investors were made with respect to Whitewing and LJM. Koenig likewise stated he was aware of the employee's anonymous letter but questioned why Investor Relations was being included in an investigation of the substance of that letter. It was explained that investors' perception of the Condor/Whitewing and Raptor structures may be useful to the investigation.

Koenig and Rieker recalled that investor questions first came to their attention after the initial disclosures in 1999 in the 10-Q that an Enron senior officer was the managing partner of LJM1, an entity with which Enron co-invested. The proxy materials for 2000 (covering the period through year-end 1999) disclosed that Andy Fastow ("Fastow"), Enron's Chief Financial Officer, was the Enron senior officer who was the managing partner of LJM. They indicated that several investors have spoken directly to Fastow for clarification.

Rieker indicated that there were earlier questions about the Whitewing structure. Whitewing is a securitization issue, but people thought it was a revenue management tool. According to Rieker, much of this confusion was caused by the hedge funds which were always attacking Enron.

Koenig and Rieker indicated they began getting inquiries about Whitewing when Enron's stock price went down. The investor/analyst's questions about Whitewing were directed at unfamiliar terms such as derivatives and required further explanation. Koenig responded that Ken Lay's comments about making Enron's financial reports more reader-friendly related to the

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management discussion and analysis portion of the financial statements, and not the related party disclosures.

Koenig and Rieker indicated that investor/analysts' inquiries over the past six months have turned largely to cash flow, not related party transactions.

In connection with Enron's second quarter results and the second quarter 10-Q, presentations were made regarding the dilutive effect of Enron's contingent share commitment. Because of this contingent share commitment, there was some dilutive effect in the second quarter of 2001. No questions were recalled about the potential dilutive effect that may occur in the third quarter of 2001. Investors are largely concerned about whether a company achieves its earnings per share target.

Koenig and Rieker recalled no specific questions from investors/analysts on the portion of the 2001 proxy statement that addresses four structured entities in which LJM2 participated. Rieker points out that those are probably the Raptor vehicles which are referred to as "Entities" in the financial statements accompanying the various 10-Q reports. The only real noise that investors/analysts raised about LJM is the association of Andy Fastow as the managing partner in LJM.

Although neither Koenig nor Rieker are familiar with the details of the investments with LJM, Koenig was present in a finance committee meeting that reviewed the transactions in detail on a transaction by transaction basis.

According to Koenig and Rieker, investors want simplicity; because Enron's related party transactions are complex and not easily understood, they necessarily raise additional questions. However, they point out that this is not the only complexity inherent in Enron's business, and if there were no related party transactions, they would still have full employment explaining other complexities of Enron's business.

Koenig and Rieker reiterated that the contingent equity obligation is present; it is disclosed; and it is figured into Enron's earnings per share. Rieker referenced the 2001 second quarter analysts' conference where there was a presentation on the dilutive share number increasing from 860 million to 900 million during the preceding twelve months. Any dilutive effect of Enron's share commitment should be so small as to be immaterial, and, in any event, it already is included in the equation of Enron's earnings per share target.

Rieker stated that she believed investors understood that the value of the merchant investment portfolio within Enron (as well as every other merchant investment portfolio) has declined. This may have ramifications down the road, but investors/analysts' inquiries do not delve into this specifically.

At the close of the interview, Rieker supplied the presentation referenced earlier for the second quarter 2001, which was also posted on the Enron web site for a number of weeks. That



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presentation included a page entitled "Contingent Equity Commitments" which analyzed the components impacting share count of Enron stock 2001 versus 2000. The chart shows a dilution of Enron stock by an additional net 29 million shares issued and outstanding in the second quarter of 2001 over and above those existing in the second quarter of 2000. She indicated this was the dilution attributable to the contingent equity commitments to the Raptor and Whitewing vehicles.

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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Greg Whalley, August 31, 2001

On Friday, August 31, 2001, Joe Dilg and the author interviewed by telephone Greg Whalley ("Whalley"), President and Chief Operating Officer of Enron Corp. to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures. Whalley was in London and was not available for a personal interview.

Whalley stated that he had not seen the employee's anonymous letter, although he had heard about it and it took him some time to realize that he knew the author. He further indicated that he knew the author as Sharon Smith (apparently she does not go by the same name today). He does not know, however, why he was named as a person who might share the concerns stated in the letter.

In January or February of 2001, when Enron Wholesale was being put together, he asked a number of questions about the Raptor vehicle. Apparently, this came up when Enron North America employees suggested that he consider possible transactions with Raptor. Whalley sat down with Rick Causey, Chief Accounting Officer, and Ben Glisan, Treasurer, and got the basics of how the vehicle worked and how it was being managed. Once he got comfortable with how the situation was being managed and that Causey and Glisan had a handle on it, he backed off.

Whalley stated that he did not like the Raptor vehicle because of the short-sighted view of value that it fostered. That is, in negotiating a transaction with a third party, one's view of the value of that transaction may be affected because there is always the opportunity to turn around and place the asset in a Raptor-like vehicle and, while recognizing short term value, avoid the long term consequences of the initial trade.

The conflict of interest in dealing with LJM was disclosed and was apparent both within the Enron organization and to outside investors.

At various points during the conversation, Whalley questioned why an investigation was being conducted, that it seemed to be an issue of fact, and that it all hinges on whether the accounting

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structure used in Raptor was appropriate. If it was appropriate, there is no issue, but if it was not appropriate, there is an issue.

Whalley was likewise aware of the possible dilutive effect on Enron's earnings per share in the future if assets placed in the Raptor vehicles declined significantly in value. It was his impression in discussions with Causey and Glisan that there are several options to deal with this problem. He would not share the view of the author of the anonymous letter that these declines in value would lead to major problems in 2002 and 2003. He suggested that Causey and Glisan would be the logical persons to talk with about those options.

c: Joseph C. Dilg
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# MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 14, 2001

RE: Interview with David Duncan and Debra Cash, September 5, 2001

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On Wednesday, September 5, 2001, Joe Dilg and the author interviewed David Duncan ("Duncan") and Debra Cash ("Cash"), both partners with Arthur Andersen L.L.C. ("AA") to obtain information relevant to an Enron employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures. The accounting issues involved in these structures are very complex, and any technical aspects of accounting treatment discussed below should be confirmed for accuracy before being relied upon.

Duncan commenced the interview by stating that he had become aware of an Enron employee who had raised accounting issues regarding the Condor/Whitewing and Raptor structures. Upon internal AA advice, he then contacted Jim Derrick and was placed in touch with Rex Rogers to determine the nature of the inquiries raised by the employee. Duncan and Cash apparently knew the identity of the employee, although they did not reveal it. They further stated that the employee called one of their AA partners who was not assigned to the Enron account and attempted to discuss certain issues with him. That partner contacted Duncan and/or Cash and advised them of the inquiry. Duncan stated that his primary interest was to determine whether any new information had been brought forth by the employee's inquiry.

Duncan first addressed the Condor inquiry. Step 1 is to understand that Condor is a non-consolidated entity. In order to determine that, one looks to control. Condor is under shared control. The party who shares control with Enron has the ability to vote its interest as it sees fit, and also has the right to remove Enron from management. Once all factors are considered, including consultation with AA's technical people and practice staff, it was concluded that Condor qualified as an unconsolidated entity.

Once it is determined that Condor is an unconsolidated entity, the next inquiry is what happens upon a sale of assets to Condor. The first sub-question under this heading is: Is there a sale? The answer depends on what has been sold. If it is a financial instrument there is one set of accounting rules and, if it is a hard asset, there is another set of rules. AA reviewed each transaction on a case-by-case basis to determine from the type of asset whether there was a sale and whether

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there was a gain or loss upon the sale. No gains are realized from sales to an affiliated party such as Condor. If it is determined that a sale has occurred, the asset is moved from the seller's balance sheet to Condor's balance sheet. In accounting for cash flow, there are 3 possible categories:

- operations
- investments
- financing.

Placing revenues into one or the other of the above categories was a key decision. Duncan recalls that the vast majority of sales fell into the operating category. The issue in making that determination is the intent toward the asset at the time of its acquisition. Duncan stated that a textbook example is a large tract of real estate. If initially purchased to hold as an investment and later sold, the revenue would fall under the investment category. If purchased by a real estate developer to subdivide, develop and sell off the lots, the subsequent sales would be placed in the operating category. In Enron's case, the distinction was largely whether the asset was purchased as a merchant bank asset or a strategic asset. The sale of a merchant bank asset would generate operating cash flow.

AA has confirmed the transactions that have been conducted with Condor. AA audits Condor and has completed its year 2000 audit – *i.e.*, all transactions for 1999. The net impact of those transactions to Enron are set forth in a footnote to the financial statements in its annual report. Possible criticism of that footnote is that related parties and non-cash transactions are lumped together and not separated individually. Thus, it is difficult to tell which portion of those revenues relates directly to the Condor transactions.

A question arises whether an asset is a merchant investment or a merchant asset. Merchant investments are marked to fair market value; merchant assets are not. To be investments, they have to be in an investment company. Enron sometimes desires to move items from an asset to an investment category but once their character is declared, it is difficult to do so.

The inquiry of supporting Condor with Enron stock goes back to the initial capitalization with Enron stock. That stock increased in value while it was equity in Condor.

There is literature on (a) special purpose entities and (b) joint ventures. The former is subject to a strict set of rules, while the latter is very subjective. AA believes that Condor falls into the latter category because it is structured. Duncan also believes that the entity would comply with the emerging taskforce principles applicable to special purpose entities.

Duncan commented that the beauty of Condor was the fact that Enron's stock price went up after it was committed to the Condor vehicle. That gave Condor more capacity. Enron may have to do credit checks of Condor-owed obligations to Enron, but he does not think that has been a problem.



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Duncan explained that Enron sold a "put" on Enron stock to Condor. The "put" is share settleable. Where there is debt to another that is supported by the debtor's stock, there is specific guidance in the accounting rules. If the instrument is cash settleable, it moves through income; if it is share settleable, it moves through equity. These shares are also included in the calculation of earnings per share. According to Duncan, this activity is disclosed in footnote 11 to Enron's Annual Report for Year 2000.

Turning to a discussion of the Raptor vehicles, Duncan commented that there was some analogy to Condor in that the Raptor vehicles are also supported by Enron stock. Enron approached AA about using a third party investor – *i.e.*, LJM – to be organized/managed by a senior officer of Enron. Duncan saw technical issues and corporate governance issues and wanted to make sure that approval for the transaction was obtained from the highest levels. As to a technical aspect, Raptor vehicles are one step removed from Condor – instead of an affiliate transaction, LJM would be a third party which would place equity in Raptor. To qualify, the LJM entity had to have unique control features not normally found in the partnerships. The limited partners had to have participatory involvement and the power to remove the Enron senior officer as manager without cause.

In determining whether investment in Raptor was made with third party equity, the contribution of Enron's senior officer to LJM had to be excluded. Further, none of the money contributed by the third parties could be borrowed. AA tested to assure that third party equity was in the transaction. AA viewed the Raptor entities as single purpose entities that had to be capitalized in accordance with specific SPF rules.

The Raptor vehicles were structured to achieve hedges against assets that had gone up in value. This was accomplished by a sale or pledge of the asset to the Raptor vehicle, and Enron getting a note back. Outside equity in the Raptor vehicle had to be three percent (3%). The Raptor vehicle needed to have credit capacity in its equity. Equity was supplied to the Raptor entity by a transaction whereby Enron would sell it stock. When the stock appreciated in value, the increase would increase Raptor's credit worthiness. The key feature was that Enron could settle in cash. The ultimate settlement of the derivative would give Enron cash, not shares – therefore, it would come into Enron as income.

Enron sold the Raptor entity shares with restrictions. In order to value the shares, a fairness opinion was obtained from Price-Waterhouse on the first Raptor-like transaction, and the basic format was used by analogy in subsequent transactions. It was concluded that the impairment test should lead to full market value being assigned to the Enron shares. This gave the Raptor vehicles capacity to do transactions with Enron. Had Enron stock gone up in value, it would have provided credit coverage for any decrease in the asset value. As time passed, the Raptor entity may elect to hedge its exposure. It purchased a derivative to hedge on the stock. This was a share settleable hedge. The impact was on equity, not income. When settleable, the payment by Enron in stock would not affect the income statement.

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A number of scenarios can be envisioned depending on whether the stock and assets go up or down in value. If both stock and assets go up, the Raptor entity can settle with Enron and Enron can show income. If the stock goes up but assets go down, the entity can still settle and Enron will show income. If both stock and assets go down, Enron can settle with the impact being in its equity, not income position.

Duncan states that all of this is disclosed: nothing is left out that needed to be included in AA's audit opinion.

The key feature in Raptor transactions is the hedging activity. The man on the street may look at the share settleable hedge and question how it will work.

During the interview, Duncan raised the question of whether it would be appropriate for AA to visit with the Enron employee who made the inquiries. The point was made that the employee's inquiries might better be satisfied if she sat down with AA and received an explanation. From AA's standpoint, it simply wants to assure that there are no new facts raised by the employee.

Duncan explained that when the Raptor vehicles were originated, Enron sold a put that could be exercised by Raptor. After 60-90 days passed, and Enron stock had appreciated, the put would be settled by cash payment to the Raptor entity. Upon settlement, Raptor would distribute money to its equity investors. Once the distribution was made, the investors had amounts returned equal to their investment plus profit. Yet, technically, their investment had been properly made. The question is whether there is a valid business reason for the "put" transaction and AA relies on Enron's representation that a good business reason exists. Although this accounting treatment may look facially questionable, it satisfies the technical requirements.

Procedurally, AA reports to Enron's credit committee five times a year. The Condor and Raptor transactions have been discussed with them. The detail is not high, but information is available. There are not a lot of questions by the audit committee. A list of transactions entered into since the last meeting is generally discussed and approval is received for those transactions.

The audit committee is presented with a booklet of information for its review before or at each meeting. The booklet of the audit and compliance committee meeting held February 12, 2001, was examined as a sample. The booklet in similar form is presented for each meeting.

According to Duncan, Enron has never failed to follow AA's recommendation on technical and accounting matters. AA does not audit LJM, but had discussions with Fastow about whether they should or wanted to audit LJM.

AA pointed out the need for better documentation and analysis of transactions involving LJM. At some point in time, Enron adopted a Deal Approval checklist for these transactions.

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Duncan, Cash and two other AA partners are full time on the Enron account. They have lots of discussions about lots of issues with Enron. AA has discussions internally on Enron issues, both from the practical standpoint and from a technical side. The structured transaction such as Condor and Raptor issues are discussed thoroughly with these internal groups.

c: Joseph C. Dilg
Houston 651256.1



VEL 00031

**Investments and Outside Business Interests of Officers and Employees**

Employees of the Company have inquired from time to time as to the propriety of their association with, or the investment of their personal funds in, business enterprises similar in character to certain activities of the Company. In response, the Company has established certain principles for the guidance of officers and employees with respect to personal business and investment interests.

The primary consideration of the employment of every full-time (regular as well as temporary) officer and employee should be the fact that the employer is entitled to expect of every such person complete loyalty to the best interests of the Company and the maximum application of skill, talent, education, etc., to the discharge of job responsibilities, without any reservations whatever. Therefore, it follows that no full-time officer or employee should:

(a) Engage in any outside activity or enterprise which could interfere in any way with job performance;

(b) Make investments or perform services for his or her own or related interest in any enterprise under any circumstances where, by reason of the nature of the business conducted by such enterprise, there is, or could be, a disparity or conflict of interest between the officer or employee and the Company; or

(c) Own an interest in or participate, directly or indirectly, in the profits of any other entity which does business with or is a competitor of the Company, unless such ownership or participation has been previously disclosed in writing to the Chairman of the Board and Chief Executive Officer of Enron Corp. and such officer has determined that such interest or participation does not adversely affect the best interests of the Company.

Notwithstanding any provision to the contrary in this Policy on Investments, securities of publicly owned corporations which are regularly traded on the open market may be owned without disclosure if they are not purchased as a result of confidential knowledge about



the Company's operations, relations, business, or negotiations with such corporations.

If an investment of personal funds by an officer or employee in a venture or enterprise will not entail personal services or managerial attention, and if there appears to be no conflict or disparity of interest involved, the following procedure nevertheless shall be followed if all or any part of the business of the venture or enterprise is identical with, or similar or directly related to, that conducted by the Company, or if such business consists of the furnishing of goods or services of a type utilized to a material extent by the Company:

(a) The officer or employee desiring to make such investment shall submit in writing to the Chairman of the Board and Chief Executive Officer of Enron Corp. a brief summary of relevant facts; and

(b) The Chairman of the Board and Chief Executive Officer of Enron Corp. shall consider carefully the summary of relevant facts, and if he concludes that there appears to be no probability of any conflict of interest arising out of the proposed investment, the officer or employee shall be so notified and may then make the proposed investment in full reliance upon the findings of the Chairman of the Board and Chief Executive Officer of Enron Corp.

