

COLLAPSE OF THE ENRON CORPORATION

HEARING

BEFORE THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

FEBRUARY 26, 2002

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COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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COLLAPSE OF THE ENRON CORPORATION

TUESDAY, FEBRUARY 26, 2002

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m. in room SD-253, Russell Senate Office Building, Hon. Byron L. Dorgan, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. I call the hearing to order. We would ask for order in the hearing room.

This morning the Committee continues its examination of what has happened with respect to the Enron Corporation. We have had two previous hearings. Previously, we heard from a number of Enron employees, retirees, and investors, many of whom lost their life savings when this corporation collapsed.

Today, we hope to begin the process of hearing from some of those who worked inside the Enron Corporation. We will hear from Ms. Sherron Watkins. She is the employee who wrote the memo to Mr. Lay last August saying that Enron was in danger of imploding "in a wave of accounting scandals." She continues to be employed by the Enron Corporation.

We also will hear from Mr. McMahon. Mr. McMahon is the former Treasurer of the Enron Corporation and now serves as President and Chief Operating Officer. Finally, we will hear from Mr. Skilling who is a former CEO of Enron.

Some 10 weeks ago, as we began the inquiry, Ms. Janice Farmer sat at our witness table. She was an Enron employee and told us how the bankruptcy of Enron had demolished her life savings. This is a case of America's largest corporate bankruptcy. It is not unusual that, in our system, or in our society, enterprises would file for bankruptcy. It is unusual that we have had a corporation file for bankruptcy and a subsequent investigation, called the Powers Report, launched by the Board of Directors of that corporation, saying what they found inside the corporation was "appalling."

It is also the case that the people at the top in this corporation, officers and members of the Board of Directors, made a substantial amount of money, tens of millions of dollars in some cases, while people at the bottom, employees and investors, lost their life savings in many instances.

The question here is what happened? How did it happen? Who was responsible for it happening? And what can we do to prevent this sort of thing from happening again?

I have said previously—and let me mention again how important this is—the method by which we accumulate capital in this country is to have an investor in Bismarck, North Dakota, or anywhere in the country for that matter, buy a share of stock based on the belief that the financial statement represented by that corporation and approved by its accountants is a fair and honest representation of what is happening inside that corporation.

If that trust is broken—and I believe that it was in this situation—when that trust is broken, it undermines the method by which we accumulate capital for our system of capitalism. I think we must find out what happened. Where were the accountants? Where was the law firm? Where were the security analysts? Where were the officers and directors of the company? And how do we prevent this sort of thing from happening again?

It is my hope, following recognition of the Ranking Member of the Full Committee and Subcommittee, that we could limit opening statements to a minute or so for those who have opening statements and then go right to the witnesses. We do have a vote that will occur at 10 o'clock. It is my intention that we would break for 15 minutes during that vote and then come back and proceed.

Let me call on Senator McCain for his opening statement.

**STATEMENT OF HON. JOHN MCCAIN,
U.S. SENATOR FROM ARIZONA**

Senator MCCAIN. Thank you, Senator Dorgan, for chairing this hearing, and I thank the witnesses for appearing before us today.

Enron has drawn an enormous level of public and Congressional interest because the story of this one company challenges fundamental assumptions about our economic system. One such assumption is that the public receives accurate assessments of a company's financial health and that they rely on this information to make rational investment decisions. Enron's collapse raises serious doubts about whether existing financial disclosure rules and accounting standards enable the public to get an accurate or even a rough idea about companies' true financial condition.

Another assumption is that there are adequate gatekeepers in place to filter financial information and ensure its integrity. Enron has proven this assumption wrong. Gatekeepers within the company failed, external gatekeepers in the form of auditors and financial analysts failed, and Congress failed.

Enron's bankruptcy dramatically illustrates that the corporate interests and public interests cannot be assumed to be the same. Enron has given all of us a costly lesson in showing that we cannot rely on a system that lacks adequate regulation and that depends solely on conscience and good judgment.

I hope our witnesses are able to explain to this Committee what went so terribly wrong with Enron and what you would have done or would have us do differently to ensure this story is not repeated.

Thank you.

Senator DORGAN. Senator McCain, thank you very much.

Before I call on the Ranking Member of the Consumer Affairs Subcommittee, let me say that there are more than eight Members present and Sherron Watkins has requested the Committee issue a friendly subpoena compelling her testimony before the Committee today. I would move that the Chairman be authorized to issue a subpoena on behalf of the Committee. All those in favor say aye.

[A chorus of ayes].

Senator DORGAN. Opposed, no.

[No response].

Senator DORGAN. The motion is agreed to.

Let me call on Senator Fitzgerald.

**STATEMENT OF HON. PETER G. FITZGERALD,
U.S. SENATOR FROM ILLINOIS**

Senator FITZGERALD. Thank you, Mr. Chairman.

Ms. Watkins, Mr. McMahan, thank you for being here today.

Mr. Skilling, I want to thank you very much for appearing and agreeing to testify. Some of your Enron colleagues who were also asked to testify have made a different choice. Watching them, I have to believe that you are aware that your voluntary appearance before this Committee entails a measure of risk and that you therefore must be somewhat anxious. Consequently, whatever role you may have played in the collapse of Enron, I think there is at least something to be said for your willingness to talk about what happened to your company.

I do, however, approach your testimony with some skepticism. Appearing before the House, you disclaimed responsibility. That disclaimer encouraged the perception that Mr. Andrew Fastow played perhaps the pivotal role in the collapse of the company. But if the theory is that Fastow went rogue somewhere deep in the jungles of Enron and was the assault agent of the apocalypse, I just do not buy it.

As Senators, we are intensely interested not just in individual responsibility, but also in what appears to have been a systemic collapse of controls, a spectacular corporate implosion—and the collapse of controls occurred both within the company at all levels of risk management and external to the company, as Senators McCain and Dorgan have already indicated.

We also saw the collapse of controls outside the corporation, whether by the rating agencies, the auditing firms, the law firms, the analysts, and even at the end of the day, the SEC.

Our purpose then is to figure out how JEDIs, LJMs, Raptors, and a Chewco turned the whole world on its head. We have a chess game here, Mr. Skilling, and the challenge is to find a way to check every single one of the moves you made on that Enron Board.

As part of that effort, this Committee thought it important to ask both you and Mr. Lay, as central figures in this drama, to tell us what you know.

Now, Mr. Skilling, we are witnessing a tale of two CEOs. As you may know, your predecessor and successor, Mr. Lay, chose not to speak. Mr. Lay walked away. But that was only one possible choice. You have chosen differently and this Committee is pleased that the Fifth Amendment flu has not claimed another victim. Your

willingness to testify is appreciated and I am sure there are many advising you to remain silent.

Mr. Skilling, I think there may be a great deal you can tell us about your days at Enron that would both help this Committee and this country. I look forward to your testimony.

Senator DORGAN. Senator Fitzgerald, thank you very much.

For those of you who have just arrived, I had asked that if we could perhaps, for those who do have opening statements, limit them to a minute so that we can begin the testimony. We had rather good opening statements when Mr. Lay appeared.

Senator FITZGERALD. Mr. Chairman, could I get permission or consent of the Committee to enter my full statement in the record, as I abbreviated it somewhat?

Senator DORGAN. Without objection.

[The prepared statement of Senator Fitzgerald follows:]

PREPARED STATEMENT OF HON. PETER G. FITZGERALD
U.S. SENATOR FROM ILLINOIS

Mr. Skilling, I want to thank you very much for appearing and agreeing to testify today. Some of your Enron colleagues who were also asked to testify have made a different choice. Watching them, I have to believe that you are aware that your voluntary appearance before this committee entails a measure of risk and that you therefore must be somewhat anxious. Consequently, whatever your role may have been in the collapse of Enron, I think there is at least something to be said for your willingness to talk about what happened to your company.

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As Senators, we are intensely interested not just in individual responsibility, but also in what appears to have been a systemic collapse of controls—a spectacular corporate implosion. It's a collapse that appears to have been both intra- and inter-institutional. Within Enron itself, we see a fundamental collapse of control beginning with the employees explicitly charged with managing Enron's many off-the-books partnerships. We see a collapse of control at the level of top management—including the Chairman and the CEO—charged with overseeing the employees managing the partnerships. We see a collapse of control by the Board of Directors charged with monitoring the performance of the Chairman and CEO who are, in turn, charged with monitoring the performance of the employees monitoring the performance of these partnerships. That's just within the confines of Enron itself.

Then we see a collapse of controls at a macro level—by the very institutions that are supposed to ensure the integrity of the capital markets. The United States has a whole industry—the accounting industry—to audit publicly traded corporations. Enron busted through the auditors. Investment and lending institutions played a role as well, improvidently extending capital and credit for ventures they apparently didn't understand and about which they failed to ask pertinent questions. Enron busted through the banks. Stock analysts are supposed to monitor the direction of the companies they follow and warn investors of potential pitfalls. Enron busted through the analysts. Rating agencies play a critical role in evaluating the financial condition of publicly traded companies and in warning investors of negative trends. Enron busted through the agencies. Finally, we have a Securities Exchange Commission, which polices the financial markets and protects investors. Apparently, not even the SEC could stop an Enron.

Our purpose, then, is to figure out how JEDIs, LJMs, Raptors and a Chewco turned a whole world on its head. We have a chess game here, Mr. Skilling, and our challenge is to find a way to check every single one of the moves you made on that Enron board. As part of that effort, this Committee thought it important to ask both you and Mr. Lay, as central figures in this drama, to tell us what you know.

Now, Mr. Skilling, we are witnessing a tale of two CEOs. As you may know, your predecessor—and successor—Mr. Lay, chose not to speak. Mr. Lay walked away. But that was only one possible choice. You have chosen differently, and this committee is pleased that the Fifth Amendment flu hasn't claimed another victim. Your

willingness to testify is appreciated when I'm sure there are many advising you to remain silent.

Mr. Skilling, I think there may be a great deal you can tell us about your days at Enron that would help both this committee and the country. I look forward to your testimony.

Senator DORGAN. Senator Wyden.

**STATEMENT OF HON. RON WYDEN,
U.S. SENATOR FROM OREGON**

Senator WYDEN. Thank you, Mr. Chairman.

I think it particularly important this morning that we examine the relationship between Mr. McMahon and Mr. Fastow. I would like to just go through the list of people that say that Mr. Skilling knew or was warned about the partnerships that were managed by Mr. Fastow. Mr. McMahon has said he complained personally to Mr. Skilling about his concerns with the Fastow partnerships. According to Ms. Watkins, J. Clifford Baxter told her that he had met with Mr. Skilling repeatedly to express his concerns about the partnerships. In an interview with the law firm Vinson & Elkins, Enron's Chief Risk Officer said that he talked to Mr. Skilling as far back as 2000 about the mounting risks of the Raptor partnerships. Ken Lay told internal investigators that Mr. Skilling knew the details of many of the key partnerships and even presented the idea for one of them to the Board of Directors. The Powers Report states that Mr. Skilling, Ken Lay, and the rest of the Board agreed and understood, and Mr. Skilling was the senior member of management responsible for the LJM partnership, and Mr. Skilling certainly knew or should have known the magnitude and the risks associated with these transactions.

It is clear that there was a long record of individuals right at the center of the company who were saying that you, Mr. Skilling, were aware of this. I think what I want to examine, because you have said that you have done nothing wrong and that you did not know about much of this, is really how many warnings would have been needed in order to have you take seriously the threats that so many around you were talking about. I hope we will get to examine that and other issues.

Thank you for the chance to make this statement.

Senator DORGAN. Senator Cleland.

**STATEMENT OF HON. MAX CLELAND,
U.S. SENATOR FROM GEORGIA**

Senator CLELAND. Mr. Skilling and those of you who are willing to testify today, thank you for appearing before us. I might say, I am sure this is an unreal feeling for you, an unreal experience. In many ways it is an unreal experience for me. I just want you to know where I am coming from. My state, particularly the 262,000 teachers and the well over 100,000 retired state employees, lost \$127 million, Mr. Skilling, due to the failures, I think, of leadership and openness and in effect the lying, cheating, and stealing of the top officials of Enron.

I will be asking questions today, not so much on my behalf, but on behalf of the teachers, the retired employees, and the people in Georgia who worked for Enron, who believed in you and your leadership team, many of whom have had to declare personal bank-

ruptcy because your company went bankrupt due to the bankrupt leadership of that company.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Burns.

**STATEMENT OF HON. CONRAD BURNS,
U.S. SENATOR FROM MONTANA**

Senator BURNS. Mr. Chairman, I will just submit my statement for the full record. I want to thank the executives for appearing here today. I appreciate that very much, and the willingness to answer some of the questions that will be asked by this panel.

I still think we are boiling down to answer the three W's: not only what, but when it was apparent that we had really serious internal problems, and why the management acted as they did. Also I believe we are here to listen and make judgment, was it the failure of the laws that are in place now and what we should do from here on. I will tell you, no matter what happens after this, all the problems that harmed the retirement funds, investors, and employees, will not suddenly be gone after these hearings are over or after the dust has settled from the Enron collapse.