In the event the Chairman of the Board and Chief Executive Officer of Enron Corp. should desire to make such an investment, he may do so only upon approval of the majority of a quorum of the Executive Committee of the Board of Directors of Enron Corp., other than himself, at any regular or special meeting of such Committee.

Every officer and employee shall be under a continuing duty to report, in the manner set forth above, any situation where by reason of economic or other interest in an enterprise there is then present the possibility of a conflict or disparity of interest between the officer or employee and the Company. This obligation includes but is not limited to (1) any existing personal investment at the date of promulgation of this policy, (2) any existing personal investment at the time of employment of any officer or employee by the Company, and (3) any existing personal investment, whether or not previously approved, which may become in conflict with the provisions of this policy because of changes in the business of the Company or changes in the business of the outside enterprise in which investment has been made.

In the event of a finding by the Chairman of the Board and Chief Executive Officer of Enron Corp. (or by the Executive Committee of the Board of Directors of Enron Corp., if applicable) that a material conflict or disparity of interest does exist with respect to any existing personal investment of an officer or employee, then, upon being so notified, the officer or employee involved shall immediately divest himself or herself of such interest and shall notify the Chairman and Chief Executive Officer of Enron Corp. (or the Executive Committee, if applicable) in writing that he or she has done so.

# LJM APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

**GENERAL**

Deal name:

Date Approval Sheet completed:

Enron person completing this form:



Expected closing date:

Business Unit:

Business Unit Originator:

This transaction relates to ☐LJM1 and/or ☐LJM2.

This transaction is ☐ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:__________________________.

Person(s) negotiating for Enron:

Person(s) negotiating for LJM:

Legal counsel for Enron:

Legal counsel for LJM:

**DEAL DESCRIPTION** [Insert short description of the transaction involving/between Enron and LJM; do not describe the underlying asset or transaction.]

**ECONOMICS** [Insert short description of the Enron economics of the transaction involving/between Enron and LJM; do not describe the economics of the underlying asset or transaction.]

**DASH** [Attach the DASH relating to the underlying asset or transaction. Insert brief update on the DASH if the underlying asset or transaction has changed materially since the original DASH was completed.]

**LJM APPROVAL SHEET**
**Page 2**

CONFIDENTIAL

**ISSUES CHECKLIST**

1. Sale Options
   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:
   ☐Condor ☐JEDI I ☐Margaux ☐EnSerCo ☐Rawhide ☐Chewco ☐JEDI II
   ☐Third Party ☐Direct Sale Please explain: ____________________.
   b. Will this transaction be the most beneficial alternative to Enron? ☐Yes ☐No. If no, please explain:__________.
   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☐No. Please explain: _______.
2. Prior Obligations
   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☐No. If yes, please explain how this issue was resolved: ____________________.
   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☐No. If yes, please explain: ____________________.
3. Terms of Transaction
   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings ☐Other:____________________.
   b. Was this transaction done strictly on an arm's-length basis? ☐Yes ☐No. If no, please explain:______________.
   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☐No. If yes, please explain:____________________.
   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☐No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☐Yes ☐No.
4. Compliance
   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.
   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.
   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: ____________________.
   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. (The first annual review by the Audit Committee has not yet occurred.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | | | |
| Business Unit Legal | | | |
| Enron Corp. Legal | Rex Rogers | | |
| Global Finance Legal | Scott Sefton | | |
| RAC | Rick Buy | | |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

# LJM INVESTMENT SUMMARY

**DEAL NAME: Pluto**
Originated: Enron North America
Expected Closing Date: 12/29/99
Expected Funding Date: 12/29/99

Date Completed: December 29, 1999
Investment Analyst: Chris Loehr
Investment Type: Debt and Equity

**APPROVAL AMOUNT REQUESTED**
Capital Commitment $ 26.3 MM

**DEAL DESCRIPTION**
Purchase $23,174,400 face value of MEGS, L.L.C. ("MEGS") debt from ENA, which based on market prices and required liquidity premiums, has a value of $25,570,569.78 and will yield 9.9%. Purchase 90% of the equity in MEGS from ENA for $743,040 which is expected to yield 25%. MEGS is a special purpose entity that purchased an offshore gathering system from Mariner Energy and Burlington Resources and is entitled to contractual cashflows under a gathering agreement with the same.

**TRANSACTION SUMMARY**
On Dec. 28, 1999, LJM will purchase from Enron North America $23.2 million face value of MEGS debt and 90% of MEGS equity for total consideration of $26,313,609.78.

**CASH FLOW SUMMARY**
LJM is entitled to the 14.15% monthly coupon on the debt. Equity is expected to receive a 25% return paid monthly. Both the debt and equity investments amortize monthly by the amount that contractual cashflows exceed return on capital.

**RETURN SUMMARY**
LJM's investment, if held to maturity, would yield a blended return of 10.28%.

**EXIT STRATEGY**
- LJM has entered into a marketing agreement with ENA, whereby ENA agrees to use its reasonable best efforts to market the equity on LJM's behalf.
- ENA will have a 90 day exclusivity period during which any gain on sale that exceeds LJM's targeted 25% return on investment will be split 90% to ENA and 10% to LJM.
- Exclusivity period ends 90 days from signing of contracts. At that point any gain on sale that exceeds LJM's targeted 25% return on investment will be split 75% to ENA and 25% to LJM.
- It is expected a resale of the equity will take place within two months.
- ENA has agreed to bear syndication risk on the debt. It is expected that the debt will be monetized in a Merlin-like vehicle which will purchase the debt to yield LJM a 25% annualized return in the first half of 2000.

**RISKS AND MITIGANTS**

| Risk | Mitigant |
|---|---|
| Credit risk | Mariner and Burlington are the counterparties to the gathering agreement which stipulates contractual cashflows for each party, regardless of actual volumes shipped (ship or pay contract). Burlington credit risk is mitigated its A- credit rating and the guarantee provided to MEGS by Burlington. Mariner credit risk is mitigated by above market pricing on the Mariner tranche of debt. |
| Reserve risk | The contractual cashflows in the gathering agreement are predicated on natural gas volumes expected over the life of the Burlington/Mariner well. Should the reserves be substantially less than projected, the gathering agreement may become uneconomic for the counterparties. |
| Operating risk | Mariner, as operator, is responsible for all operating expenses and maintenance related to the gathering system. ENA will act as Managing Member and will be responsible for all other operations. |
| | |

VEL 00113

CONFIDENTIAL

# LJM2 APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

**GENERAL**

Deal name: Pluto

Date Approval Sheet completed: December 28, 1999

Enron person completing this form: Chris Loehr

Expected closing date: December 29, 1999

Business Unit: Enron North America

Business Unit Originator: Brian Redmond

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☑ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:_______________.

Person(s) negotiating for Enron: Joe Deffner, Greg Caudell, Kathy Lynn

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Andrews & Kurth

Legal counsel for LJM: Kirkland & Ellis (Mike Edsal)

**DEAL DESCRIPTION**

LJM2 will purchase from Enron North America a 90% equity interest in MEGS, L.L.C. for $743,040. LJM2 will also purchase ENA debt at MEGS, L.L.C. with $23.2 million principal amount and 14.15% coupon for $25,570,569.78. The premium paid on the debt reflects LJM2's market view that 9.9% is an appropriate return for the blended Burlington/Mariner credit risk.

**ECONOMICS**

LJM2 will purchase the equity with the expectation of receiving a 25% IRR on its investment. LJM2 and ENA will enter into a marketing agreement under which ENA agrees to use its reasonable best efforts to sell the equity on LJM2's behalf and under which ENA receives 90% of any gains exceeding LJM2's 25% return. Due to the significant premium, LJM2's debt investment will yield approximately 9.9%. ENA has agreed to bear syndication risk on the debt piece.

**DASH**

Attached. The only material changes in the attached DASH are the now executed contracts that were contemplated when the DASH was done. MEGS, Mariner, and Burlington entered into a gathering agreement stipulating the contractual cashflows. MEGS and Mariner entered into an operating agreement under which Mariner and Burlington cover all operating expenses pro rata. The gathering system has been tested and is currently operational.

**LJM APPROVAL SHEET** **CONFIDENTIAL**
**Page 2**

**ISSUES CHECKLIST**

1. Sale Options

 a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

 ☑Condor ☑JEDI II ☐Third Party ☐Direct Sale. Please explain: A sale to Condor would not allow Enron to book earnings. JEDI II would have required CalPERS' consent since the transaction is not a Qualified Investment. Due to the small size of the equity piece and due to JEDI II's unwillingness to present CalPERS' a transaction with more Mariner credit exposure, JEDI II declined.

 b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:____________.

 c. Were any other bids/offers received in connection with this transaction? ☑Yes ☐No. Please explain: The debt was marketed to several banks, including Bank of America. Bank of America was unwilling to accept further Mariner credit exposure and declined.

2. Prior Obligations

 a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: ____________.

 b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: ____________.

3. Terms of Transaction

 a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☑Earnings

 ☑Other: Funds flow of approximately $24 million.

 b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:____________.

 c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:____________.

 d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

 a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

 b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

 c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: ____________.

 d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

 e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

 f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. (The Audit Committee has not held a meeting since LJM2's formation.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

**VEL 00115**

**LJM APPROVAL SHEET**
**Page 3**



| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | | | |
| Business Unit Legal | | | |
| Enron Corp. Legal | Rex Rogers | | |
| Global Finance Legal | Scott Sefton | | |
| RAC | Rick Buy | | |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

CONFIDENTIAL

# LJM2 APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

## GENERAL

Deal name: Raptor II

Date Approval Sheet completed: June 26, 2000

Enron person completing this form: Trushar Patel

Expected closing date: June 30, 2000

Business Unit: Enron Corp.

Business Unit Originator: Ben Glisan

This transaction relates to ☐LJM1 and/or ☑LJM2.

This transaction is ☐ a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☑other:__creation of hedging structure________.

Person(s) negotiating for Enron: Ben Glisan

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Vinson & Elkins

Legal counsel for LJM: Kirkland & Ellis

## DEAL DESCRIPTION

Timberwolf I LLC ("Timberwolf") is a special purpose entity organized for the purpose of entering into certain derivative transactions. LJM2, through its 100% voting control of Timberwolf, has the unilateral ability to make the investment decisions for Timberwolf and is not contractually obligated to execute any derivative transactions with Enron. LJM2 will execute derivative transactions with Grizzly I LLC ("Grizzly"), a wholly-owned subsidiary of Enron, to the extent those investment decisions are aligned with LJM2's investment objectives. Enron, through Grizzly, will offer LJM2 the opportunity to execute derivative instruments relating to both public and private energy and telecommunication investments made by Enron.

## ECONOMICS

Timberwolf's distributions to equity holders will be limited by earnings at Timberwolf. To the extent there are earnings and sufficient cash to distribute, distributions will be made according to the following waterfall:

- First, $41 million to LJM2
- Second, distributions as necessary until LJM2 receives a 30% IRR over the term of the structure (unless the IRR was achieved through the $41 million distribution above)
- Third, 100% to the special limited partnership interest, Grizzly I LLC, a wholly-owned subsidiary of Enron

## DASH

See attached.

VEL 00146

LJM APPROVAL SHEET
Page 2

CONFIDENTIAL

ISSUES CHECKLIST

1. Sale Options

a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

☐Condor ☐JEDI II ☐Third Party ☐Direct Sale. Please explain: Not a sale of an asset by Enron

b. Will this transaction be the most beneficial alternative to Enron? ☑Yes ☐No. If no, please explain:____________.

c. Were any other bids/offers received in connection with this transaction? ☐Yes ☑No. Please explain: Private structured finance transaction

2. Prior Obligations

a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes ☑No. If yes, please explain how this issue was resolved: ____________.

b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☑No. If yes, please explain: ____________.

3. Terms of Transaction

a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☐Earnings

☑Other: Ability to hedge mark-to-market exposure on investments in publicly and privately held companies

b. Was this transaction done strictly on an arm's-length basis? ☑Yes ☐No. If no, please explain:____________.

c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☑No. If yes, please explain:____________.

d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☑No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☑Yes ☐No.

4. Compliance

a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☑Yes ☐No.

b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☑No.

c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☑Yes ☐No. If no, please explain: ____________.

d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? ☑Yes ☐No.

e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? ☑Yes ☐No.

f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☑No. (The Audit Committee has not held a meeting since LJM2's formation.) Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No. *

* The transaction has been approved by the Exec. Committee of ENE's Board of Directors.

VEL 00147

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**LJM APPROVAL SHEET**
**Page 3**

CONFIDENTIAL

| APPROVALS | Name | Signature | Date |
| --- | --- | --- | --- |
| Business Unit | SMS Ben Glisan | Ben Glisan | 6-28-00 |
| Business Unit Legal | | | |
| Enron Corp. Legal | Rex Rogers | Rex Rogers | 7 14, 00 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 6/28/00 |
| RAC | Rick Buy | | 7/10/00 |
| Accounting | Rick Causey | Richard A. Causey | 6/29/00 |
| Executive | Jeff Skilling | | |

# ENRON DEAL SUMMARY

CONFIDENTIAL

**DEAL NAME: Raptor II**
Originated: Enron Corp.
Expected Closing Date: 6/30/00
Expected Funding Date: 7/6/00

Date Completed: June 26, 2000
Investment Analyst: Trushar Patel
Investment Type: Equity

**INVESTMENT**

| | |
|---|---|
| LJM2 Capital Commitment | $ 30,000,000 |

**DEAL DESCRIPTION**

Timberwolf I LLC ("Timberwolf") is a special purpose entity organized for the purpose of entering into certain derivative transactions. LJM2, through its 100% voting control of Timberwolf, has the unilateral ability to make the investment decisions for Timberwolf and is not contractually obligated to execute any derivative transactions with Enron. LJM2 will execute derivative transactions with Grizzly I LLC ("Grizzly"), a wholly-owned subsidiary of Enron, to the extent those investment decisions are aligned with LJM2's investment objectives. Enron, through Grizzly, will offer LJM2 the opportunity to execute derivative instruments relating to both public and private energy and telecommunication investments made by Enron.

**TRANSACTION SUMMARY**

- On June 27, 2000, LJM2 will purchase 100% of the voting interest in Timberwolf for $30,000,000
- Timberwolf is a bankruptcy remote, special purpose vehicle that will be capitalized with:
  - LJM2's capital investment
  - A series of forward sales on Enron shares ($500 million of gross value but $350 million of net value after a 34.8% liquidity discount has been ascribed given the restrictions imposed on the underlying shares) resulting in ultimate ownership by Timberwolf of Enron common stock
  - The sale of puts on [7 million] Enron shares with a strike of [$57.50], a maturity in [six months] from close and a premium due of [$5.5] per share.
- In exchange for the above capitalization, Timberwolf will provide Grizzly: (i) a $400 million note whose principal is convertible into derivatives, and (ii) a special limited partnership interest in Timberwolf initially valued at $1,000.
- To limit Timberwolf's exposure to the mark-to-market movements of the underlying derivative transactions, Timberwolf and Grizzly agree to limit the notional amount of swaps and premiums paid as follows: (i) up to $1.5 billion notional value of at-the-money swaps, (ii) up to $400 million of net premiums on other derivative transactions, and (iii) up to $1 billion of loss on premium paid derivatives.
- LJM2 will have a fair market value put for its membership interest in Timberwolf that allows LJM2 to put its interest back to Grizzly in the event that LJM2 has not received the greater of $41 million or a 30% IRR by December 27, 2000. Enron has provided support for Grizzly's financial obligation under such an event in the form of a guaranty.
- At the maturity of the structure, Timberwolf will liquidate the excess value, if any, of the Enron shares under the forward sales over the derivative losses, if any, at Timberwolf and any principal outstanding on the Timberwolf note. The excess proceeds, if any, will be distributed to LJM2 and Grizzly in accordance with their capital accounts and the distribution waterfall.

**INVESTMENT RETURN SUMMARY**

*Base Case Return*

It is expected that Timberwolf will have earnings and cash sufficient to distribute $41 million to LJM2 within six months.

*Distributions*

Timberwolf's distributions to equity holders will be limited by earnings at Timberwolf. To the extent there are earnings and sufficient cash to distribute, distributions will be made according to the following waterfall:

- First, $41 million to LJM2
- Second, distributions as necessary until LJM2 receives a 30% IRR over the term of the structure (unless the IRR was achieved through the $41 million distribution above)
- Third, 100% to the special limited partnership interest, Grizzly I LLC, a wholly-owned subsidiary of Enron

*Fair Market Value Put*
In the event that LJM2 has not received the greater of $41 million or a 30% IRR on its investment by December 27, 2000, LJM2 will have a fair market value put whereby LJM2 can put its interest in Timberwolf back to Grizzly. The fair market value of the membership interest is determined largely by Enron's stock price.

*Expenses*
Enron has agreed to cover all of LJM2's accounting and legal expenses related to this transaction. Enron will cover expenses related to formation of the structure as well as ongoing expenses.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Global Finance Originator | SMS Ben Glisan | Ben Glisan | 6-28-00 |
| Global Finance Legal | Scott Sefton | Scott Sefton | 6/28/00 |

# LJM APPROVAL SHEET

This Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or L" "' Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition t, t in lieu of) any other Enron approvals that may be required.