I think it is incumbent on us to take the information gained here and more information from the agencies that were involved in the enforcement of those regulations to do what is necessary to protect the American people. I think our system is at stake here and that it is up to us to make sure that it works in case this happens again.

Now, I know how the panel that is before us today feels this morning. I went stone broke once, too. But I did not have as many moving parts as it appears that this case might have had. But nonetheless, I believe that we have to take and judge from what we gather today and prevent that the protection of the system is in place and the confidence is restored in the American system, which has served more people in this country than any other system that has ever been invented on this planet.

Thank you very much, Mr. Chairman.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF HON. CONRAD BURNS,
U.S. SENATOR FROM MONTANA

Thank you Mr. Chairman for holding this hearing. I welcome our three witnesses and I look forward to their testimony today. I have a few brief remarks I would like to offer for the record.

As in our previous hearings, I am hopeful that the information offered today can further enlighten this committee and the American people of the events that led to Enron's collapse. I am hopeful we can answer to the 4 Ws. Not only What, but When it was apparent that there were these internal problems, Why management acted they way they did, and Who were the principals. I believe we should be here to listen and be prepared to act based on the information collected and on the facts as they are known.

As I have stated before, Congress is tasked with a responsibility to the American people. We are not here to judge or convict but we are here to ensure the American people that when a circumstance such as this, the folks that are at the helm do the right thing and that is protect those who have little to control the situation or have the ability to protect themselves. I consider this an extremely important task as our Nation's economy and the basic principles of capitalism have been jeopardized by the Enron collapse.

We must find out which rules were bent or broken along the way, and the rules that should have been in place but did not exist. Once these important questions

have been answered, we can address policy concerns at the SEC, FASB and other agencies with jurisdiction, or ultimately, Congress. In short, Congress WILL take action to make sure this collapse and the ramification can be prevented.

In conclusion, I believe that it is important to remember we cannot legislate morality, that is something we expect of all Americans regardless of whether they are powerful corporate executives or blue collar workers working to put food on their family's table. In this case it is evident we can write out an extensive list of people to blame and Enron's employees won't suddenly have a solid future. Private investors won't magically see their stock gain value. Retirees' 401(k) plans won't suddenly re-appear. I don't think it is out of line to ask the important question of what now? What are Enron's plans for break-up and their actions and plans for former and present employees who lost so much. I believe we need to constantly remind ourselves that this is not about Enron executives, this is about the Nation's economy and investor confidence.

Senator DORGAN. Senator Breaux.

**STATEMENT OF HON. JOHN B. BREAUX,
U.S. SENATOR FROM LOUISIANA**

Senator BREAUX. Just very briefly, Mr. Chairman, thank you.

I think when you have a bad event, a lot of times there is a tendency for the people who surround the bad event to all say: I do not know how it happened, I do not know when it happened, and I do not know why it happened; it just happened. Well, things do not just happen.

There are reasons for things that are bad—how they occur, when they occur, and why they occur. I think it is important for this Committee to really find out what happened, to find out what the Federal role is in seeing that the laws that protect the American people are, in fact, the right laws, and if they need to be changed, that we do our very best to make sure that they are, in fact, changed. That is what we are trying to find out.

There are other venues for other activities surrounding this situation, but we need to know what happened and how and where and why.

Thank you.

Senator DORGAN. Senator Carnahan.

**STATEMENT OF HON. JEAN CARNAHAN,
U.S. SENATOR FROM MISSOURI**

Senator CARNAHAN. Thank you, Mr. Chairman.

This Committee has an extraordinary opportunity today. The three who have agreed to testify can help us unravel the tangled events that ensnared Enron. As top executives, they should have been able to give a reasonable explanation of why America's seventh largest company collapsed in a wave of accounting scandals, as predicted by one of these witnesses.

Each of these witnesses has testified already before the House. Their testimony on different days presented conflicting accounts, and we did not receive a true picture. Today, these witnesses have a duty to explain what they knew and how they responded to what they knew.

I realize the painstaking work of investigating Enron's collapse and the accountability will fall to others—the Securities and Exchange Commission, the Justice Department, the the Federal courts—but the job of this Committee is also important. Congress is responsible for crafting the laws that govern our financial mar-

kets and overseeing the enforcement of these laws by the Executive Branch. But, Members of Congress also serve as representatives of the people of this nation, and they want to know why this happened.

They want to know if it is happening elsewhere, and they want to know if it will happen again. It is in the public interest to know why jobs were lost, why savings evaporated, and why confidence was shattered.

Mr. Skilling, if you plan to tell this Committee that you did not understand Enron's true financial condition, then you will need to explain why, why you failed to understand things that any diligent CEO would have understood. If you insist that you were unaware of the company's financial condition, then I hope that you are prepared to explain why you portrayed yourself as someone who did.

I look forward to hearing from each of the witnesses today, and I thank them for agreeing to testify. I hope you have come here today armed only with the truth and ready to bear that burden for us with a sincere heart. Thank you.

Senator DORGAN. Senator Boxer.

**STATEMENT OF HON. BARBARA BOXER,
U.S. SENATOR FROM CALIFORNIA**

Senator BOXER. Thank you, Mr. Chairman, for your leadership on this issue.

Mr. Skilling, when it is my turn to question I am going to talk about the energy crisis that California experienced. Just to give you a little heads up of the line of my questioning, I want to tell you a little bit about the story that is beginning to emerge to Californians, the way we are seeing this crisis. This is how we see it. We see that Enron got out from governmental oversight at both the state and Federal level, and worked very aggressively to get out from under that oversight. The sole exception was the Federal Energy Regulatory Commission.

Mr. Chairman, I have asked them, the FERC, to give us a list of meetings that they have had with Enron. They put together a list from their recollection, and we see that there are 25 meetings in the period of time in which Californians were desperate for them to act. I am going to question you about this aggressive lobbying with FERC decisionmakers.

We also hear from Enron traders—that is t-r-a-d-e-r-s—that Enron jammed transmission lines, used futures and derivatives to, according to California State Senator Joe Dunn, possibly buy and sell the same electricity 15 times, in an effort to inflate prices.

As you answer these questions, I hope that you will realize that at the time you were making jokes about California, we were realizing that energy is a necessity, not a luxury, and we were worried, Mr. Skilling, in the summer that elderly people in the inland parts of my state might lose their air conditioning and literally face death. The agriculture industry in my state was fearful that loss of refrigeration would cause economic devastation. Silicon Valley put solving the energy crisis as its number one priority in order to keep the information economy flowing. In the winter months, as we still were getting no relief from FERC, we feared that freezing temperatures would harm our people, particularly the elderly and frail.

From everything I can put together, Mr. Skilling, you helped cause these anxieties while you laughed about it. The people of California were not laughing then. They are not laughing now. Our state wants justice, and I hope that today maybe we can get on that path to justice.

Thank you.

Senator DORGAN. Senator Allen.

**STATEMENT OF HON. GEORGE ALLEN,
U.S. SENATOR FROM VIRGINIA**

Senator ALLEN. Thank you, Mr. Chairman.

I agree with Senator Breaux's view. Whether anybody was deliberate and willful in their deceit and fraud, or simply negligent will be determined not in this Committee, but rather in a criminal or civil proceeding in the courts. The larger issue is that there are many people who lost much of their investments, such as savings for their children's college education or their retirement, because they believed that Enron was a sound investment. That is the larger issue here because it is a matter of confidence for the American people as to the reliability and the credibility of the information about the company's financial condition. They need a clear and fully accurate description of assets and liabilities, cash-flow, true revenues, and true costs and obligations.

Mr. Chairman, a reliable accounting system is the linchpin of our free market system. This is not just about individual investors. It relates to the retirement systems in various companies, various state organizations, as well as even investment advisers who were misled as to the actual economic viability of Enron.

I appreciate Ms. Watkins, Mr. Skilling, and Mr. McMahon coming here today. I hope that in the midst of all this, our witnesses will tell us what they believe could have and should have been done differently to have prevented the chicanery and deceit that robbed so many investors of their savings. We need to learn from this so that we can make changes in laws that would be appropriate and practical to make sure that investors and their advisers have full access to information about companies. That should be the goal of this Committee: To learn what went wrong and how it can be prevented in the future.

I thank these witnesses here for hopefully sharing with us what they think can be done, because this is about more than Enron in the views of most people in this country. Hopefully, there will be remedies. But we need to move forward to make sure that something like this cannot happen again.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Rockefeller.

**STATEMENT OF HON. JOHN D. ROCKEFELLER IV,
U.S. SENATOR FROM WEST VIRGINIA**

Senator ROCKEFELLER. Mr. Chairman, I will put my statement in the record and note also that I strongly associate my views with those expressed by Senator Carnahan, Senator Burns, and Senator Allen.

Thank you.

[The prepared statement of Senator Rockefeller follows:]

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER IV,
U.S. SENATOR FROM WEST VIRGINIA

Thank you, Mr. Chairman, for holding this hearing. I will not offer an opening statement, except to say that I hope we all realize the primary reason we should be conducting this inquiry is to make sure that the types of things that happened to the employees, retirees, and investors of Enron do not happen to anyone else whose life's savings are invested in a major corporation.

This is not about partisanship, and it is not about which Member of Congress took campaign contributions from which company or which executive. This is very simply an investigation that is most relevant as a cautionary tale. Like all Americans, we should be angry about what Enron did, but let's dedicate ourselves to conducting an investigation the intent of which is to prevent this from happening again.

Senator DORGAN. Let me observe that this is the Congress, and not a criminal justice system proceeding. It is not a prosecution; it is a search for the truth in a congressional hearing. Those are very different approaches. We have three people to testify today who have testified previously on different occasions, and we have heard three very different stories about what happened inside the Enron Corporation. I welcome the opportunity to take the testimony today from these three:

Ms. Sherron Watkins, Vice President of Corporate Development, Enron Corporation; Mr. Jeffrey McMahon, President and Chief Operating Officer, Enron Corporation; and Mr. Jeffrey Skilling, former Chief Executive Officer of the Enron Corporation.

The witnesses know that it is our intention to take testimony today under oath. If there are no objections to that, by the rules of this Committee, you are also advised that you are entitled to be advised by counsel during your testimony. I would ask that when I call on you to begin your testimony that you identify your counsel for us.

I would like, if we could, to have the three witnesses rise and raise your right hand, and I will give you the oath:

Do you swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth?

Ms. WATKINS. I do.

Mr. SKILLING. I do.

Mr. MCMAHON. I do.

Senator DORGAN. You may be seated. You are under oath and recognized for opening remarks.

We will begin the opening remarks with Ms. Watkins. Ms. Watkins, why do you not proceed and identify your counsel for the Committee.

**STATEMENT OF SHERRON WATKINS, VICE PRESIDENT
OF CORPORATE DEVELOPMENT, ENRON CORPORATION;
ACCOMPANIED BY PHILIP HILDER, ESQ.**

Ms. WATKINS. My counsel is Mr. Philip Hilder.

Senator DORGAN. Would you pull the microphone very close to you while you are presenting testimony. Thank you very much.

Ms. WATKINS. Good morning, Mr. Chairman, Members of the Committee. I am Sherron Watkins and I thank you for the opportunity to speak to you this morning. I am currently employed by Enron Corporation as a Vice President. By way of background, I hold a master's degree in professional accounting from the University of Texas at Austin, and I have been a certified public accountant since 1983.

I began my career in 1982 at Arthur Andersen as an auditor. I spent eight years at Andersen in both the Houston and New York offices. I joined New York-based MG Trade Finance in 1990 to manage their commodity-backed finance assets, a position I held until October 1993.

In October 1993, I was hired by Mr. Andrew Fastow and moved back to Houston to manage Enron's newly formed partnership with CalPERS, California Public Employee Retirement System. The partnership was called the Joint Energy Development Investments Limited Partnership, or JEDI. I held the JEDI portfolio management position until the end of 1996.

Senator ALLEN. Mr. Chairman, it is really hard to hear because of the noise in the hall, and Ms. Watkins we really want to hear you.

Senator DORGAN. Senator Allen is correct. Let us ask that we close the door. Do we have security at the door? If we could ask that the door be closed and remain closed.

Ms. Watkins, if you would pull the microphone as close as you can and speak up, the Committee would very much appreciate it.

Ms. WATKINS. Just continuing with my testimony: From 1997 until early 2000, I worked for Enron International, primarily in the mergers and acquisitions group, which is also known as the corporate development group. In early 2000, I transferred to Enron Broadband Services, where I worked until June of 2001 in a variety of roles.

In mid- to late June of 2001, I went to work directly for Mr. Fastow, assisting in the corporate development work that had recently been put under his supervision upon the resignation of Cliff Baxter in May of 2001. I worked for Mr. Fastow in this new role until August of 2001. I have since been reassigned to the human resources group with a variety of roles.