GENERAL

Deal name: Nowa Sarzyna

Date Approval Sheet completed: December 17, 1999

Enron person completing this form: Nicole Alvino

Expected closing date: December 20, 1999

Business Unit: Enron Europe

Business Unit Originator: Anne Edgley

This transaction relates to ☐LJM1 and/or ☒LJM2.

This transaction is ☒a sale by Enron ☐a purchase by Enron ☐a co-sale with Enron ☐a co-purchase with Enron and/or ☐other:______________________.

Person(s) negotiating for Enron: Anne Edgley, Maroun Abboudy, Cheryl Lipshutz, Trushar Patel

Person(s) negotiating for LJM: Michael Kopper

Legal counsel for Enron: Freshfields, London – Julian Makin

Legal counsel for LJM: Kirkland &Ellis, Los Angeles – Eva Davis

DEAL DESCRIPTION [Insert short description of the transaction involving/between Enron and LJM; do not describe the underlying asset or transaction.]

LJ*" will purchase 75% of the Nowa Sarzyna power project from Enron Europe.

ECONOMICS [Insert short description of the Enron economics of the transaction involving/between Enron and LJM; do not describe the economics of the underlying asset or transaction.]

LJM2 will purchase 75% of Enron's economic interests in Enron Poland Investments B.V. for $30 MM. LJM2 is entitled to 75% of the cash flow in the form of dividends and shareholder loans.

DASH [Attach the DASH relating to the underlying asset or transaction. Insert brief update on the DASH if the underlying asset or transaction has changed materially since the original DASH was completed.]

Attached

AF100151

**LJM APPROVAL SHEET**
**Page 2**

**ISSUES CHECKLIST**

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

   ☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Chewco ☒Third Party ☐Direct Sale. Please explain: Third party could not transact quickly enough.

   b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain:__________.

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes☒No. If yes, please explain how this issue was resolved: __________.

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: __________.

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings ☐Other:__________.

   b. Was this transaction done strictly on an arm's-length basis? ☒Yes ☐No. If no, please explain:__________.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain:__________.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: __________.

   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

| **APPROVALS** | **Name** | **Signature** | **Date** |
|---|---|---|---|
| Business Unit | John Sherriff | | |
| Business Unit Legal | Mark Evans | | |
| Enron Corp. Legal | Rex Rogers | [illegible] | 10/20/99 |
| Global Finance Legal | Scott Sefton | S. Sefton | 12/20/99 |
| RAC | Rick Buy | R. B. | 12 20 99 |
| Accounting | Rick Causey | | |
| Ex tive | Jeff Skilling | | |

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AF100152

"FOIA CONFIDENTIAL TREATMENT REQUESTED BY ANDREW FASTOW"

LJM APPROVAL SHEET
Page 2

**ISSUES CHECKLIST**

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected.

   ☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Cbewzo ☒Third Party ☐Direct Sale. Please explain. Third party could not transact quickly enough.

   b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain ______

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain. The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes☒No. If yes, please explain how this issue was resolved: ______

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: ______

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings ☐Other ______

   b. Was this transaction done strictly on an arm's length basis? ☒Yes ☐No. If no, please explain: ______.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain ______.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain. ______

   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | John Sherriff | | |
| Business Unit Legal | Mark Evans | | |
| Enron Corp. Legal | Rex Rogers | [signature] | 12/20/99 |
| Global Finance Legal | Scott Sefton | [signature] | 12/20/99 |
| RAC | Rick Buy | [signature] | 12/20/99 |
| Accounting | Rick Causey | [signature] | 12/20/99 |
| Executive | Jeff Skilling | | |

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LJM APPROVAL SHEET
Page 2

## ISSUES CHECKLIST

1. Sale Options

   a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:

   ☐Condor ☒Margaux ☐Enserco ☐Rawhide ☐JEDI I ☐JEDI II ☐Chewco ☒Third Party ☐Direct Sale. Please explain: Third party could not transact quickly enough.

   b. Will this transaction be the most beneficial alternative to Enron? ☒Yes ☐No. If no, please explain: ____________.

   c. Were any other bids/offers received in connection with this transaction? ☐Yes ☒No. Please explain: The short time frame to transaction execution, and the need for certainty of closure drove the decision not to seek other bids.

2. Prior Obligations

   a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? ☐Yes☒No. If yes, please explain how this issue was resolved. ____________.

   b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? ☐Yes ☒No. If yes, please explain: ____________.

3. Terms of Transaction

   a. What are the benefits (financial and otherwise) to Enron in this transaction? ☐Cash flow ☒Earnings, ☐Other: ____________.

   b. Was this transaction done strictly on an arm's-length basis? ☒Yes ☐No. If no, please explain: ____________.

   c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron? ☐Yes ☒No. If yes, please explain: ____________.

   d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? ☐Yes ☒No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? ☒Yes ☐No. (market standard)

4. Compliance

   a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? ☒Yes ☐No.

   b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee? ☐Yes ☒No.

   c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? ☒Yes ☐No. If no, please explain: ____________.

   d. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? ☐Yes ☒No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? ☐Yes ☐No. ANNUAL REVIEW NOT YET TAKEN PLACE.

| APPROVALS | Name | Signature | Date |
|---|---|---|---|
| Business Unit | John Sherriff | [signature] | 21/12/99 |
| Business Unit Legal | Mark Evans | [signature] | 21/12/99. |
| Enron Corp. Legal | Rex Rogers | [signature] | 12/20/99 |
| Global Finance Legal | Scott Sefton | S. Sefton | 12/20/99 |
| RAC | Rick Buy | R. Buy | 12/20/99 |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

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## roiana investment Summary

DEAL NAME: Poland
Originated: Enron Europe
Expected Closing Date: December 20, 1999
Expected Funding Date: December 21, 1999

Date Completed: December 17, 1999
Investment Analysts: Trushar Patel, Nicole Alvino
Investment Type: Equity

EXPECTED MAXIMUM COMITTMENT OF LJM2

| | Capital Commitment | $ 30 MM | | |
|---|---|---|---|---|
| **Poland Discount Rate Components:** | | | | |
| *(Used by Underwriting Group)* | | | | |
| US Risk Free Rate (2yr) | 5.81% | | **Sovereign Rating** | **BBB-/Baa3** |
| Country Premium (Pol' 04) | 2.00% | | | |
| Equity Premium (Underwriting) | 5.69% | | | |
| **Discount Rate** | 13.5% | | | |

DEAL DESCRIPTION

Purchase of indirect 75% equity interest in the Nowa Sarzyna Facility ("ENS") located in southeastern Poland, a gas-fired heat and power station with a generating capacity of 116 MW and thermal generating capacity of 70 MW. The Facility is located within the chemical complex of Organika (state owned chemical producer).

**Power Sales:**

Electric power will be sold to the Polish Grid Company (state owned owner and operator of Poland's transmission grid and principal purchaser and wholesale supplier of electricity in Poland) under a 20 year Power Delivery Agreement ("PDA"). The price of energy and capacity is expressed in zlotys but indexed to the US dollar every 6 months for the previous six months.

**Fuel Supply:**

The Polish Oil and Gas Company (a state owned integrated monopoly that controls the entire natural gas sector in Poland) will supply natural gas to ENS under a 20 year Fuel Supply Agreement. The fixed and variable price of fuel is passed through the power and steam sales agreements. ENS will not bear the risk of fuel price fluctuation as energy prices in the PDA and fuel costs in the Fuel Supply Agreement are indexed using the same indices.

**Steam Sales:**

ENS has agreed to sell low and high pressure steam to Organika (state owned chemical company) under a 20 year steam sales agreement. This agreement represents approximately 90% of the Facility's total thermal output. ENS is also negotiating to sell the remaining 10% of thermal energy to the City of Nowa Sarzyna for residential heating purposes.

TRANSACTION SUMMARY

Enron Europe Limited, through a 100%-owned affiliate, Nowa Sarzyna Holding BV, owns 100% of the Nowa Sarzyna Facility. LJM2 will purchase 75% of Enron's economic ownership interests and 75% voting interests(relating to dividend and share issuance matters only) through a purchase of 75% of Enron Poland Investments BV.

CASH FLOW SUMMARY

With its 75% ownership of the economic interest in Enron Poland Investments BV, LJM2 is entitled to 75% of the cash flows in the form of dividends and/or shareholder loans.

RETURN SUMMARY

Given the underlying assumptions of the Enron Europe Nowa Sarzyna model, LJM2 will pay $30 MM for 75% of EPI. LJM2 is taking on full equity risk with no Enron guarantees, and has used a discount rate of 14.255% in valuing this investment. LJM2 assumes they can sell the asset to a strategic buyer by 3/31/00 at the model discount rate of 13.5%

EXIT STRATEGY

Enron Europe commits to make reasonable and best efforts to launch Project Margaux, a securitization of Enron Europe assets. If Margaux is launched, Margaux will make an offer to buy the asset to be included in the Margaux asset pool. If Margaux is not launched by 3/31/00, EEL will make reasonable and best efforts to sell LJM2's equity interests to a "qualified" third party buyer.

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LJM Deal Approval Sheet

RISKS AND MITIGANTS

| Risk | Description | Mitigation/Comments |
|---|---|---|
| Plant Completion Risk | Risk that project is not completed on time. | Builder's all risk insurance and delay in start-up insurance at the project level, ENS, of which LJM2 owns 75%. |
| Operator Risk | Risk that Operator will not operate and maintain the plant to meet contractual capacity and availability requirements. | The project company has contracted with an affiliate of Enron Corp., EE&CC to construct, operate and maintain the facility. Proven GE frame 6B turbines will be used. |
| Fuel Supply/Price Risk | Supply reliability and low volatility of fuel prices is critical to the plant performing to contractual requirements. | The state gas & oil company will be fuel supplier under a 20yr agreement. The fixed and variable components of the fuel cost will be passed through to the energy price in the PPA. |
| Offtaker Credit Risk | Risk that the offtaker will not be able to honor their obligations to pay for capacity and power delivered under the PPA. | The offtaker will be the Polish Grid Company (state owned power company), which solicited tenders for this project to satisfy the need to replace older coal fired plants (65% of their generation is over 25 years old). |
| Regulatory Risk | As part of the new energy laws in Poland - the supply, transmission and distribution sectors may be privatized. The Polish Grid Company has the right to assign the PPA to a private entity. | The PPA also stipulates that any assignee assumes all obligations under the PPA, is capable and qualified to perform and its obligations under the PPA are guaranteed by the Polish Grid Company or an entity of comparable creditworthiness to the Polish Grid Company. The Polish Grid Company cannot assign the PPA without prior written consent from ENS. |
| Environmental/Permitting Risks | Risk that the required permits are not obtained to proceed with commercial operations. | All permits have been obtained. |
| Inflation Risk | Risk of value being eroded due to inflation. | Contracts are structured to escalate with inflation indexes. |
| Currency Risk | Payments are to be made in Zlotys. | Zloty payments are indexed to the US dollar and adjustments are made every six months for the previous six-month period. |
| Political Risk | Country specific events that may degrade anticipated revenues and returns from the project. | LJM2 will be provided with an insurance policy underwritten by Enron, with payment guaranteed by Enron which will mirror the sovereign risk policy in place for the project at present. |

AF100156

**APPROVALS**

| Name | Signature | Date |
|---|---|---|
| John Sherriff | J R Sh | 21-12-99 |
| Anne ~~Edgely~~ Edgley | Anne J. Edgley | 21.12.99 |
| Mark Evans | M Evans | 21.12.99 |
| Cheryl Lipshutz | Cheryl Lipshutz | 12-20-99 |

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Privileged and Confidential:
Attorney Work Product
9/21/01

**Outline of Points to Discuss
With Ken Lay and Jim Derrick**

1. Scope of undertaking

   a. Review of factual information raised by anonymous letter

   b. Per early discussion with Jim Derrick, decision made not to engage independent accountant at this stage

   c. Determine whether the facts warrant a further independent legal or accounting investigation

   d. Caveats:

      (1) No second-guessing of accounting treatment by AA

      (2) No detailed transaction analysis

      (3) No discovery-style investigation

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2. Activities undertaken

   a. Review of selected documents

      (1) Board and committee minutes and presentations

      (2) Public filings

      (3) Deal approval sheets and investment summaries

      (4) Miscellaneous materials

   b. Interviews with key Enron and AA personnel

      (1) Andy Fastow

      (2) Rick Causey

      (3) Rick Buy

      (4) Greg Whalley

      (5) Jeff McMahon

      (6) Jordan Mintz

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(7) Mark Koenig/Paula Rieker

(8) Sherron Watkins

(9) David Duncan/Debra Cash (AA)

3. Identification of primary concerns

a. Inherent conflict of interest by Andy Fastow's ownership in LJM

b. Accounting treatment of Condor and Raptor structures

c. Adequacy of disclosures to reflect the true nature of the Condor and Raptor vehicles

d. Overlay of poor investment performance and impact on Enron's financial statements

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4. Conflict of interest – findings

   a. LJM was fully disclosed and approved in advance

   b. Special approval procedures were adopted and utilized on transactions involving LJM

   c. LJM transactions were reviewed by audit committee and finance committee on annual basis

   d. No apparent economic harm to Enron as a result of the following perceived conflicts of interest:

      (1) Pressure on Enron employees who negotiated with LJM, but who ultimately report to Fastow

      (2) Potential tie-in between Enron business and investment in LJM

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5. Accounting issues – findings

   a. All material facts of Condor and Raptor transactions appear to have been disclosed to and reviewed by AA

   b. In several areas, AA relied on business judgment of Enron

      (1) Business purpose of specific transactions

      (2) Valuation of assets placed in Condor and Raptor structures

   c. Enron and AA representatives both acknowledge that the accounting treatment is aggressive, but no reason to believe inappropriate from a technical standpoint

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d. AA's audit opinion and report to audit committee implicitly approves of the transactions involving ...dor and ...or structures

6. Adequacy of disclosures – findings

a. AA is comfortable with the footnotes to the financials describing the Condor and Raptor structures and other LJM transactions

b. One could always argue that disclosures contained in proxy solicitations, management's discussions and analysis of financials and financial footnotes could be more detailed

7. Bad cosmetics

   a. Concern frequently expressed that the transactions with Condor and Raptor would not look good if subjected to a Wall Street Journal exposé or a class action lawsuit

   b. The concerns are fueled by:

      (1) use of Enron stock to support transactions with Condor and Raptor

      (2) recognizing earnings through derivative transactions with Raptor when it could be argued that there was no true "third party" involved

      (3) because both merchant investment value and Enron stock have fallen, the Raptor entities may not be able to repay their debt to Enron, thus raising the question "Who ultimately bears this loss?"

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(4) the inherent conflict of interest issue

(a) valuation

(b) timing

c. Notwithstanding these bad cosmetics, Enron representatives uniformly stated that the Condor and Raptor vehicles were clever, useful vehicles that benefitted Enron

8. Conclusion:

a. The facts disclosed through this review do not warrant further investigation by independent counsel and auditors.

b. Bad cosmetics and poor market conditions give rise to the serious risks of adverse publicity and litigation.

c. AA will want assurances that this review did not disclose facts previously unknown to them (which raises the issue of waiver of the attorney client privileges). AA will want the following assurances, at a minimum,

(1) that Enron had no agreement with LJM that LJM would not lose money;

(2) that Enron paid no fees to LJM in excess of those disclosed to AA.

Houston 660650.1

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Dear Mr. Lay,

Has Enron become a risky place to work? For those of us who didn't get rich over the last few years, can we afford to stay?

Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.

The spotlight will be on us, the market just can't accept that Skilling is leaving his dream job. I think that the valuation issues can be fixed and reported with other goodwill write-downs to occur in 2002. How do we fix the Raptor and Condor deals? They unwind in 2002 and 2003, we will have to pony up Enron stock and that won't go unnoticed.

To the layman on the street, it will look like we recognized funds flow of $800 mm from merchant asset sales in 1999 by selling to a vehicle (Condor) that we capitalized with a promise of Enron stock in later years. Is that really funds flow or is it cash from equity issuance?

We have recognized over $550 million of fair value gains on stocks via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm, The New Power Co by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.

I am incredibly nervous that we will implode in a wave of accounting scandals. My 8 years of Enron work history will be worth nothing on my resume, the business world will consider the past successes as nothing but an elaborate accounting hoax. Skilling is resigning now for 'personal reasons' but I think he wasn't having fun, looked down the road and knew this stuff was unfixable and would rather abandon ship now than resign in shame in 2 years.

Is there a way our accounting guru's can unwind these deals now? I have thought and thought about how to do this, but I keep bumping into one big problem – we booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay back it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse. We are under too much scrutiny and there are probably one or two disgruntled 'redeployed' employees who know enough about the 'funny' accounting to get us in trouble.

What do we do? I know this question cannot be addressed in the all employee meeting, but can you give some assurances that you and Causey will sit down and take a good hard objective look at what is going to happen to Condor and Raptor in 2002 and 2003?

VEL 00040

Summary of alleged issues:

Raptor

Entity was capitalized with LJM equity. That equity is at risk; however, the investment was completely offset by a cash fee paid to LJM. If the Raptor entities go bankrupt LJM is not affected, there is no commitment to contribute more equity.

The majority of the capitalization of the Raptor entities is some form of Enron N/P, restricted stock and stock rights.

Enron entered into several equity derivative transactions with the Raptor entities locking in our values for various equity investments we hold.

As disclosed, in 2000, we recognized $500 million of revenue from the equity derivatives offset by market value changes in the underlying securities.

This year, with the value of our stock declining, the underlying capitalization of the Raptor entities is declining and Credit is pushing for reserves against our MTM positions.

To avoid such a write-down or reserve in Q1 2001, we 'enhanced' the capital structure of the Raptor vehicles, committing more ENE shares.

My understanding of the Q3 problem is that we must 'enhance' the vehicles by $250 million.

I realize that we have had a lot of smart people looking at this and a lot of accountants including AA&Co. have blessed the accounting treatment. None of that will protect Enron if these transactions are ever disclosed in the bright light of day. (Please review the late 90's problems of Waste Management – where AA paid $130+ mm in litigation re: questionable accounting practices).

**The overriding basic principle of accounting is that if you explain the 'accounting treatment' to a man on the street, would you influence his investing decisions? Would he sell or buy the stock based on a thorough understanding of the facts? If so, you best present it correctly and/or change the accounting.**

My concern is that the footnotes don't adequately explain the transactions. If adequately explained, the investor would know that the "Entities" described in our related party footnote are thinly capitalized, the equity holders have no skin in the game, and all the value in the entities comes from the underlying value of the derivatives (unfortunately in this case, a big loss) AND Enron stock and N/P. Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transactions with us at the same prices or without substantial premiums from Enron. In other words, the $500 million in revenue in 2000 would have been much lower. How much lower?

Raptor looks to be a big bet, if the underlying stocks did well, then no one would be the wiser. If Enron stock did well, the stock issuance to these entities would decline and the transactions would be less noticeable. All has gone against us. The stocks, most notably Hanover, The New Power Co., and Avici are underwater to great or lesser degrees.

I firmly believe that executive management of the company must have a clear and precise knowledge of these transactions and they must have the transactions reviewed by objective experts in the fields of securities law and accounting. I believe Ken Lay deserves the right to judge for himself what he believes the probabilities of discovery to be and the estimated damages to the company from those discoveries and decide one of two courses of action:

1. The probability of discovery is low enough and the estimated damage too great; therefore we find a way to quietly and quickly reverse, unwind, write down these positions/transactions.
2. The probability of discovery is too great, the estimated damage to the company too great; therefore, we must quantify, develop damage containment plans and disclose.

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

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Condor and Raptor work:

1. Postpone decision on filling office of the chair, if the current decision includes CFO and/or CAO.

2. Involve Jim Derrick and Rex Rogers to hire a law firm to investigate the Condor and Raptor transactions to give Enron attorney client privilege on the work product. (Can't use V&E due to conflict – they provided some true sale opinions on some of the deals).

3. Law firm to hire one of the big 6, but not Arthur Andersen or PricewaterhouseCoopers due to their conflicts of interest: AA&Co (Enron); PWC (LJM).

4. Investigate the transactions, our accounting treatment and our future commitments to these vehicles in the form of stock, N/P, etc..
For instance: In Q3 we have a $250 mm problem with Raptor 3 (NPW) if we don't 'enhance' the capital structure of Raptor 3 to commit more ENE shares.
By the way: in Q1 we enhanced the Raptor 3 deal, committing more ENE shares to avoid a write down.

5. Develop clean up plan:

   a. Best case: Clean up quietly if possible.

   b. Worst case: Quantify, develop PR and IR campaigns, customer assurance plans (don't want to go the way of Salomon's trading shop), legal actions, severance actions, disclosure.

6. Personnel to quiz confidentially to determine if I'm all wet:
   a. Jeff McMahon
   b. Mark Koenig
   c. Rick Buy
   d. Greg Whalley

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Dear Mr. Lay,

Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.

The spotlight will be on us, the market just can't accept that Skilling is leaving his dream job. I think that the valuation issues can be fixed and reported with other goodwill write-downs to occur in 2002. How do we fix the Raptor and Condor deals? They unwind in 2002 and 2003, we will have to pony up Enron stock and that won't go unnoticed.

To the layman on the street, it will look like we recognized funds flow of $800 mm from merchant asset sales in 1999 by selling to a vehicle (Condor) that we capitalized with a promise of Enron stock in later years. Is that really funds flow or is it cash from equity issuance?

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I am incredibly nervous that we will implode in a wave of accounting scandals. The business world will consider the past successes as nothing but an elaborate accounting hoax. Skilling is resigning now for 'personal reasons' but I think he wasn't having fun, looked down the road and knew this stuff was unfixable and would rather abandon ship now than resign in shame in 2 years.

Is there a way our accounting guru's can unwind these deals now? I have thought and thought about how to do this, but I keep bumping into one big problem – we booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse. We are under too much scrutiny and there are probably one or two disgruntled 'redeployed' employees who know enough about the 'funny' accounting to get us in trouble.

VEL 00044

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Summary of accounting irregularities:

Raptor

The Raptor entities were capitalized with LJM equity. The contributed equity is technically at risk; however, the investment was completely offset by some sort of cash structuring fee paid to LJM. If the Raptor entities go bankrupt LJM is not affected, there is no commitment to contribute more equity.

The majority (i.e., 99%) of the capitalization of the Raptor entities is some form of Enron N/P, restricted stock and contingent stock rights.

Enron entered into several equity derivative transactions with the Raptor entities locking in our values for various equity investments we hold.

As disclosed, in 2000, we recognized $500 million of revenue from the equity derivatives offset by market value changes in the underlying securities.

This year, with the value of our stock declining, the underlying capitalization of the Raptor entities is declining and Credit is pushing for reserves against our MTM positions.

To avoid such a write-down or reserve in Q1 2001, we 'enhanced' the capital structure of the Raptor vehicles, committing more ENE shares.

My understanding of the Q3 problem is that we must 'enhance' the vehicles by $250 million.

I realize that we have had a lot of smart people looking at this and a lot of accountants including AA&Co. have blessed the accounting treatment. None of that will protect Enron if these transactions are ever disclosed in the bright light of day. (Please review the late 90's problems of Waste Management – where AA paid $7mm (sued for$130+ mm) in litigation re: questionable accounting practices).

**One of the overriding basic principles of accounting is that if you explain the 'accounting treatment' to a man on the street, would you influence his investing decisions? Would he sell or buy the stock based on a thorough understanding of the facts? If so, you best present it correctly and/or change the accounting.**

My concern is that the footnotes don't adequately explain the transactions. If adequately explained, the investor would know that the "Entities" described in our related party footnote are thinly capitalized, the equity holders have no skin in the game, and all the value in the entities comes from the underlying value of the derivatives (unfortunately in this case, a big loss) AND Enron stock and N/P. Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transactions with us at the same prices or without substantial premiums from Enron. In other words, the $500 million in revenue in 2000 would have been much lower. How much lower?

Raptor looks to be a big bet, if the underlying stocks did well, then no one would be the wiser. If Enron stock did well, the stock issuance to these entities would decline and the transactions would be less noticeable. All has gone against us. The stocks, most notably Hanover, The New Power Co., and Avici are underwater to great or lesser degrees.

I firmly believe that executive management of the company must have a clear and precise knowledge of these transactions and they must have the transactions reviewed by objective experts in the fields of securities law and accounting. I believe Ken Lay deserves the right to judge for himself what he believes the probabilities of discovery to be and the estimated damages to the company from those discoveries and decide one of two courses of action:

1. The probability of discovery is low enough and the estimated damage too great; therefore we find a way to quietly and quickly reverse, unwind, write down these positions/transactions.
2. The probability of discovery is too great, the estimated damage to the company too great; therefore, we must quantify, develop damage containment plans and disclose.

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

To put the accounting treatment in perspective I offer the following:

1. We've contributed contingent Enron equity to the Raptor entities. Since it's contingent, we have the consideration given and received at zero. We do, as Causey points out, include the shares in our fully diluted computations of shares outstanding if the current economics of the deal imply that Enron will have to issue the shares in the future. This impacts 2002 – 2004 EPS projections only.

2. We lost value in several equity investments in 2000. $500 million of lost value. These were fair value investments, we wrote them down. However, we also booked gains from our price risk management transactions with Raptor, recording a corresponding PRM account receivable from the Raptor entities. That's a $500 million related party transaction – it's 20% of 2000 IBIT, 51% of NI pre tax, 33% of NI after tax.

3. Credit reviews the underlying capitalization of Raptor, reviews the contingent shares and determines whether the Raptor entities will have enough capital to pay Enron its $500 million when the equity derivatives expire.

4. The Raptor entities are technically bankrupt; the value of the contingent Enron shares equals or is just below the PRM account payable that Raptor owes Enron. Raptor's inception to date income statement is a $500 million loss.

5. Where are the equity and debt investors that lost out? LJM is whole on a cash on cash basis. Where did the $500 million in value come from? It came from Enron shares. Why haven't we booked the transaction as $500 million in a promise of shares to the Raptor entity and $500 million of value in our "Economic Interests" in these entities? Then we would have a write down of our value in the Raptor entities. We have not booked the latter, because we do not have to yet. Technically, we can wait and face the music in 2002 – 2004.

6. The related party footnote tries to explain these transactions. Don't you think that several interested companies, be they stock analysts, journalists, hedge fund managers, etc., are busy trying to discover the reason Skilling left? Don't you think their smartest people are pouring over that footnote disclosure right now? I can just hear the discussions – "It looks like they booked a $500 million gain from this related party company and I think, from all the undecipherable ½ page on Enron's contingent contributions to this related party entity, I think the related party entity is capitalized with Enron stock." ..... "No, no, no, you must have it all wrong, it can't be that, that's just too bad, too fraudulent, surely AA&Co wouldn't let them get away with that?" ..... "Go back to the drawing board, it's got to be something else. But find it!" ...... "Hey, just in case you might be right, try and find some insiders or 'redeployed' former employees to validate your theory."

Condor and Raptor work:

1. Postpone decision on filling office of the chair, if the current decision includes CFO and/or CAO.

2. Involve Jim Derrick and Rex Rogers to hire a law firm to investigate the Condor and Raptor transactions to give Enron attorney client privilege on the work product. (Can't use V&E due to conflict – they provided some true sale opinions on some of the deals).

3. Law firm to hire one of the big 6, but not Arthur Andersen or PricewaterhouseCoopers due to their conflicts of interest: AA&Co (Enron); PWC (LJM).

4. Investigate the transactions, our accounting treatment and our future commitments to these vehicles in the form of stock, N/P, etc..
For instance: In Q3 we have a $250 mm problem with Raptor 3 (NPW) if we don't 'enhance' the capital structure of Raptor 3 to commit more ENE shares.
By the way: in Q1 we enhanced the Raptor 3 deal, committing more ENE shares to avoid a write down.

5. Develop clean up plan:

   a. Best case: Clean up quietly if possible.

   b. Worst case: Quantify, develop PR and IR campaigns, customer assurance plans (don't want to go the way of Salomon's trading shop), legal actions, severance actions, disclosure.

6. Personnel to quiz confidentially to determine if I'm all wet:
   a. Jeff McMahon
   b. Mark Koenig
   c. Rick Buy
   d. Greg Whalley

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Summary of Raptor oddities:

1. The accounting treatment looks questionable.

    a. Enron booked a $500 mm gain from equity derivatives from a related party.
    b. That related party is thinly capitalized, with no party at risk except Enron.
    c. It appears Enron has supported an income statement gain by a contribution of its own shares.

    One basic question: The related party entity has lost $500 mm in its equity derivative transactions with Enron. Who bears that loss? I can't find an equity or debt holder that bears that loss. Find out who will lose this money. Who will pay for this loss at the related party entity?

    If it's Enron, from our shares, then I think we do not have a fact pattern that would look good to the SEC or investors.

2. The equity derivative transactions do not appear to be at arms length.

    a. Enron hedged New Power, Hanover, and Avici with the related party at what now appears to be the peak of the market. New Power and Avici have fallen away significantly since. The related party was unable to lay off this risk. This fact pattern is once again very negative for Enron.
    b. I don't think any other unrelated company would have entered into these transactions at these prices. What else is going on here? What was the compensation to the related party to induce it to enter into such transactions?

3. There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly. This alone is cause for concern.

    a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. He complained mightily to Jeff Skilling and laid out 5 steps he thought should be taken if he was to remain as Treasurer. 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets and never addressed the 5 steps with him.
    b. Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.
    c. I have heard one manager level employee from the principle investments group say "I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company." The principle investments group hedged a large number of their investments with Raptor. These people know and see a lot. Many similar comments are made when you ask about these deals. Employees quote our CFO as saying that he has a handshake deal with Skilling that LJM will never lose money.

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4. Can the General Counsel of Enron audit the deal trail and the money trail between Enron and LJM/Raptor and its principals? Can he look at LJM? At Raptor? If the CFO says no, isn't that a problem?

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October 15, 2001

**Privileged and Confidential:**
**Attorney-Client Communication**
**and Attorney Work Product**

Mr. James V. Derrick, Jr.
Executive Vice President and General Counsel
Enron Corp.
1400 Smith Street
Houston, Texas 77002

Re: Preliminary Investigation of Allegations of an Anonymous Employee

Dear Jim:

You requested that Vinson & Elkins L.L.P. ("V&E") conduct an investigation into certain allegations initially made on an anonymous basis by an employee of Enron Corp. ("Enron"). Those allegations question the propriety of Enron's accounting treatment and public disclosures for certain deconsolidated entities known as Condor or Whitewing and certain transactions with a related party, LJM, and particularly transactions with LJM known as Raptor vehicles. The anonymous employee later identified herself as Sherron Watkins, who met with Kenneth L. Lay, Chairman and Chief Executive Officer of Enron, for approximately one hour to express her concerns and provided him with materials to supplement her initial anonymous letter. This letter constitutes our report with respect to our investigation and sets forth the scope of our review, the activities undertaken, the identification of primary concerns, and our analysis and conclusions with respect to those concerns.

1. **Scope of Undertaking**

In general, the scope of V&E's undertaking was to review the allegations raised by Ms. Watkins' anonymous letter and supplemental materials and to conduct an investigation to determine whether the facts she has raised warrant further independent legal or accounting review.

By way of background, some of the supplemental materials provided by Ms. Watkins proposed a series of steps for addressing the problems she perceived, which included retention of independent legal counsel to conduct a wide-spread investigation, and the engagement of independent auditors, apparently for the purpose of analyzing transactions in detail and opining as to the propriety of the accounting treatment employed by Enron and its auditors Arthur Andersen

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L.L.P. ("AA"). In preliminary discussions with you, it was decided that our initial approach would not involve the second guessing of the accounting advice and treatment provided by AA, that there would be no detailed analysis of each and every transaction and that there would be no full scale discovery style inquiry. Instead, the inquiry would be confined to a determination whether the anonymous letter and supplemental materials raised new factual information that would warrant a broader investigation.

2. **Activities Undertaken**

Our preliminary investigation included the review of selected documents provided to us by Enron and from our internal sources, interviews with key Enron and AA personnel and discussions with V&E attorneys who are familiar with legal issues addressed by Enron in connection with the subject transactions. The focus, of course, was to identify background information, disclosures and personal views with respect to the Condor/Whitewing and Raptor vehicles and Enron's relationship with LJM.

Documents reviewed in this process included excerpts of meetings of Enron's Board of Directors, including minutes of meetings of the Audit and Finance Committees of the Board, various public filings of Enron (annual reports, 10-K's, 10-Q's), documents relating to Enron's transactions with LJM, including Deal Approval Sheets and Investment Summaries, and various miscellaneous materials in the nature of presentations and memoranda. The focus of our document review was to determine whether the requisite approval of the transactions referenced in the anonymous letter had been obtained from Enron's Board and its committees, the nature of the disclosures made with respect to the transactions and relationships questioned by the anonymous letter and supplemental materials and to provide general background information.

Interviews were also conducted with various Enron personnel based either on their connection with the transactions involving Condor/Whitewing, LJM and Raptor, or because they were identified in materials provided by Ms. Watkins as persons who might share her concerns. Those persons interviewed were: Andrew S. Fastow, Executive Vice President and Chief Financial Officer; Richard B. Causey, Executive Vice President and Chief Accounting Officer; Richard B. Buy, Executive Vice President and Chief Risk Officer; Greg Whalley, President and Chief Operating Officer (formerly Chairman of Enron Wholesale); Jeffrey McMahon, President and Chief Executive Officer, Enron Industrial Markets (formerly Treasurer of Enron) ; Jordan H. Mintz, Vice President and General Counsel of Enron Global Finance; Mark E. Koenig, Executive Vice President, Investor Relations; Paula H. Rieker, Managing Director, Investor Relations; and Sherron Watkins, the author of the anonymous letter and supplemental materials.