While working for Mr. Fastow in 2001, I was charged with reviewing all assets that Enron considered for sale and determining the likely economic impact of the sale. As part of the sale analysis, I reviewed the estimated book values and market values of each asset. A number of assets were hedged with an entity called Raptor. Any asset that was hedged should, for the most part, have a locked-in sales value for Enron. Meaning that despite current market prices, Enron should realize the hedged price that it held with Raptor.

It was my understanding that the Raptor special purpose entities were owned by LJM, the partnership owned by Mr. Fastow. In completing my work, certain Enron business units provided me with analyses that showed that certain of the hedged losses incurred by Raptor were actually coming back to Enron. The general explanation was that the Enron stock backstopping the Raptor hedge had declined in value such that Raptor would have a shortfall and would be unable to fully cover the hedged price that it owed to Enron.

I was highly alarmed by the information I was receiving. My understanding as an accountant is that a company could never use its own stock to generate a gain or avoid a loss on its income statement. I continued to ask questions and seek answers, primarily from former coworkers in the Global Finance group or in the busi-

ness units that had hedged assets with Raptor. I never heard reassuring explanations.

I was not comfortable confronting either Mr. Skilling or Mr. Fastow with my concerns. To do so, I believed, would have been a job-terminating move.

On August 14, 2001, I was informed of Mr. Skilling's sudden resignation and felt compelled to inform Mr. Lay of the accounting problems that faced him. I sent Mr. Lay an anonymous letter on August 15, 2001, in response to a request for questions for an upcoming all-employee meeting to be held August 16 to address Mr. Skilling's departure. At the all-employee meeting, Mr. Lay commented that our vision and values had slipped and that any employee who was truly concerned about anything at Enron, please bring those concerns to him or any number of the top management, including Cindy Olson, Steve Kean, and others.

On August 16, I met with Ms. Olson to show her a copy of the letter and discuss it with her. She encouraged me to meet with Mr. Lay personally. Since Mr. Lay was traveling for the rest of the week, she said the meeting would probably take place the week of August 20.

I met with Mr. Lay on the afternoon of Wednesday, August 22, 2001. The meeting lasted just over one-half hour. I provided him with memos I had drafted to help explain the problems facing the company. Additionally, I provided an analysis of the Raptor entity economics and a presentation prepared by Enron's risk assessment and control group.

I primarily used the memo titled "Summary of Raptor Oddities" as talking points with Mr. Lay. My main point to Mr. Lay was that by this time Raptor owed Enron in excess of \$700 million under certain hedging agreements. My understanding was that the Raptor entities basically had no other assets aside from these hedging activities. Therefore, they had collectively lost over \$700 million. I urged Mr. Lay to find out who lost that money. If he discovered that the loss would be borne by Enron shareholders via an issuance of stock in the future, then I thought we had a very large problem on our hands.

I gave Mr. Lay my opinion that it is never appropriate for a company to use its stock to affect the income statement.

At the conclusion of the meeting, Mr. Lay assured me that he would look into my concerns. I also requested a transfer as I was uncomfortable remaining as a direct report to Mr. Fastow.

I fully expected Mr. Lay to conduct a thorough investigation into my concerns. I was disappointed that such was not the case. I was incredibly frustrated with Mr. Lay's actions or lack thereof. I believed that Enron had a brief window to salvage itself this last fall, and we missed that opportunity because of Mr. Lay's failure to recognize or accept that the company had manipulated its financial statements.

I intend to fully cooperate with this Committee and welcome the opportunity to answer any questions the Senators may have.

[The prepared statement of Ms. Watkins follows:]

PREPARED STATEMENT OF SHERRON WATKINS,
VICE PRESIDENT OF CORPORATE DEVELOPMENT, ENRON CORP.

Good Morning Mr. Chairman, Members of the Committee. I am Sherron Watkins. Thank you for the opportunity to address the Committee this morning.

BACKGROUND

I am currently employed by Enron Corporation as a Vice President. By way of background, I hold a master's degree in professional accounting from the University of Texas at Austin and have been a certified public accountant since 1983.

- I began my career in 1982 at Arthur Andersen as an auditor. I spent 8 years at Andersen in both the Houston and New York offices.
- I joined New York-based MG Trade Finance in 1990 to manage their portfolio of commodity-backed finance assets—a position I held until October 1993.
- In October 1993, I was hired by Mr. Andrew Fastow and moved back to Houston to manage Enron's newly formed partnership with CalPERS, the California Public Employee Retirement System. The partnership was called the Joint Energy Development Investments Limited Partnership or JEDI. I held the JEDI portfolio management position until the end of 1996.
- From 1997 until early 2000, I worked for Enron International, working primarily in the mergers and acquisitions group, which is also known as the corporate development group.
- In early 2000, I transferred to Enron Broadband Services where I worked until early June of 2001 in a variety of roles.
- In mid to late June of 2001, I went to work directly for Mr. Fastow, assisting in the corporate development work that had been put under his supervision after Cliff Baxter retired in May of 2001. I worked for Mr. Fastow in this new role until late August 2001.
- I have since been reassigned into the human resources group with a variety of assignments.

DISCOVERY OF RAPTOR PROBLEMS

- While working for Mr. Fastow in 2001, I was charged with reviewing all assets that Enron considered for sale and determining the likely economic impact of a sale. As part of the sale analysis I reviewed the estimated book values and market values of each asset.
- A number of assets were hedged with an entity called Raptor. Any asset that was hedged should, for the most part, have a locked-in sales value for Enron. Meaning that despite current market prices, Enron should realize the hedged price with Raptor.
- It was my understanding that the Raptor special purpose entities were owned by LJM; the partnership run by Mr. Fastow.
- In completing my work, certain Enron business units provided me with analyses that showed certain hedged losses incurred by Raptor were actually coming back to Enron. The general explanation was that the Enron stock backstopping the Raptor hedge had declined in value such that Raptor would have a shortfall and would be unable to fully cover the hedge price that it owed to Enron.
- I was highly alarmed by the information I was receiving. My understanding as an accountant is that a company could never use its own stock to generate a gain or avoid a loss on its income statement. I continued to ask questions and seek answers, primarily from former co-workers in the Global Finance group or in the business units that had hedged assets with Raptor. I never heard reassuring explanations.