Interviews were also conducted with David B. Duncan and Debra A. Cash, both partners with AA assigned to the Enron audit engagement.

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In addition to the foregoing formal interviews, discussions were likewise held with Rex Rogers, Vice President and Assistant General Counsel of Enron, and Ronald T. Astin of V&E regarding general background information and the identification of specific issues relating to the matters raised by the anonymous letter and supplemental materials.

After completing interviews with all of the foregoing individuals, supplemental interviews were conducted with Andrew S. Fastow and Richard B. Causey of Enron and David B. Duncan and Debra A. Cash of AA to confirm certain information learned in the overall interview process.

As we initially discussed, we limited our interviews (with the exception of the AA partners mentioned above) to individuals still employed with Enron. Therefore, we did not interview individuals no longer with Enron mentioned in the anonymous letter or supplemental materials or any third party related to LJM.

3. **Identification of Primary Concerns**

Our preliminary investigation revealed four primary areas of concern expressed by Ms. Watkins' anonymous letter and supplemental materials. Accordingly, our document review and interview process focused on those areas of concern and whether the facts raised by Ms. Watkins' anonymous letter and supplemental materials presented any new information as to those matters that may warrant further independent investigation. Those areas of primary concern are as follows:

a. the apparent conflict of interests by Mr. Fastow's ownership in LJM;

b. the accounting treatment accorded the Condor and Raptor structures in Enron's financial statements;

c. the adequacy of public disclosures of the Condor and Raptor transactions; and

d. the potential impact on Enron's financial statements as a result of the Condor/Whitewing and Raptor vehicles because of the decline in value of the merchant investments placed in those vehicles as well as the decline in the market price of Enron common stock.

Our findings and conclusions with respect to each of these areas of concern are set forth separately below.

4. **Conflict of Interest**

Mr. Fastow actually organized two separate investment partnerships. The first, LJM-Cayman L.P. ("LJM1"), was launched in June, 1999. The LJM concept appears to have been fully discussed

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with the Office of the Chairman and was presented to and approved by Enron's Board of Directors at a special meeting on June 28, 1999. That approval included the Board's waiver of Enron's code of ethics to permit Mr. Fastow to act as the general partner of LJM1. The primary purpose for the organization of LJM1 was to establish a non-Enron entity with which Enron could enter into a swap transaction to hedge its investment in Rhythms NetCommunications. It was likewise recognized that LJM might negotiate to purchase additional assets in Enron's merchant portfolio. LJM raised $16 million in outside equity, invested in a Raptor vehicle that entered into a swap for Rhythms NetCommunications and also purchased a sufficient portion of Enron's equity in the Cuiaba power plant in Brazil to allow Enron to deconsolidate that project.

The second investment partnership – LJM2 Co-Investment, L.P. ("LJM2") – was organized in October, 1999.[1] At an October 11, 1999 meeting of the Finance Committee of the Board of Directors, Enron's activities with LJM1 were reviewed and the proposal for transacting business with LJM2 was discussed and approved. The Board of Directors, at its meeting on October 12, 1999, waived Enron's code of ethics to permit Mr. Fastow to serve as general partner of LJM2 and established guidelines for Enron's transaction of business with LJM2. Those included: (i) no obligation to do transactions between Enron and LJM2; (ii) the Chief Accounting and Risk Officers would review, and where appropriate, approve transactions with LJM2; (iii) there would be an annual review by the Board's Audit Committee of completed transactions or recommendations, as appropriate; and (iv) there would be an annual review as to the application of the Company's code of ethics to assure that such transactions would not adversely affect the best interests of the Company.

The LJM2 partnership raised $349 million in equity from investors ranging from commercial and investment banks, insurance companies, public and private pension funds and high net worth individuals. LJM2 has engaged in approximately 21 separate transactions with Enron.

Pursuant to the Board's guidelines, special procedures were adopted and utilized for the transaction of business with LJM. Those procedures included the preparation of a special LJM2 Deal Approval Sheet ("DASH") that would be prepared for every Enron/LJM2 transaction generally describing the nature of the commercial transaction and the relevant economics. Approval was also required by a variety of senior level commercial, technical and commercial support professionals. DASH was supplemented by an LJM approval process checklist testing for compliance with Board directives for transactions with LJM2, including questions addressing the following:

- alternative sales options and counter-parties,

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[1] The initial LJM partnership was then referred to as "LJM1." LJM1 and LJM2 will be referred to jointly as "LJM" unless there is a particular reason to distinguish between the two investment partnerships.

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- determination that the transaction was conducted at arm's length,
- disclosure obligations, and
- review of the transaction by Enron's Office of the Chairman, Chief Accounting Officer and Chief Risk Officer.

As part of these procedures, it also appeared that several additional controls were adhered to. These included LJM senior management professionals never negotiating on behalf of Enron; Enron professionals negotiating with LJM reporting to senior Enron professionals other than Mr. Fastow; Enron Global Finance commercial, legal and accounting monitoring of compliance with procedures and controls for regular updates for Chief Accounting and Risk Officers, and internal and outside counsel regularly consulted regarding disclosure obligations and review of any such disclosures.

Based on our review of the LJM Deal Approval Sheets and accompanying checklist, it appears that the approval procedures were generally adhered to. Transactions were uniformly approved by legal, technical and commercial professionals as well as the Chief Accounting and Risk Officers. In most instances, there was no approval signature for the Office of the Chairman except for several significant transactions. It also appeared that the LJM transactions were reviewed by the Audit Committee on an annual basis. At the February 7, 2000 meeting of the Audit Committee, all LJM transactions occurring prior to that date were reviewed. A review of all the LJM transactions during the following year was made at the February 12, 2001 meetings of both the Audit and Finance Committees.

Based on our interviews with various Enron representatives, and notwithstanding the foregoing guidelines and procedures that were adopted, concerns were expressed about the awkwardness in LJM's operating within Enron and two potential conflicts of interest. The awkwardness arose from the fact that LJM's professionals – primarily individuals reporting to Mr. Fastow and Michael Koppers – were also Enron employees who officed in Enron space and worked among Enron employees. Transactions were negotiated between Enron employees acting from Enron and other Enron employees acting for LJM. Within Enron, there appeared to be an air of secrecy regarding the LJM partnerships and suspicion that those Enron employees acting for LJM were receiving special or additional compensation. Although there was a Services Agreement between Enron and LJM pursuant to which LJM compensated Enron for the services of Enron personnel and use of Enron's facilities, this fact did not quell the awkwardness of the Enron employees "wearing two hats." Much of this awkwardness should be eliminated on a going-forward basis, however, by reason of Mr. Fastow's sale of his ownership interest in LJM effective July 31, 2001 to Mr. Koppers (who resigned from Enron prior to the transaction) and the complete separation of LJM's employees and facilities from Enron.

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The first area of potential conflict of interest voiced by several individuals was the risk that undue pressure may be placed on Enron professionals who were negotiating with LJM because those individuals would ultimately have their performance evaluated for compensation purposes by Mr. Fastow in his capacity as Chief Financial Officer. In particular, Jeffrey McMahon stated that while he was Treasurer of Enron he discussed this conflict directly with Mr. Fastow and Jeffrey Skilling, and that the conflict was not resolved prior to his acceptance of a new position within Enron. Mr. McMahon stated, however, that he was aware of no transaction where Enron suffered economic harm as a result of this potential conflict.

The second potential conflict of interest identified by several individuals was that investors in LJM may have perceived that their investment was required to establish or maintain other business relationships with Enron. Although no investors in LJM were interviewed, both Mr. Fastow and Mr. McMahon stated unequivocally that they told potential investors that there was no tie-in between LJM investment and Enron business. Moreover, Mr. Fastow stated that Merrill Lynch was paid a fee for marketing LJM2 partnership interests and that a number of investors, such as private and public pension funds and high net worth individuals, had no business relationship with Enron.

In summary, none of the individuals interviewed could identify any transaction between Enron and LJM that was not reasonable from Enron's standpoint or that was contrary to Enron's best interests. Conversely, the individuals interviewed were virtually uniform in stating that LJM provided a convenient alternative equity partner with flexibility that permitted Enron to close transactions that otherwise could not have been accomplished. Moreover, both the awkwardness and potential for conflict of interest should be eliminated on a going-forward basis as a result of Mr. Fastow's divestment of his ownership interest in the LJM partnerships.

5. **Accounting Issues**

As stated at the outset, the decision was made early in our preliminary investigation not to engage an independent accounting firm to second guess the accounting advice and audit treatment provided by AA. Based on interviews with representatives of AA and Mr. Causey, all material facts of the Condor/Whitewing and Raptor vehicles, as well as other transactions involving LJM, appeared to have been disclosed to and reviewed by AA. In this regard, AA reviewed the LJM solicitation materials and partnership agreement to assure that certain safeguards were provided that would permit LJM to be a source of third party equity in transactions conducted with Enron. AA likewise reviewed specific transactions between Enron and LJM to assure that LJM had sufficient equity in the transaction to justify the accounting and audit principles being applied.

The relationship between Enron and AA was an open one and, according to Mr. Causey, Enron consults AA early and often on accounting and audit issues as they arise. AA concurs with this statement, but points out that in certain of its accounting and audit treatment, it must rely on

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Enron's statement of the business purpose for specific transactions and Enron's valuation of assets placed in the Condor/Whitewing and Raptor structures.

Enron and AA representatives both acknowledge that the accounting treatment on the Condor/Whitewing and Raptor transactions is creative and aggressive, but no one has reason to believe that it is inappropriate from a technical standpoint. In this regard, AA consulted with its senior technical experts in its Chicago office regarding the technical accounting treatment on the Condor/Whitewing and Raptor transactions, and the AA partners on the Enron account consulted with AA's senior practice committee in Houston on other aspects of the transactions. Enron may also take comfort from AA's audit opinion and report to the Audit Committee which implicitly approves the transactions involving Condor/Whitewing and Raptor structures in the context of the approval of Enron's financial statements.

Following our initial interview with AA representatives you agreed with us that it was desirable and appropriate to provide them with Ms. Watkins' anonymous letter and supplemental materials so that AA could comment directly on specific allegations contained in those materials. AA identified two allegations in particular that, if accurate, would affect their accounting and audit treatment. Those allegations were, in effect: (i) There was a handshake deal between Mr. Skilling and Mr. Fastow that LJM would never lose money on any transaction with Enron; and (ii) LJM received a cash fee in the Raptor transactions that completely recouped its investment and profit.

Mr. Fastow adamantly denies any agreement with Mr. Skilling or anyone else that LJM would never lose money in transactions with Enron, and he recognized that such an agreement would defeat the accounting treatment that was the very objective for the formation of LJM. Mr. Causey is unaware of any such agreement and has seen no evidence of it.

Both Mr. Fastow and Mr. Causey acknowledge that LJM was to receive a cash fee for its management of the Raptor vehicles in an amount not to exceed $250,000.00 annually for each company, for a total of $1,000,000.00 for the four entities. AA was aware of Enron's payment of these fees as well as other organizational costs of the Raptor entities, but these fees fall far short of recouping LJM's investment in the Raptor entities. Both Mr. Fastow and Mr. Causey were quick to point out, however, that in each Raptor vehicle the first transaction was a "put" of Enron shares which was settled favorably to LJM prior to maturity, and as a result thereof, distributions were made to LJM in amounts equal to or greater than its initial investment in those Raptor vehicles. AA is aware of these transactions and is comfortable that, by reason of the applicable special purpose entity accounting rules, the transactions do not undermine LJM's equity investment in the Raptor vehicles.

When questioned about her basis for these two allegations in her anonymous letter and supplemental materials, Ms. Watkins acknowledged that she had no personal, first hand knowledge of either allegation. Both were based solely on rumors that she heard during the two months she was working in Enron Global Finance, and she was uncertain about any details of the alleged cash fee

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allegation. Notwithstanding the lack of any solid basis for the allegations, we think it is likely that AA will seek some kind of assurance from Enron and perhaps from Messrs. Fastow and Causey that no such agreement or cash fee payment occurred.

6. **Adequacy of Disclosures**

Notwithstanding the expression of concern in Ms. Watkins' anonymous letter and supporting materials regarding the adequacy of Enron's disclosures as to the Condor/Whitewing and Raptor vehicles (which, to a large extent, reflect her opinion), AA is comfortable with the disclosure in the footnotes to the financials describing the Condor/Whitewing and Raptor structures and other relationships and transactions with LJM. AA points out that the transactions involving Condor/Whitewing are disclosed in aggregate terms in the unconsolidated equity affiliates footnote and that the transactions with LJM, including the Raptor transactions, are disclosed in aggregate terms in the related party transactions footnote to the financials.

The concern with adequacy of disclosures is that one can always argue in hindsight that disclosures contained in proxy solicitations, management's discussion and analysis and financial footnotes could be more detailed. In this regard, it is our understanding that Enron's practice is to provide its financial statements and disclosure materials to V&E with a relatively short time frame within which to respond with comments.

7. **Potential Bad Cosmetics**

Concern was frequently expressed that the transactions involving Condor/Whitewing and Raptor could be portrayed very poorly if subjected to a Wall Street Journal exposé or class action lawsuit. Factors pointed to in support of these concerns included (i) the use of Enron stock to provide equity necessary to do transactions with Condor/Whitewing and Raptor; (ii) recognizing earnings through derivative transactions with Raptor when it could be argued that there was no true "third party" involved in those transactions; (iii) because both merchant investment value and Enron stock have fallen, the Raptor entities may not be able to satisfy their obligations to Enron, thus raising the question "Who ultimately bears this loss?"; (iv) the apparent conflict of interest issue raises questions as to the valuation of assets sold to or that were the subject of transactions with Raptor and the timing of those transactions, (generally at a point when the valuation was at a historical high point).

8. **Conclusions**

Based on the findings and conclusions set forth with respect to each of the four areas of primary concern discussed above, the facts disclosed through our preliminary investigation do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors.

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Our preliminary investigation, however, leaves us with concern that, because of the bad cosmetics involving the LJM entities and Raptor transactions, coupled with the poor performance of the merchant investment assets placed in those vehicles and the decline in the value of Enron stock, there is a serious risk of adverse publicity and litigation. It also appears that because of the inquiries and issues raised by Ms. Watkins, AA will want additional assurances that Enron had no agreement with LJM that LJM would not lose money on transactions with Enron and that Enron paid no fees to LJM in excess of those previously disclosed to AA. Finally, we believe that some response should be provided to Ms. Watkins to assure her that her concerns were thoroughly reviewed, analyzed, and although found not to raise new or undisclosed information, were given serious consideration.

We have previously reported verbally to Mr. Lay and you regarding our investigation and conclusions and, at your request, have reported the same information to Robert K. Jaedicke, in his capacity of Chairman of the Audit Committee of Enron's Board of Directors. At Dr. Jaedicke's request, we gave a verbal summary of our review and conclusions to the full Audit Committee. Should you desire to discuss any aspect of this written report or any other details regarding our review of this matter, please do not hesitate to contact us at your convenience.

Very truly yours,

VINSON & ELKINS L.L.P.

By:______________________________
Max Hendrick, III

c: Joseph C. Dilg
Houston 669423.1

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**DRAFT**

MEMORANDUM

| | |
|---|---|
| TO: | Enron File |
| FROM: | Lowry A. Crook |
| DATE: | January 20, 2002 |
| RE: | Interview of Rex Rogers |

On January 18, 2002, Stuart Delery, Reed Brodsky, and Lowry Crook of Wilmer, Cutler & Pickering ("WCP") spoke with Rex Rogers, Enron Corp.'s Vice President and Associate General Counsel, at Enron's Houston headquarters to gather information from him in order to allow WCP to provide legal advice to the Special Investigative Committee of Enron's Board of Directors. Guy Petrillo and Kelli Landis of Swidler Berlin Shereff & Friedman were present and represented Rogers.

This memorandum has been prepared by counsel in anticipation of possible litigation arising from a Securities and Exchange Commission ("SEC") investigation and any parallel or related proceedings. This memorandum incorporates the mental impressions, analyses, and opinions of counsel. As such, this memorandum is intended solely to assist counsel in providing legal representations and advice to the Special Investigative Committee, and is not intended to provide a substantially verbatim recital of Rogers's statements. The interview is based on WCP's understanding of the facts and review of documents as of the date of the interview. Furthermore, Rogers has not reviewed this memorandum. Therefore, this memorandum may contain inaccuracies and the following discussion of certain events may be incomplete or lack context.

Initially, Delery explained to Rogers that WCP represents the Special Investigative Committee appointed by Enron's Board to investigate certain transactions between Enron and related parties, and that we were speaking to him as part of that investigation. Delery stated that WCP did not represent Enron's officers or employees, including Rogers; that WCP views the conversation as privileged but that privilege belongs to the Special Investigative Committee or Enron; and that the Special Investigative Committee or Enron, rather than Rogers, could decide what to do with the privilege. Delery told Rogers that anything he told WCP would be conveyed to the Special Investigative Committee, and that the information could be communicated to others, such as Enron's Board, others associated with Enron, the SEC, U.S. Attorneys' Offices, and other government investigators.