EVENTS LEADING TO MY MEMOS TO MR. KENNETH LAY

- I was not comfortable confronting either Mr. Skilling or Mr. Fastow with my concerns. To do so, I believed would have been a job terminating move.
- On August 14, 2001, I was informed of Mr. Skilling's sudden resignation and felt compelled to inform Mr. Lay of the accounting problems that faced Enron.
- I sent Mr. Lay an anonymous letter on August 15, 2001 in response to a request for questions for an upcoming all-employee meeting to be held August 16th to address Mr. Skilling's departure.
- At the all-employee meeting Mr. Lay commented that our visions and values had slipped and that if any employee was truly troubled by anything at Enron, please bring those concerns to him or any number of the top management including Cindy Olson, Steve Kean and others.

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I intend to fully cooperate with the Committee and welcome the opportunity to answer any questions the Senators may have at this time.

Senator DORGAN. Thank you, Ms. Watkins.

Next we will hear from Mr. Jeffrey McMahon, the President and Chief Executive Officer of Enron. Good morning. Excuse me, the President and Chief Operating Officer. I should not elevate you at this hearing.

STATEMENT OF JEFFREY McMAHON, PRESIDENT AND CHIEF OPERATING OFFICER, ENRON CORPORATION

Mr. McMAHON. Good morning, Mr. Chairman and Members of the Committee. My name is Jeff McMahon. I am currently the President and Chief Operating Officer of Enron Corp. I have been an employee of Enron since 1994. From late October of last year until early this month, I served as Chief Financial Officer of the company. Before that, I was President and Chief Executive Officer of Enron's Industrial Markets Group. From 1998 until March 2000, I was the Treasurer of Enron Corp. Before that, I served as Chief Financial Officer of its European Operations.

As the Committee knows, earlier this month I was named President and Chief Operating Officer, at the same time that Steve Cooper was named the new interim Chief Executive Officer and Chief Restructuring Officer of the company. As part of the new management team at Enron, my focus is on the future—the future of the business, the future of our nearly 20,000 existing employees worldwide who are looking for continued employment, the future of our over 8,000 retirees who are looking for continued retirement benefits from the company, and the various other stakeholders, including our creditors and former employees who have an interest in Enron's future.

Working closely with the Board of Directors and the Creditors Committee, we are developing a restructuring plan designed to

bring the company out of bankruptcy and preserve value for the company's creditors, employees, and stakeholders. I believe that Enron can emerge from bankruptcy by returning to its roots. As Mr. Cooper expressed at the announcement of his appointment as interim CEO, a reorganized Enron will be dedicated primarily to the movement of natural gas and the generation of electricity related to gas assets that Enron currently owns.

With respect to the issues the Committee is examining, as the Chairman knows, I've been fully and freely cooperating with this and other congressional committees in this matter, and I welcome today's opportunity to answer, to the best of my ability, questions the Committee may have about past events at Enron or our future direction.

Thank you, Mr. Chairman.

[The prepared statement of Mr. McMahan follows:]

PREPARED STATEMENT OF JEFFREY MCMAHON, PRESIDENT AND CHIEF OPERATING OFFICER, ENRON CORPORATION

Good morning, Mr. Chairman and Members of the Committee, my name is Jeff McMahan. I am currently the President and Chief Operating Officer of Enron Corp. I have been an employee of Enron since 1994. From late October of last year until early this month, I served as Chief Financial Officer of the company. Before that, I was President and Chief Executive Officer of Enron's Industrial Markets Group. From 1998 until March 2000, I was Treasurer of Enron Corp. Before that, I served as Chief Financial Officer of its European Operations.

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With respect to the issues the committee is examining, as the Chairman knows, I have been fully and freely cooperating with this and other congressional committees in this matter. I welcome today's opportunity to answer, to the best of my ability, questions the committee may have about the past events at Enron or our future direction.

Thank you, Mr. Chairman.

Senator DORGAN. Mr. McMahan, thank you very much.

It is my understanding that a vote has just started on the floor of the Senate. I think we would be advised to take a 15-minute recess. There is only one vote. Members of the Committee will be able to vote and come back and reconvene immediately.

The hearing will stand in recess for 15 minutes.

[Recess from 10:05 a.m. to 10:20 a.m.]

Senator DORGAN. The hearing will reconvene and come to order.

Senator Snowe, you were not here when we did opening statements. We attempted to limit them to one minute. Let me recognize you before I recognize Mr. Skilling.

**STATEMENT OF HON. OLYMPIA J. SNOWE,
U.S. SENATOR FROM MAINE**

Senator SNOWE. I thank you, Mr. Chairman, and I ask to include my entire statement in the record.

Senator DORGAN. Without objection.

Senator SNOWE. Given the unprecedented collapse of Enron, resulting in the largest bankruptcy in the history of this country, and given the impact that it has had on dedicated and trusted employees who lost their 401(k) savings at the same time many officials at the top levels of the company were enriched, and given the impact on investors who were led astray, it is certainly appropriate that we continue to conduct these hearings.

Hopefully, these hearings will lead closer to the truth. We certainly do not know whether it will or not. But I do know this: I wish there had been more Ms. Watkins and Mr. McMahon in the organization, because it might have well prevented this catastrophic demise of one of the largest companies in America.

There are many plausibility issues here, Mr. Skilling, and I hope that you will address them today. As I said when Mr. Lay was before this Committee several weeks ago, there is a plausibility gap between the facts as we know them and the assertions and the denials that have been made by many of you at the top of this company. Many of those conflicts are not inconsequential when we are talking about contradictions and inconsistencies. Many of those have been underscored by the Powers Report.

So I hope that we will be able to be in a position here today to begin to clarify many of these issues, because clearly, accountability and responsibility does rest with those at the higher levels of the company. Certainly that does start with you in the time period that you were CEO.

Thank you, Mr. Chairman.

[The prepared statement of Senator Snowe follows:]

PREPARED STATEMENT OF HON. OLYMPIA J. SNOWE,
U.S. SENATOR FROM MAINE

Thank you, Mr. Chairman, for holding this hearing today. I would also like to thank Ms. Watkins, Mr. McMahon, and Mr. Skilling for appearing before us after testifying in the House on separate occasions previously.

As I noted at the February 12 hearing when former Enron CEO and Chairman Ken Lay invoked the Fifth Amendment and declined to testify, the fall of the colossal Enron enterprise is not a run-of-the-mill business bankruptcy. A company that once boasted over \$100 billion in revenues rapidly disintegrated into bankruptcy losing \$67 billion in investor money and nearly \$1 billion in the retirement plans of its own loyal employees.

Given this unprecedented collapse and the impact it has had on dedicated employees and misinformed investors alike, the American people have a great many questions—and it is our obligation to try to get to the bottom of what went wrong. The testimony of today's witnesses will hopefully provide us with some of these answers—and, in the process, provide us with insight on how to prevent a repeat performance of this tragedy in the future.