Delery explained that WCP's questions would focus on disclosures in Enron's SEC filings and proxy statements, on Enron's disclosure process, and on corporate governance issues.

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## I. Background

Rogers received a Bachelor's Degree in Business Administration from the University of Texas in 1971; he received a J.D. from the South Texas College of Law in 1977; and he received an L.L.M. from New York University School of Law in 1978.

Rogers worked at the SEC's Fort Worth Regional Office and Houston Branch Office from 1979 to 1984. He ultimately became Branch Chief of Enforcement; his focus was on insider trading. In 1984, Rogers left the SEC and began working for a Houston law firm that is now called Butler & Binion, where he did corporate finance work.

In 1985 Rogers began working at Houston Natural Gas, which eventually became Enron. Rogers's initial duties involved corporate securities compliance. Rogers is now Vice President and Associate General Counsel at Enron Corp. He reports directly to Jim Derrick and has done so since Derrick began working for Enron in 1991.

Enron's legal staff is very decentralized. Although Enron and its affiliates at one time employed more than 250 lawyers, Enron Corp., the parent company, only employs about ten lawyers. Rogers supervises lawyers working in the following areas for Enron and all of its subsidiaries: environmental, labor and employment, and employee benefits. Rogers also has responsibility for Enron Corp.'s Public Utility Holding Company Act and information technology (mostly trademark) issues. Finally, Rogers is involved in securities compliance for Enron Corp. and its affiliates. 50-75% of Rogers's time is spent managing and supervising other attorneys. Rogers's securities work for Enron has involved mostly "plain vanilla" debt and equities issued by Enron Corp. Rogers was not involved in structuring, negotiating, or drafting the related party transactions. Those functions were performed by other groups.

Rogers is responsible for advising Board members and officers on Enron's Code of Ethics. Generally he answers questions relating either to securities trades or conflicts issues.

## II. Rogers on Fastow

Fastow was difficult to work with, but Rogers had a satisfactory relationship with him. Fastow did not call Rogers about issues; instead Fastow would have called his attorneys in Enron Global Finance ("EGF"). Scott Sefton was the EGF General Counsel when the related party transactions began. Although Sefton was diligent with regard to Enron issues, Rogers thinks Fastow may have thought of Sefton as EGF's or Fastow's attorney, rather than Enron's attorney. Most people say that Fastow fired Sefton.

## III. Presentation of LJM Concept to the Board

Rogers was present at the meeting when the LJM relationship was presented to the Board. He attended the meeting because he thought it was important that the Board understand the conflict and governance issues involved. Rogers does not recall attending any other Board meetings involving discussions of LJM or other related party transactions. Fastow and Jeff Skilling primarily presented the concept to the Board. Rogers believes that Ken Lay also attended. During the presentation, Fastow and Skilling discussed the fact that Enron had a big appetite for capital. LJM would be another source of capital and could be used for hedging. They then discussed conflicts of interest and the difficulty of ensuring that transactions were at arm's length and in Enron's best interests. The lawyers were not concerned that the transactions would necessarily be substantively improper. Instead the concern was that the arrangement presented a very real conflict of interest, that they needed to make sure the Board understood the conflict, and that the Board would make sure the transactions were at arm's length and approved. The presenters stated that that the arrangement was legal, but that the Board should take note of the potential public-relations and investor-relations impact. The Board was told that the relationships would have to be disclosed specifically in the proxy statements – not because anyone was concerned about disclosure issues at the time, but rather because they wanted to emphasize appearance issues. Rogers thought that the Board would have a stronger reaction to those issues. At the end of the meeting, the Board understood the conflict and their role in the control process. Rogers does not remember the Board approving any specific transactions. Nor does Rogers recall anyone discussing moving debt off of Enron's balance sheet. Rogers never had the impression that the attractiveness of the proposition had anything to do with hiding debt or moving it off Enron's balance sheet. The rating agencies always focused on the company's total picture, which included off-balance sheet debt.

Rogers does not believe he said anything at the Board meeting, because nothing anyone else said at the meeting was incorrect – Fastow and Skilling just presented the facts. Rogers's initial reaction was that the arrangement was crazy, and he wondered why Enron would embark on this course, but he knew that the arrangement could be done properly to make sure Enron's interests were protected. After the meeting, Rogers attempted to educate management on the corporate policies and need for controls. For example, he corrected several people who referred to "potential conflicts"; Rogers noted that the arrangement was in fact a conflict, not just a potential one, and that management and the board needed to focus on controls to make sure that the conflicts did not lead to any transactions that would be adverse to Enron's interests. Rogers also corrected people who referred to "waiving" Enron's ethics policy. Rogers pointed out to management that Enron would not be "waiving" its policy; Enron would actually be applying it. By granting approval, the Enron Board would be finding that the LJM relationship or transaction in question was not adverse to Enron's interests. Rogers was the only one who got excited about these semantics; the discussion in the Board minutes reflected Rogers's semantic distinctions. Rogers never raised the issue of Fastow's potential liability to LJM's investors because it was only Enron's interest that Rogers was worried about.

## IV. June 1999 Meeting with Lay, Skilling, and Fastow on LJM and RhythmsNet

Rogers does not remember attending such a meeting. The Board meeting, which occurred perhaps in Spring 1999, was the only meeting he remembers attending with Lay, Skilling, and Fastow during that time period at which LJM was discussed. He does not remember RhythmsNet being discussed there.

**V. Lawyers' Roles in Structured Financial Transactions**

Structured financial transactions have always been handled by a separately headed legal department. Most of those transactions originated at Enron Capital & Trade Resources ("ECT"), which was Andy Fastow's and Jeff Skilling's old group. The lawyers who worked on those transactions were also in ECT. Kristina Mordaunt worked on the transactions until she moved to Enron Broadband Services. Sefton also worked on these transactions when he headed the legal department at EGF. He was replaced by Jordan Mintz. In-house counsel at EGF, supported by outside counsel, worked on and drafted the documents and disclosures for the related party deals.

**VI. Enron Policies and Procedures**

**1. General Conflict Issues and Procedures**

Sharon Butcher, Enron's Corp.'s Assistant General Counsel, worked with outside counsel on Enron's compliance and ethics policies. They tried to maintain a current set of policies for Enron. When questions arose, employees would take them to their group's general counsel, who in turn would go to Rogers.

Under Enron's ethics code, any activity that would result in an actual or potential conflict (e.g. board, officer, or employee remuneration from any company doing business or potentially competing with Enron) required a written request for permission from the Chairman. Enron's Code of Conduct does not require Board approval for every related party transaction. Rogers answered questions regarding the ethics code, but the employee still had to submit a written request to the Chairman, who had to find that the transaction was not adverse to Enron's interests. There was no form; most requests were made by letter. Rogers did not advise Lay with regard to these determinations, and he did not know if any other lawyers advised Lay if or when these issues arose.

**2. Enron's Initial Procedures Regarding LJM Transactions**

The LJM1 arrangement was the first time that the type of related party governance issues we are dealing with arose at Enron. The attorneys working on the related party transactions handled the attendant governance/conflict issues. Rogers does not know whether Mordaunt was involved in specific transactions, but she was aware early on of Fastow's dual roles for Enron and LJM. Sefton made an initial effort to put together forms and circulate them for approvals. These forms were refined and eventually became the LJM Approval Sheets. When the transactions began, Rogers did not know much about the related party transactions until the quarterly report was issued.

**3. LJM2's Private Placement Memo**

The first related party document that Rogers remembers commenting on was a private placement memo for LJM2. Rogers believes that Kirkland & Ellis prepared the memo on behalf of LJM2. That memo just "appeared out of the blue." Whoever created the memo was not trying to hide it, but they did not know to distribute it to a wider group. Someone at ECT, probably a lawyer, asked Rogers if he wanted to take a look at it, and he answered yes. Rogers asked Bob Baird at Vinson & Elkins ("V&E") to review and comment on the memo; Rogers believes that Sefton was on vacation when the memo appeared. Baird gave the memo a significant review and numerous issues became apparent.

Rogers's attention was directed to an e-mail dated October 4, 1999, from Baird to Sefton, Rogers, and Ron Astin of V&E, containing comments by Baird on the private placement memo, along with some handwritten reactions to the comments in the margin. Rogers stated that the handwriting was not his; he believed that the writing was Sefton's. Baird had discussed the private placement memo at great length with Sefton. Rogers discussed the memo separately with Baird and briefly with Sefton.

The initial draft memo appeared to have had no input from Enron attorneys. Rogers thought the memo made the LJM2 private placement appear to be an Enron offering, it gave the incorrect impression that Enron was obliged to bring deals with LJM2, and it included some unintentional misrepresentations. Together they edited and cleaned up the memo so that it would not appear to be an Enron offering or to imply an Enron obligation to bring deals with LJM2. Rogers is not sure whether he saw the final draft, but the next couple of drafts cleared up these problems. This memo's problems gave rise to heightened concerns about the LJM conflicts and deal approval process.

**4. Development of LJM Approval Sheets**

Shortly after the experience with the flawed LJM2 private placement memo, Sefton circulated forms for LJM Approval Sheets. Their purpose was to establish layers of review for the LJM related party transactions. The LJM Approval Sheets were to be reviewed by:

- Rick Buy, the Chief Risk Officer ("CRO"). Buy was to review the related party deals just as he would review any Enron transaction. He was to perform a normal risk analysis, which is primarily a quantitative analysis that Rogers did not exactly understand. But Buy was to have a heightened sensitivity to potential conflict problems.
- Rick Causey, the Chief Accounting Officer ("CAO"). Causey was to review the related party deals before they closed and assess how the deals would affect Enron's financial statements.
- Skilling. Rogers understood that the LJM Approval Sheets would require Skilling's approval. Skilling was to personally approve the structures and Fastow's role. At the time these transactions began, Skilling was the COO and no one anticipated the volume of LJM-related transactions that would occur. As this volume increased and Skilling was promoted to CEO, Skilling probably had to rely heavily on Buy and Causey.
- Rogers. Rogers informed others that he would not be reviewing the transaction, and that he was only signing with regard to the sheets' statement that the

transaction was required to be disclosed in the proxy statement because of the amount involved (see below).

When the LJM Approval Sheet form was first circulated. Rogers was surprised to see that his approval was required. Rogers called Sefton and asked why Rogers was included on the LJM Approval Sheet when he had not been a part of and had not reviewed the LJM transactions. Sefton said that Fastow wanted Rogers's name on the LJM Approval Sheet so that Rogers could review whether the transaction required proxy disclosure. Rogers replied that the threshold for disclosure was $60,000, and that he knew already that every single transaction would therefore require disclosure. In addition, Rogers said that he could not perform a proper review and approve the transactions without hiring at least four more lawyers. Rogers therefore asked to be removed from the approval list. Sefton said he would remove Rogers's name from the list, but Sefton never did so.

After Rogers complained to Sefton, Rogers began signing the LJM Approval Sheets without reviewing the underlying transaction. He told others (but not Buy or Causey) that he was not reviewing the transactions and that he was only signing as to the statement that the transaction would require proxy disclosure. Accordingly, Rogers did not spend any time on the LJM Approval Sheets: he just reviewed whether the deals exceeded $60,000. Rogers saw the LJM Approval Sheets as informational – a way to keep tabs on the transactions. Rogers is not proud of the fact that he signed the LJM Approval Sheets without reviewing the transactions, and he wishes that he had not done so. He does not know why he did not cross his name out or leave them unsigned.

Rogers expressed reservations about signing to Mintz. Rogers did not express reservations to Buy because he did not have much interaction with Buy. Rogers never told Buy or Causey that his signature meant only that the transaction would require proxy disclosure. Rogers did decide that he would sign only after Causey and Buy; one role his review played was to make sure that both Causey and Buy had approved the transactions. On several occasions, Rogers sent the LJM Approval Sheet back for Buy's and Causey's signature before he would agree to sign it.

Rogers believed that it was most important to have the CRO and CAO review and sign off on the transactions. Buy was known to commercial people at Enron as an internal cop. He could kill deals, and he did a good job of scrutinizing them. Rogers never witnessed Buy under any pressure to approve an LJM transaction because the transaction involved Fastow. If Buy's group approved a deal. Rogers believed it was fair to Enron. Rogers also believed that Causey had high integrity. Rogers understood that the CAO examined the transactions, anticipated how they would be booked. and decided on appropriate financial disclosure. Therefore, if both Buy and Causey approved deals. Rogers felt confident that they were at arm's length and in Enron's best interest. And before the transactions reached Causey or were even signed. Enron and Andersen would have considered the accounting issues, because Enron had what was called "real-time accounting," and the Andersen auditors practically lived at Enron. Indeed, Rogers believed that some of the accounting issues were vetted all the way up to Andersen's highest levels. Finally, EGF's lawyers and V&E were heavily involved in the transactions.

Rogers would be disappointed, however, if anyone claimed that they had relied on the fact that Rogers signed the LJM Approval Sheet. Rogers did not discuss the LJM Approval Sheets with Derrick. Most discussions regarding the LJM Approval Sheets would have occurred at later meetings that Mintz called to discuss transactions or the process.

**5. The Board's Role in the Process**

From the beginning, the Board was not required to approve every transaction. Unless Board approval was required for some other reason, a related party transaction was not submitted to the Board until the Audit Committee reviewed all the LJM transactions after-the-fact. Enron's policies required that the Chairman approve related party transactions, but Rogers does not know who obtained approval from the Chairman, or whether anyone obtained the Chairman's approval.

**6. Changes in the Approval Process Under Mintz**

Although Sefton was diligent, his successor, Mintz, was a bit more diligent, concerned, and communicative than Sefton. As a result, Rogers became more involved with LJM issues when Mintz took over Sefton's position. Mintz would usually send his LJM-related questions to Astin, but copy Rogers.

Mintz was the first to raise the need for new procedures regarding these transactions. Mintz sought to review and improve the approval procedures. Rogers was in favor of a new policy concerning LJM because the deals involved an executive officer and CFO, and the conflict was therefore fairly significant. Rogers, Mintz, Derrick, and Astin met to discuss these issues. The purpose of the meetings was not to discuss accounting issues or the propriety of the transactions; rather, the purpose was to discuss new policies and procedures to ensure that the transactions were at arm's-length and would not be disadvantageous to Enron's interests. Much of the meetings involved discussions of peoples' roles in the process.

Rogers's attention was directed to a February 28, 2001 e-mail from Mintz to Derrick, Rogers, Astin, and Rob Walls, along with an attached agenda for a March 7, 2001 meeting called a "Legal Review of Enron's Transacting with LJM." Rogers stated that he remembered only one meeting in Derrick's office: it was called by Mintz. Rogers does not remember Walls attending the meeting. Mintz just wanted to make sure that Derrick and Rogers understood the procedures in place regarding LJM. The purpose of the meeting was not to question specific LJM transactions or discuss their financial treatment. Rather, the purpose was to discuss policies and procedures for documenting deals and ensuring that LJM transactions were truly at arm's-length. Mintz asked whether Enron was attempting to negotiate the deals with other parties. Mintz believed that Enron should be doing so. The meeting's participants reiterated the importance of the reviews by Buy and Causey and of reporting back to the Board so that the Board could understand the volume and terms of the LJM transactions.

Around that time, Rogers told Bob Butts in Enron's accounting office that the SEC would be reviewing Enron soon because Enron had not been reviewed since 1997. Butts agreed. Rogers knew that the SEC would closely scrutinize the LJM transactions when they found out that the CFO was involved with LJM, and he conveyed this view to Butts. Rogers asked if everyone was prepared for that scrutiny, and Butts responded that they knew the scrutiny was coming.

Rogers did not implement the procedures for approval of particular LJM transactions. He may have been part of other discussions or meetings concerning a few LJM transactions, but those meetings involved reviewing transactions already in place, rather than transactions that were in the process of being structured.

At some point they became aware that employees on Enron's payroll were negotiating on LJM's behalf. They decided that the issue needed to be addressed. Eventually those employees were dedicated to LJM, though they continued to work at Enron until the Summer of 2001. At that point, Kopper replaced Fastow as the managing member of LJM1 and LJM2's general partners, and the people working for LJM moved across the street from the Enron building.

**7. Other Issues**

Although much has been made about Fastow and LJM, there were many structured financings not involving LJM. Enron also made poor investments because its finance plan was poor.

Rogers had no knowledge of the tax indemnification relating to the Chewco buyout.

**VII. The Proxy Statement Preparation Process**

The preparation of the proxy involved a smaller group of people than the preparation of the 10-Q and 10-K. Rogers thought that, although the process sounds disorganized, it actually functioned fairly efficiently. Lawyers in Rogers's group drafted the bulk of the proxy statement. However, because the proxy was based on disclosures from the deal lawyers, Rogers's lawyers functioned largely as information gatherers. Kriste Sullivan, a labor and employment lawyer who works for Rogers, and Carol Essig, a paralegal, circulated schedules and collected comments on the draft proxies. Drafting the proxy was a team effort involving three lawyers on Rogers's staff, input from the Benefits office, and heavy input from outside counsel.