As we turn to our witnesses, I would first like to commend Ms. Watkins for her bravery in bringing her concerns to the attention of Mr. Lay in August, and for not mincing words in warning him that Enron could “implode in a wave of accounting scandals.” Given that her concerns proved prescient, I look forward to hearing more about her role in informing Ken Lay of the accounting indiscretions occurring in Mr. Fastow's Finance department, and the subsequent actions that were taken in response to those concerns.

I also look forward to hearing the testimony of Mr. McMahon who, as far as we know, was the first to approach Jeff Skilling about his serious concerns with the

conflict of interest presented by Mr. Fastow's involvement with the LJM partnerships. Given that the LJM partnerships accounted for at least 40 percent of Enron's reported pre-tax income by 2000, I look forward to learning more about Mr. McMahon's meeting with Mr. Skilling.

Finally, because accountability and responsibility starts at the top, Mr. Skilling's testimony is of particular interest—especially when considering that he resigned from Enron shortly before its collapse and claims no knowledge of the financial dealings that brought Enron down. I believe it is incumbent upon the former COO and CEO to prove the validity of his claims given the conflicting findings of the Powers Report and other witnesses, conflicts that are not inconsequential.

For instance, during his testimony before the House Energy and Commerce Subcommittee on Oversight and Investigations, Mr. Skilling stated that he was “not aware of any financing arrangements designed to conceal liabilities or inflate profitability.” However, the Powers Report—in reviewing the minutes of the May 1, 2000, Board meeting attended by Mr. Skilling—found notes indicating that the Board and Enron management were aware that Raptor I was not a true economic hedge and that it did not “transfer economic risk but transfers profit and loss volatility.” Isn't this a method of masking debts that really do exist while creating profits that don't exist?

In addition, as outlined earlier, Mr. Skilling seemingly ignored the concerns of Enron Treasurer Jeff McMahon during a meeting on March 16, 2000. And not only were his conflict of interest concerns ignored, but shortly after the meeting, Mr. McMahon was transferred to a post in the company where he would have no contact with Andrew Fastow and his partnerships. Was that just a coincidence or a sinister effort to push aside one who dared question the financial structure that ultimately brought Enron down?

Furthermore, Mr. Skilling essentially claimed to not be fully aware of Mr. Fastow's dealings with the LJM partnerships despite the fact that controls were specifically put in the place by the Board of Directors and management to ensure that Mr. Fastow's allegiance to Enron—and not his own personal financial gains—remained foremost.

The bottom line is that Mr. Skilling's explanation of events—while perhaps convenient for his purposes—lacks plausibility given the conflicting findings and statements of others. Hopefully today's hearing will bring us closer to the truth in terms of what Mr. Skilling knew and when he knew it—and ultimately bring us closer to unraveling the tragic events that unfolded at Enron so that they are never repeated again.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Snowe, thank you.

Senator Nelson, we allowed one minute for opening statements. Do you have a statement?

**STATEMENT OF HON. BILL NELSON,
U.S. SENATOR FROM FLORIDA**

Senator NELSON. Mr. Chairman, I would like to continue with my interest in finding out what happened to many of these state pension funds around the nation. That will be part of my line of questioning, particularly the fact that the Florida pension fund bought almost 3 million shares during a 3-week period while the stock was dropping like a rock, whereas the money manager, Alliance Capital Management that had handled other pension funds—for example, New York—sold their Enron shares in August, but were purchasing shares for the Florida retirement fund starting on October 22 in that 3-week period, just extraordinarily defying logic.

So, I will follow up with that at the appropriate time.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Nelson, thank you.

Mr. Skilling, why do you not proceed, and would you introduce your counsel as well.

**STATEMENT OF JEFFREY SKILLING, FORMER CHIEF
EXECUTIVE OFFICER, ENRON CORPORATION; ACCOMPANIED
BY BRUCE HILER, ESQ., O'MELVENY & MYERS**

Mr. SKILLING. Yes, Mr. Chairman. This is my counsel, Mr. Bruce Hiler, who represents O'Melveny & Myers.

Should I go ahead?

Senator DORGAN. Please proceed.

Mr. SKILLING. Mr. Chairman, distinguished Senators: My name is Jeff Skilling. I worked at Enron for 10 years, spent my last 6 months there as CEO. I left the company in August of 2001.

The bankruptcy of Enron has been devastating to its employees, its shareholders, and many others who were connected in one way or another to this once-fine institution. As I did when I appeared before Congress, I want to apologize to all of those affected people for what Enron has come to symbolize. I know that no words can repair the harm that has been done and, as hard and as difficult as these past few months have been for me and my family, I know that many others have suffered far, far worse.

I am here today to do my best to help answer the legitimate questions on everyone's mind regarding what happened at Enron. Let me begin with a recap of what I understand about what Enron has said in recent SEC filings.

First, there has been a restatement of three items, none of which affected cash-flow or future period earnings. Second, there may have been self-dealing by a small number of executives, among whom I have not and cannot be counted.

But, in addition to those statements, there is also a raft of currently unproven assertions of additional accounting issues, the primary ones relating to something called the Raptor hedges. What do we know about these hedges? We know that the company's accountants, Arthur Andersen, agreed with the treatment of these transactions all the way up to their technical group in Chicago. We also know that the Powers team hired another accountant that apparently disagrees with Andersen, and I take it also that Ms. Watkins also disagrees with Andersen.

If the focus of this hearing is a game of dueling accountants, I will state right now that I am not an accountant and probably have little to add to that debate between experts.

I know that you will be asking questions about who did what at Enron, but I hope in addition to those technical issues you will also ask about how a company as strong as Enron can be bankrupted by what I call a run on the bank. I have some thoughts that I think a number of you have asked for that might be helpful and are important to the financial system.

But before we start, there are a few things I think this record should reflect. I will not respond to all the outrageous things said about me in this process because some have been so silly that they merit no response. Three others, however, do merit a response:

First, I have not lied to the Congress or anyone else about my recollection of events while I was at Enron.

Second, I never duped Ken Lay. I heard Ms. Watkins testify to her opinion. I have no idea what the basis is for that opinion.

Third, I do not believe that my testimony is contradicted by or is materially different than the testimony of either Mr. McMahon

or Mr. Mintz, for both of whom I have a tremendous amount of respect.