Astin worked on the proxy because Derrick and Rogers had much confidence in him and trusted him to be straight. Astin understood that he was also protecting Derrick.

**VIII. Related Party Transaction Disclosures in the Proxy Statements**

**1. The Officer and Director Questionnaires**

The Corporate Secretary's office circulated Officer and Director questionnaires ("O&D questionnaires"), which were designed in part to elicit information about related party transactions. Rogers was not involved in preparing the O&D questionnaires. Elizabeth Labanowsky, Vice President in Enron Property & Services legal department, prepared them. In the past, Enron had a more extensive questionnaire, but it just tracked the SEC's language and was very difficult to read and understand. Over the years, V&E worked with Enron to streamline the questionnaire and make it easier to use.

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Sullivan and Essig were responsible for collecting the O&D questionnaires. However, they were more focused on compensation issues than related party transactions. The officers and directors tend to need help providing the information sought in the forms; the initial O&D questionnaire responses were often not sufficient.

Fastow had so many transactions requiring so much information that Rogers's group did not wait for Fastow's O&D questionnaire. Lawyers in Fastow's group and outside counsel at V&E who worked on these deals provided the information to begin the disclosure drafting process.

Rogers's attention was directed to an Addendum dated February 23, 2000, which was attached to Fastow's fiscal year 1999 O&D questionnaire. Rogers was not involved in preparing the language for this addendum, but he did read it after it was signed. However, Rogers does not recall seeing the addendum before the fiscal year 1999 proxy was released. He had much less involvement with this questionnaire because it was prepared during Sefton's tenure, and Sefton did not communicate with Rogers as much as Mintz did. Rogers does not agree with the form of the addendum today, although this does not mean that the disclosure was inappropriate. The addendum recommends in several places that the reader discuss the transactions with Sefton. The addendum was consistent with Fastow's style: he viewed the questionnaires as a pain, so instead of taking responsibility and answering for himself he took the unorthodox approach of referring the reader to his lawyer.

Rogers's attention was then directed to an Addendum dated March 12, 2001, which was attached to Fastow's fiscal year 2000 O&D questionnaire, along with an e-mail exchange among Astin, Rogers, and Mintz, dated March 9-12, 2001, which discusses the addendum. Rogers reviewed the addendum before it was signed, but he thought the approach to the addendum (having the questionnaire refer to the proxy) was totally backwards. In addition, Rogers thought that Fastow should answer the question and send it to the lawyers, rather than having the lawyers fill it out for him. Moreover, the answer did not disclose Fastow's compensation. Mintz was the person who was given the responsibility of going back to Fastow with the addendum, because Mintz was the one who had a relationship with Fastow.

Other directors did not approach the O&D questionnaires this way. If a director did not fill out the questionnaire properly, then someone from Enron would go back to them to get a complete answer. However, other related party transactions or holdings were generally much smaller – somewhere closer to $70,000. Pug Winokur, for example, was a principal in an oilfield services company to which Enron paid $300,000. Winokur did not know the amount, but he knew his role, so he got the figures from Enron.

Rogers does not remember discussing whether someone should tell Fastow that his response to the questionnaire was inadequate. Nor does Rogers recall discussing the inadequacy of Fastow's addenda with Derrick; Rogers doubts that Derrick ever looked at any O&D questionnaire other than his own. The only comments on Fastow's addendum that Rogers recalls were in the e-mail exchange

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**2. Drafting and Revision of the Disclosures**

The Global Finance lawyers working on the individual transactions prepared the initial draft related party transaction disclosures. Sefton, and later Mintz, took a first shot at drafting these disclosures. They probably had help from Astin at V&E.

The proxy statements went through many drafts, and the related party transaction portion was the most difficult to write. The draft related party disclosures were circulated widely. In addition to Rogers, the Financial Reporting/Accounting group would receive copies, including Butts, Gary Peng, and Jan Johnson – all of whom worked on the 10-Qs and 10-Ks. That group reports ultimately to Causey. V&E received early drafts and may have helped prepare some initial drafts. Copies would also have been shared with Fastow and probably with the commercial people who worked on the Enron transactions. Derrick received later drafts.

Sullivan and Essig, who collected the comments, coordinated with Global Finance on the related party disclosures. The only portion of the proxy that Rogers's group did not keep the master copy of were the related party disclosures. Comments regarding LJM transactions went first to Mintz or Sefton, because Sullivan would not have known much at all about the LJM arrangements. In addition, Enron's culture is such that Fastow would never communicate directly with Sullivan. Mintz did a good job of collecting EGF's comments on the related party disclosures.

Rogers's attention was directed to a memo re Proxy Schedule and Responsibilities dated January 18, 2000, from Sullivan and Clement Abrams to distribution. It stated that Peng had responsibility for "Numbers for related transactions with officers and directors, and "Peng/Sefton" had responsibility for "Related Transactions with Directors and Executive Officers." Rogers's attention was also directed to a similar memo dated January 18, 2001, which also stated that Peng had responsibility for related transactions numbers, but that "Peng/Mintz" had responsibility for "Related Transactions with Directors and Executive Officers." Rogers explained that it made sense that Peng would be responsible for putting together and verifying the related party numbers. That was part of Peng's job on the 10-Qs and 10-Ks, and the information in the proxy and the financial statement footnotes should not be inconsistent. Sefton was responsible in particular for information regarding the LJM related party transactions. Rogers does not recall approving the division of responsibility, but he felt sure that he reviewed these responsibility memos and did not see anything wrong with them.

**3. Rogers's Role**

Rogers's attention was directed to an e-mail dated February 13, 2001 from Mintz to Sullivan and Abrams. It attached a draft LJM disclosure and stated that the draft "has not yet been reviewed by Messrs. Astin and Rogers; their advice is critical before finalizing." Rogers stated that he did not remember any detailed conversations regarding LJM related party disclosures on the proxies. Rogers assumes that there were many conversations between or among Fastow, Mintz, and Astin. Rogers spoke with Mintz and Astin regarding disclosures, but he never did his own due diligence on the underlying transactions. Rogers does not remember whether he had comments on the draft LJM disclosures for either the FY 1999 or FY 2000 proxy. If Rogers did have comments or questions, they would have been communicated in a mark-up. Rogers generally thought the disclosures were difficult to understand. Surprisingly, the longer drafts that were circulated early in the process were even more difficult to understand.

Rogers affirmed that he understood Regulation S-K's standards that applied to the proxy disclosures. However, Rogers spent more time on other parts of the proxy – for example the compensation disclosures. Rogers relied very heavily on Astin and V&E for meeting the S-K standards with regard to the LJM disclosures because Astin, unlike Rogers or Rogers's staff, had actually worked on the transactions at issue. Rogers also relied on Butts and Andersen. Nevertheless, those disclosures were certainly a part of Rogers's responsibility if at the end of the day they were wrong.

Rogers was satisfied that Enron had an adequate process in place for identifying related party transactions requiring disclosure. Rogers explained to EGF (including Sefton and afterwards Mintz) that every transaction between Enron and LJM would be disclosed in the proxy statement. EGF kept a record of those deals and provided an overview and initial draft disclosure for each transaction. V&E was to review the disclosures for transactions they worked on, with an eye to making sure the facts were correct. Rogers does not recall if any other firms reviewed LJM disclosures for transactions that they happened to work on. The accounting staff at Enron also reviewed the disclosures. Then Rogers reviewed them. Rogers did not use the LJM Approval Sheets in reviewing the disclosures; he did not keep copies or forward them. However, Rogers understood that Peng, Butts, and Andersen received copies of the LJM Approval Sheets.

Rogers viewed himself as the gatekeeper who reviewed the proxy statements before filing. He made the final comments on the drafts. Derrick was looking to Rogers to protect the Company with regard to the securities issues arising out of disclosure of the LJM transaction, but everyone was relying heavily on outside lawyers, accountants, and EGF. If there turned out to be a material omission in any of Enron's disclosures, Rogers thinks Derrick would be disappointed with him for missing it.

**4. Others' Roles in Related Party Disclosures**

***a. Fastow***

Fastow was the primary person required to sign off on the portions of the proxy statement, including the related party transactions, that involved him. Sefton told Rogers that Fastow wanted to see drafts of the related party discussion in the proxy statements. Rogers assumes Fastow reviewed the drafts during Mintz's tenure as well.

***b. Other Enron Officers***

Enron officers had an opportunity to look at the proxy statement, but they probably just relied on the judgment of the accountants and lawyers.

***c. Board Members***

Board members received the final drafts of Enron's annual reports, 10-Ks, and proxy statements. The Board was attentive to the proxy statement: Rogers believes that they read it quite thoroughly. However, Rogers never got any feedback from the board regarding LJM disclosures. He is not sure how much the Board focused on the related party disclosures, but they were certainly educated with regard to the issues raised. Rogers found the Board to be conscientious, competent, and most members cordial.

*d. Vinson & Elkins*

V&E's Astin has worked on structured finance deals in recent years. Mark Metts, who now works at Enron, was his predecessor. Mark Spradling has also worked on these deals, but to a lesser extent. Enron has generally relied on Baird for securities law advice over the years, but Enron looks to Astin for advice on structured finance deals.

V&E reviewed draft proxy statements and disclosures early in the process. They had worked on the underlying transactions and Enron had relied on them for years to review Enron's filings. Rogers would not be surprised if V&E assisted in preparing some initial drafts.

*e. Andersen*

Andersen was on the distribution list and saw draft proxy statements early in the process. Although Andersen does not audit compensation figures, Enron asked Andersen to provide comfort regarding those figures. Rogers believes that Andersen spent a lot of time reviewing the related party disclosure portion of the proxy statement to make sure it was not inconsistent with the related party portions of the SEC filings. However, Andersen may not have paid the same degree of attention to the proxies as to the SEC filings.

Andersen would have given any comments to the financial reporting group. If that group did not understand the comments, they would have forwarded them to Sefton and eventually to Rogers.

*f. Review by other securities lawyers?*

When asked if there were other Enron attorneys with securities law expertise who reviewed the proxies' related party disclosures, Rogers named Sefton, who had worked on securities law issues at Fulbright & Jaworski in Houston before coming to Enron. Rogers also named Lance Schuler, Vice President and Assistant General Counsel of Enron North America, as having knowledge of securities laws, though Rogers does not know whether Schuler worked on any of the proxy statements. And Carol St. Clair, who worked at Baker & Botts before coming to Enron, had some securities experience but was not a securities lawyer. Finally, Rogers speculated that other lawyers in EGF may have had securities backgrounds, though they would not necessarily have reviewed draft proxy statements with an eye toward securities law issues.

**5. Fastow's Compensation**

Rogers recalls discussions in a meeting sometime in early 2001 of whether anyone knew the amount of compensation Fastow was receiving from the LJM transactions, and whether they could find that information out. Rogers was concerned about this issue. He thought it made sense that they could not calculate Fastow's LJM-related compensation for 1999 because the transactions had not been completed yet. Astin and Mintz were convinced that the decision not to disclose Fastow's compensation for 2000 was technically correct, but Rogers asked them why they did not know the amount. Rogers was not sure whether they did not know the amount because Fastow did not say, or because Mintz could not figure it out.

The figure that was eventually revealed was staggering; it far exceeded what they thought Fastow could be making. Rogers believes that if they had known how much Fastow was making from the arrangement, they would have tried harder to get a figure and disclose it. The size of Fastow's earnings affected the degree of the conflict. Rogers was asked whether the large dollar amounts involved in the related entities led anyone to speculate that compensation set at a reasonable percentage of the transactions would turn out to be a very large figure. Rogers answered that they had focused on the procedures rather than the figures that ultimately emerged from the transactions. Rogers also pointed out that, even as late as the Enron Board meetings in Fall 2001, the audit committee did not know what Fastow's compensation was. Rogers admitted that in hindsight he should have pressed the issue more. Rogers believed that Fastow probably had a fiduciary obligation to say what his compensation was.

Rogers, Mintz, and Astin also discussed at their meeting in early 2001 that they did not want Enron and Fastow to continue to do these deals. As lawyers, they were concerned that the CFO serving in these dual roles could open Enom up for criticism. They discussed advising Enron and Fastow not to continue to do these deals. Rogers believes that this meeting occurred after the 2000 proxy was released in early 2001. After the meeting, Rogers viewed it as Mintz's job to follow up with Fastow regarding his compensation. Rogers did not recall anyone discussing raising the issue with the Chairman's office. Rogers remembers that Astin discussed disclosure of Fastow's compensation but that V&E ultimately signed off on the decision not to disclose.

After the meeting, Mintz prepared his March 28, 2001 memo to Fastow. It warned Fastow that there was no possible legal argument for not including Fastow's LJM-related compensation in the fiscal year 2001 proxy statement. It also provided the justification for not including Fastow's compensation in the fiscal year 2000 proxy that had just been released. Rogers's attention was directed to a copy of the March 28, 2001 memo from Mintz to Fastow. The second page of the March 28, 2001 memo stated that "[t]he decision not to disclose in this instance was a close call; arguably, the more conservative approach would have been to disclose." Rogers did not recall Astin saying the decision was a "close call," but everyone had the sense that while the decision was not misleading and while it comported with Regulation S-K, Item 404, it was not the conservative call. No one said the disclosure was adequate; and no one said it was inadequate. In hindsight, it would have been better to have disclosed Fastow's compensation.

Rogers attention was directed to a copy of an April 16, 2001 memo from Mintz to Cliff Baxter, Mark Metts, and Causey. The April 16, 2001 memo, with the subject "Proposed Sale of Enron Wind to LJM – Disclosure Issues," summarized the SEC's safe-harbor which would allow Enron to avoid proxy disclosure of the transaction, but "noted that it is unlikely that compliance with such safe-harbor would also provide us with a basis for not disclosing such transaction for financial statement purposes (i.e. 10Q/10K)." Rogers did not recall being involved with this memo, and he noted that it was sent after the 2000 proxy statement was released.

Ultimately, Fastow sold his interest in LJM. Rogers speculated that growing negative reactions from the investment community may have prompted Fastow's decision. Rogers speculated that Fastow's decision could also have been prompted by the warning in Mintz's memo that Fastow's compensation would be disclosed in the following year's proxy statement.

## IX. Fiscal Year 1999 Proxy Statement (May 2, 2000)

### 1. Fastow Compensation

Rogers's attention was directed to the "Certain Transactions" section of the fiscal year 1999 proxy statement, dated May 2, 2000 ("FY 1999 Proxy"), particularly to the disclosure of Fastow's interest in LJM1 and LJM2 on pages 26 and 27. The disclosure states that the general partner of LJM1 and LJM2 is entitled to receive a percentage of the profits in excess of the general partner's total proportion of the total capital contributed to LJM1 and LJM2. Rogers stated that this disclosure was drafted by Sefton, with a lot of assistance from V&E. Rogers did not recall specific discussions concerning this disclosure.

### 2. RhythmsNet Unwind

Rogers did not recall discussing or being aware of the RhythmsNet unwind until after the proxy was issued. Nor did Rogers recall anyone discussing amending the FY 1999 proxy to reflect the transaction.

### 3. Aggregation of Transactions

Rogers's attention was directed to the FY 1999 Proxy's reference on page 26 to "six transactions." Rogers did not recall why the transactions were aggregated rather than described separately, but he felt certain that the aggregation must have been the result of a conscious decision among Sefton, Astin, and the accounting group. Rogers was not part of the decision.

Rogers was not aware of any Enron policy against disclosures identifying counterparties to agreements with Enron. Rogers did not think it made a difference to the accountants whether counterparty names were disclosed. Rogers instead recalls people discussing the complexity of the transactions and the fact that the disclosure was difficult to understand. EGF and V&E drafted the disclosure, and it was reviewed and commented upon by Fastow, the accountants, and Rogers. The disclosure went through many, many drafts, but the more people wrote, the more difficult it became to understand. Rightly or wrongly, the committee of people working on the disclosure opted for a shorter version; the longer versions were just as confusing.

### 4. MEGS and Nowa Sarzyna Repurchase

Rogers was not aware of Enron's March 2000 repurchase of LJM2's interests in MEGS and Nowa Sarzyna at the time they issued the proxy statement.

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### 5. "Second Half of 1999"

Rogers's attention was directed to a sentence on page 26 of the FY 1999 Proxy that describes LJM1 and LJM2 transactions as occurring "[i]n the second half of 1999," even though most of the transactions occurred toward the end of December 1999. Rogers explained that he did not have a solid grasp of the transactions, and he did not know that most of the transactions occurred in December 1999.

### 6. LJM Management Fees

Rogers was not aware of or involved in any discussions about disclosing LJM's management fees.

### 7. $38.5 Million Loan from Whitewing Sub

Rogers's attention was directed to the portion of the FY 1999 Proxy (pages 26-27) describing the "eighth transaction," which was a $38.5 million loan from a Whitewing subsidiary to LJM2. Rogers did not know why the transaction was disclosed in the proxy statement but not in Enron's financial statements. He had not discussed the issue with anyone.

## X. Fiscal Year 2000 Proxy Statement (May 1, 2001)

### 1. Repurchases

Rogers was not aware of any Enron repurchases from LJM1 or LJM2 at the time the proxy was released. Rogers explained that the proxy was time-sensitive and many other things were happening at the same time, so he had to rely on the group that focused on these transactions.

### 2. RhythmsNet

At the time the proxy was issued, Rogers was not aware that in 2000 LJM Swapsub was given a put that was in-the-money. Rogers does not remember any discussions concerning disclosures of the unwind.

Rogers's attention was directed to a memo re "Related-Party Proxy Disclosures" dated April 6, 2001, from Mintz to Fastow. The memo stated that the Fiscal Year 2000 Proxy Statement ("FY 2000 Proxy") did not disclose Fastow's compensation because the 1999 RhythmsNet transaction settled "under conditions permitted in the original agreement," and there was thus no new transaction between Enron and LJM1 in need of disclosure. Rogers explained that V&E made this determination. Rogers was asked how the put on Enron stock that LJM1 received in 2000 squared with this analysis. Rogers stated that he was not aware of the omissions until everyone began working on the 8-K this Fall. Given what Rogers now knows about the put, he believes that disclosing Fastow's compensation should at least have been discussed.

**3. Omission of The New Power Co. ("TNPC")**

Rogers does not recall any conversations regarding amending the FY2000 Proxy to reflect TNPC. Rob Eikenroht, one of the lawyers in Rogers's group, worked on the TNPC transaction, so Rogers knew about that transaction.

Rogers's attention was directed to two documents that appear to be transcripts of voicemails, which were attributed to Rogers and dated March 23, 2001. Both refer to an LJM investment in New Power Holdings that was missed, one states that the proxy would not be amended unless the omission was a "fatal flaw," and both state that the speaker would be prepared to argue that the proxy should not be amended because the investment was not material. Rogers did not recall these voicemails coming from him. He felt certain they did not come from him because he would not have used the phrase "gone gosling" in the first voicemail, and he would not have known the figures that were discussed in the second voice mail. He said that he did not know what these voicemails were talking about.

## XI. The 10-Q and 10-K Preparation Process

Rogers's role with the 10-Qs and 10-Ks was similar to his role with the proxy statements. No 10-Q or 10-K was filed without Rogers having a chance to review it and provide comments. For Derrick's benefit Rogers would have to be comfortable with the disclosures before they were released. However, the initial related party disclosures were drafted by the lawyers who worked on the individual deals. And the 10-Q and 10-K process differed from the proxy preparation process in the sense that Peng and Butts collected the information and circulated the drafts. In addition, a large team of lawyers, accountants, and finance people reviewed these disclosures. Rogers placed great reliance on these other experts. Rogers saw his role as making sure all the right people had reviewed the financial statements before they were filed; he derived comfort from the process and the people involved, rather than from his own investigation of the matter.

Rogers never personally obtained or reviewed backups for the financial statements, but he is aware that those working in the financial reporting group received them. Rogers remembered on at least one occasion hand-delivering comments to Johnson and/or Peng and discussing a specific transaction, but Rogers never did so in depth. Rogers's primary concern was ensuring checks and balances so that the drafting of the disclosures was not limited only to people at EGF.

The process for capturing transactions in the 10-Ks was no different from the process for the 10-Qs. They underwent the same level of review from Andersen, V&E, and internal counsel. Rogers always found the Andersen people very cordial but tough.

Rogers and his group were more directly involved with the legal sections of these financial statements – especially the initial paragraphs in the 10-Ks and the litigation contingency footnotes. Rogers drafted these sections and gave them to Peng before Peng circulated his initial draft. Generally Peng would send Rogers the previous quarter's footnote and ask Rogers to update it. Andersen picked over these sections very thoroughly, even though they involved legal rather than financial statements.

## XII. Issues Related to Particular 10-Qs and 10-Ks

### 1. 2d Quarter 1999 10-Q (August 13, 1999)

#### *a. "Senior officer"*

Rogers's attention was directed to the reference to "[a] senior officer of Enron" in footnote 8 on page 15 of the 10-Q for the 2d Quarter 1999. Rogers's comments to the draft suggested that Fastow's name be added to the disclosure, but Rogers did not press the matter. Rogers did not recall why the disclosure did not name Fastow. He remembered asking about the issue; the accountants responded that the reference to a "senior officer" pointed out the conflict, and that the rule did not require more disclosure. In any event, Rogers did not think the issue was very important after the FY 1999 Proxy disclosed Fastow's name.

#### *b. Clarity and descriptiveness of disclosures*

Making these related party footnotes at all clear was a difficult challenge from the outset. Rogers remembers discussing with Astin whether the underlying transactions were accurately disclosed and explained. Astin used to joke that the footnote could be made more clear but that doing so would take fifty pages. Rogers said that they should attempt to provide a clear explanation, even if that took ten pages. Rogers believes that he raised the clarity issue with the Enron accountants as well, but the end result was that nobody was able to make the disclosures understandable. Rogers does not recall conversing with Andersen directly on this issue. The disclosure never reached ten pages, but at the end of the day the lawyers and accountants became comfortable with the amount of explanation.

#### *c. Management representation*

Rogers's attention was directed to the following statement on footnote 8, page 15 of the 10-Q for the 2d Quarter 1999: "Management believes that the terms of the transactions were reasonable and no less favorable than the terms of similar arrangements with unrelated third parties." Rogers did not remember who drafted the statement.

However, Rogers did remember discussing that it was materially important to include an affirmative management representation in the related party footnote. Rogers believed that if the transaction was not at arm's length or not in Enron's best interest, then that fact had to be disclosed. If the transaction was at arm's length and in Enron's best interest, then it made sense to affirmatively say so: omitting such a representation just begs the question. Rogers believed that Andersen agreed with that approach.

Rogers did not know whether the accounting literature required a certain level of factual basis for making this management representation. Rogers did not recall having any direct conversations with Andersen about this issue. If Enron's approval and control policies for LJM transactions were followed, the representation ought to be true. While Rogers did not review the deals himself, Rogers understood that the lawyers and auditors were to review the DASHs and the deal terms. Rogers was not sure how the auditors and lawyers determined that Enron could not have done better on deals with an unrelated third party. EGF's mantra was that these deals probably could not have been done at all with an unrelated third party, much less done better. But Rogers was not sure whether any third parties were actually approached. In meetings among lawyers, they discussed how to document that the transactions were reasonable and no less favorable than with third parties. At some point both Mintz and Rogers asked about the backup for the representations. In response, the commercial people represented that the deals met the standard.

Rogers's attention was directed to a single page prepared by WCP that shows the changes that each financial statement made to the previous statement's management representation. Rogers could not remember why the changes were made. He believed he was asked to comment on the changes, but he did not recall instructing anyone to make changes, and he did not remember any specific comments. Rogers would not have recommended substantive changes that softened the representations, because he was not sufficiently familiar with the underlying deals to know whether such changes would be required. Rogers did not know whether someone was making a conscious attempt to change the substance of the representations. Rogers's attention was directed to the 1999 10-K's dropping of the term "reasonable." Rogers did not recall any conversations to the effect that Enron could not represent that transactions were reasonable. Rogers speculated that he would have asked Sefton or Mintz about the changes.

**2. 1999 10-K (March 28, 2000)**

***a. RhythmsNet options***

Rogers's attention was directed to the first paragraph of footnote 16 on page 34 of the 1999 10-K, which states in part that Enron received "certain financial instruments hedging an investment . . . ." Rogers did not know why these words were used in the 10-K, while the 10-Q for the 3rd Quarter 1999 had referred to the transaction as a "put."

***b. Aggregation of $360 million LJM2 acquisition of Enron "merchant assets and investments"***

Rogers did not know why the transactions were aggregated or how they were different. Rogers raised the issue of disclosing the purpose of these transactions, but he did not know at the time how much debt the transactions were moving off the balance sheet.

***c. LJM1 Cuiaba transaction***

The related party footnote describes this transaction as the acquisition of "other assets from Enron for $11 million." Rogers may have made inquiries regarding this transaction, but he did not remember any lengthy discussions. Rogers did not remember anyone considering or discussing disclosing that these "other assets" were Cuiaba.

***d. Chewco***

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Rogers's attention was directed to the statement that "an officer of Enron has invested in the limited partner of JEDI and from time to time acts as agent . . . ." Rogers could not remember who the term "officer" described; he speculated that it referred to Michael Kopper. This disclosure did not raise any red flags at the time.

*e. Undisclosed LJM service agreement*

Rogers was asked why the service agreement between Enron and LJM was not disclosed. He did not think that he was aware of the agreement at the time the 10-K was filed.

**3. 1st Quarter 2000 10-Q (May 12, 2000)**

*a. RhythmsNet transaction*

Rogers's attention was directed to the disclosure of the put option relating to the RhythmsNet transaction in footnote seven to the financial statements of the 10-Q for the 1st Quarter 2000. Until he began working on the 8-K in the Fall 2001, Rogers did not understand that Enron gave LJM the put option at no charge despite the fact that the put was already in-the-money by several dollars per share.

*b. $10 million loan to LJM2*

Rogers's attention was directed to the last sentence in paragraph 1 of footnote 7, stating "Enron advanced LJM $10 million, at a market rate of interest." Rogers did not know whether anything was done to verify that the loan was at market rate. Enron's accountants and Andersen had the responsibility of reviewing and verifying this statement.

*c. Undisclosed transactions*

Rogers believed that Enron disclosed any LJM1 or LJM2 transactions that he knew about at the time. Rogers was not aware of a rule that transactions between LJM1 or LJM2 and unconsolidated affiliates did not have to be disclosed in 10-Qs or 10-Ks. If there were transactions that were not disclosed, Rogers did not know why that would have occurred.

**4. 2d Quarter 2000 10-Q (August 14, 2000)**

*a. Raptor disclosures*

Rogers was not involved in drafting the disclosures regarding Raptor. Rogers's involvement with Raptor was limited to attending a single meeting on Section 16 issues regarding Raptor buying or selling in general.

Sefton was at Enron during Raptor's genesis; he worked closely with Astin on Raptor issues. Rogers did little more than review draft disclosures as they were exchanged. Rogers did not understand the Raptors. There were discussions at which people asked how the public could understand the Raptor disclosures if Enron's own people could not understand them. It was a big challenge to try to make the Raptor disclosures clear. Despite many drafts, Enron as a company did not succeed in making the disclosures understandable.

After the initial draft Raptor disclosures prompted questions, there was a brief, general discussion within Enron of disclosing Raptor in the Management Discussion & Analysis ("MD&A") because Raptor was so difficult to describe clearly in the footnotes. Rogers speculated that someone may have spoken with Astin about whether Raptor was required to have been disclosed in the MD&A.

*b. "Limited partners . . . unrelated to Enron"*

Rogers's attention was directed to the second sentence in the first paragraph of footnote 7, stating that "[t]he limited partners of the Related Party are unrelated to Enron." Rogers did not know who drafted or inserted this language. Nor did Rogers know what the language was referring to. He noted that other investors in LJM were not related to Enron, though he thought this was an obtuse way of saying that. Rogers stated that those at EGF who worked on these disclosures had to rely on information from Fastow; they did not have access to LJM's limited partner agreements. Rogers did not know whether anyone at EGF requested to review those agreements.

**5. 2000 10-K (March 31, 2001)**

Rogers's attention was directed to the third paragraph of footnote 16 regarding related party transactions in the 10-K for 2000, which describes a $500 million revenue recognition from Raptor-related derivatives. Rogers did not remember any discussions about the magnitude of the transaction and revenue recognition. Rogers speculated that there would have been discussions between Astin and Mintz, but he could not recall any specifically.

**6. 1st Quarter 2001 10-Q (May 14, 2001)**

*a. Review by "senior risk officers" and the Board*

Rogers's attention was directed to footnote 8 regarding related party transactions in the 10-Q for the first quarter 2001, and the statement in the first paragraph that "[a]ll transactions with the Related Party are approved by Enron's senior risk officers as well as reviewed annually by the Board of Directors." Rogers did not know what prompted this new representation. Rogers believed that Enron could have made that representation in earlier 10-Qs or 10-Ks, because their procedures had been in place since the beginning of these related party transactions. Rogers was not sure why it referred to "officers" in plural. The term refers to Rick Buy; Rogers speculated that it could be referring to Buy's staff as well. These transactions also had to receive approval from Causey, but Rogers did not know why Causey would be called a "risk officer" rather than "accounting officer."

Rogers also understood that the Board or the Board's audit committee was reviewing the transactions, though he would have to check the Board minutes to confirm that.

*b. Raptor restructuring*

Rogers did not recall these transactions. At the time of the disclosures, Rogers did not have a good understanding of the transactions being disclosed. He tried to get up to speed, but he had to rely heavily on outside counsel and those familiar with the transactions. At that time Rogers did not know that Enron would have to recognize a $360 million loss if they did not restructure.

### XIII. Analyst Calls

Investor Relations vetted the analyst calls, with assistance from the accounting group and Fastow's group as necessary. The legal group assisted to a lesser extent. The people in Investor Relations are sophisticated: most have a CPA or financial analyst background. The substance of the calls is up to them. After Regulation FD was adopted, Rogers's group tried to educate Investor Relations as to its requirements. Rogers believes that Enron probably acted consistently with Regulation FD even before it was adopted. He held a slide presentation on fair disclosure each January. Rogers did not vet Investor Relations' disclosures with respect to the related parties.

In normal times, Rogers would receive from Investor Relations a list of items to be discussed on the analyst calls. He did not always see the Q&A script.

With regard to the 3rd Quarter 2001 conference call, Rogers had an opportunity to review the Q&A script and Rogers believed that it is likely he did so. Rogers heard that Lay said all LJM transactions were reviewed by the Board. Rogers did not know whether anything was done to substantiate that statement. Lay's assertion was not completely consistent with the Enron policy, which provides that the transactions would have been reviewed at the end of the year. Rogers believes that on this subject Lay may have departed from the script; he does not believe that statement was in the written Q&A.

### XIV. Insider Trading

Derrick and Rogers are responsible for overseeing Enron's insider trading policy. Enron's securities trading policy is part of its Code of Ethics: it tracks 10b-5. The policy consists of two standards. First, no one at Enron can trade if he or she has material, non-public information. Second, executives have lock-out periods during which they cannot trade shares.

1. **Executives**

The executive lock-out policy extended beyond just officers covered by Section 16; it also applied to Enron's Management Committee. Although many of these people were not "setting policy" as defined by Section 16, they were senior people who had access to important information.

Although the executives' lock-out period was not rigid, as a practical matter it began a minimum of 2-3 weeks before Enron's earnings release. Enron did not have set safe harbor trading windows for executives, because there was always too much happening at the company.

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Prior to the third quarter 2001, there were few problems with the lock-out periods because earnings were generally positive. Therefore, executives might not be restricted from selling during the normal lockout period if Derrick and Rogers knew that the earnings release would be positive. Mark Koenig, the Executive Vice President for Investor Relations, generally had a very good sense of how the investment community would react to an earnings release. At the end of the third quarter 2001, however, they did not know what the earnings release was going to look like: the write-off issue was decided late in the process. Because of this uncertainty, executive trading was not blocked until "pretty close" to the earnings release. Rogers could not remember with any more precision the date on which trading was blocked.

The method of applying the insider trading policy to executives was simple: they could not trade unless they obtained trade-specific approval from Derrick or Rogers. Each general counsel was supposed to inform Derrick of any material events that occurred. Then, if an executive wanted to trade, he or she would call Derrick and ask for permission; if he or she could not reach Derrick, then Rogers would get the call. Rogers and Derrick sometimes talked about insider trading restrictions and block-outs on a daily basis. If Rogers was uncertain about approving a trade when he received the call, he would advise the executive not to trade until he or she talked to Derrick. If Derrick or Rogers cleared a trade, then that clearance was normally good until the end of the day. If something came up before the end of the day, the onus was on Derrick or Rogers to call the executive back and revoke the clearance. Because the clearance was by phone call, there was no written record kept of refusals or approvals. Rogers did not keep a log; he may have noted something in his notepad at the time of the call, but he would not have retained that.

Derrick communicated Enron's policy regularly at management committee meetings. Rogers believes that the executives were diligent; he knows of no violations of the pre-clearance policy. He believes that the executives under the most scrutiny right now were generally the most diligent.

**2. Non-Executive Employees**

For non-executives, Enron relies on self-policing. Rogers sometimes received calls from members of this self-policing group asking for permission to trade.

There was no company-wide blackout in the third quarter 2001. Rogers remembers speaking with Butts and Koenig about the upcoming earnings report during that time, but the write-off was decided fairly late in the process. As a result, they did not change the policy or send out a firm-wide memo regarding trading prior to the earnings release.