And now, finally, a few observations about this congressional process to which I and others have been subjected. What has happened thus far, primarily in the House, should be cause for concern of every American. The entire management and Board of Enron has been labeled everything from hucksters to criminals, with a complete disregard for the facts and evidence assembled. These untruths shatter lives and they do nothing to advance the public understanding of what happened at Enron. The framers of the Bill of Rights are watching.

My dilemma, like that of other innocents called before these committees, is whether to take refuge in constitutional protections to avoid your questions or stand on the constitutional presumption of innocence to proclaim the truth.

I am here and prepared to answer the Committee's questions because I have nothing to hide. I take and will continue to take full responsibility for my actions as a senior executive of Enron Corporation.

While I worked at Enron, I served the shareholders and the Board of Directors faithfully. When I left Enron on August 14, I did not believe the company was in financial peril and I have no knowledge of any—and had no knowledge, of any wrongdoing by its employees.

Common decency suggests that I be treated as innocent until proven otherwise. Common sense suggests that accusations made now, before the facts are in, are likely to be wrong. Unfortunately, neither common decency nor common sense will carry the day in this politicized process.

I am nonetheless hopeful that today we can get past the rhetoric and focus on the facts. Frankly, based on this morning's opening statements, I believe that we may actually have a constructive dialog today, and I hope that's the case.

Mr. Chairman, unlike so many others so much less fortunate than me, I am not a victim here. But also unlike others, I am not one of the perpetrators, either. What I know I am prepared to tell. What I do not know, I do not know either because it was kept from me or it never happened at all, like so many of these supposed facts thrown around since my hearings before the House subcommittee.

With that, Mr. Chairman, I'm prepared to answer your questions to the best of my abilities.

Senator DORGAN. Mr. Skilling, thank you very much.

First let me say that decency and common sense will prevail here. This also is a search for the truth, as I have indicated previously. The truth has proved to be rather elusive with respect to what happened inside the corporation.

Mr. Skilling, you know that the Board of Directors commissioned a study to examine what was happening inside the Enron Corporation. Mr. Powers testified before this Committee and said what the Board of Directors found in the Powers study was "appalling." That seems to me to be at odds with your testimony, because your testimony suggests: "When I left, nothing really was happening, there was nothing untoward that was happening inside the company."

That is, of course, at odds with what the Board of Directors of the corporation itself found following your departure.

I am going to ask a series of questions, as will my colleagues, and we want to try to understand what all three of you are saying. All three of you were in this corporation for some length of time. This corporation has effectively collapsed and filed for bankruptcy and is now struggling to recover from that.

Let me ask a few questions. We will go around several times, and we will have plenty of time.

Ms. Watkins, you said that you met with Mr. Lay for an hour or about an hour, I believe, when you took to Mr. Lay your memorandum, which I have read a couple of times. That was a one-hour meeting?

Ms. WATKINS. It was approximately a half-an-hour.

Senator DORGAN. A half-an-hour. Did you sense from that meeting that Mr. Lay knew what you were talking about? Did he get it?

Ms. WATKINS. He certainly knew that I was concerned, that my concerns were real. And I did feel at the end of the meeting that he was going to conduct a thorough investigation.

Senator DORGAN. Ms. Watkins, you indicated in your memorandum, you talked about you are 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."

Then when you testified before the House you said that the transactions that you were concerned about here were pretty common knowledge within Enron. Tell me about common knowledge? Would you believe that the upper echelon of Enron would know what was happening with respect to the creation of these partnerships, including Mr. Skilling, Mr. McMahon, Mr. Lay, and others? When you say common knowledge, would you describe that for us?

Ms. WATKINS. Throughout the Global Finance group, as well as upper management, I believe it was well understood that the Raptor entities were primarily backstopped with Enron stock. It wasn't a hidden fact. I do think certain people thought it was some magic structure that was acceptable. But others that had some concerns about it kept their concerns mainly to themselves.

Senator DORGAN. When you say upper management, do you believe that would include Mr. Skilling?

Ms. WATKINS. Yes, I do.

Senator DORGAN. Yet Mr. Skilling testifies that he really did not know much about this at all. I am going to go through a list of Board meetings and so on at some later time.

But, we have a circumstance where you went to Mr. Lay with a memorandum, a now famous memorandum. You said there are very serious problems. The language you used is quite remarkable—"accounting hoax," "accounting scandals," and so on. You say "common knowledge." So do you believe that includes Mr. Lay? Obviously it includes Mr. Lay after you addressed him with respect to the memorandum. Did it before that point, in your judgment?

Ms. WATKINS. During our meeting he recollected that the Raptor structures had been presented to the Board. He believed that they had been gone over in somewhat detail, that Arthur Andersen had

blessed them. And he asked me: "Are you certain there could be something wrong with these structures?"

My point to him was: "Yes, there is something wrong when an entity owes us \$700 million, we have booked that in the income statement, we have a receivable from that entity, and they're going to pay us back by cashing in our own stock."

Senator DORGAN. Mr. Skilling, were you aware of that structure? We're talking now about the structure. Were you aware of that structure?

Mr. SKILLING. Yes. I was in the Board meeting that Ms. Watkins talked about in May of 2000 when the Raptor transaction was presented. In that Board meeting, there was a relatively detailed description of the transaction, including a motion that would essentially approve or set up the original Raptor transactions, and that was approved by the Board of Directors.

Senator DORGAN. Is it your contention that that structure was appropriate, inasmuch as Ms. Watkins and others and those of us in Congress now see that what was backstopping that partnership was Enron stock? Is it your contention that you knew of it, and it was appropriate?

Mr. SKILLING. I relied on our accountants, who, in fact, I believe it's very clear—I've seen the minutes of that Board meeting, and it's very clear that Mr. Rick Causey, who was the Chief Accounting Officer of the company, represented that Arthur Andersen and our lawyers had taken a very hard look at this structure, and they believed it was appropriate.

Senator DORGAN. So you're saying that Arthur Andersen informed the top executives of the corporation that this was an appropriate structure? You knew about it, therefore, believed it was okay because your accountants said it was all right; is that the case?

Mr. SKILLING. The structure was presented to the Board of Directors. Mr. Causey said the accountants had looked at it and had signed off on it, and the Board approved that structure.

Senator DORGAN. I am going to go into a different direction, then I will come back, and we will have several rounds of questions.

Could you move the microphone just a bit closer.

Mr. SKILLING. Yes, sir.

Senator DORGAN. I want to talk about some things I think you have said that you did not know about. You say you did know about that structure. Disclosures about Mr. Fastow are interesting and also I think lead to the use of the word "appalling" in the Powers Report. Mr. Fastow has an equity position in partnerships, makes \$30 million in commissions, invests \$25,000 and 60 days later takes out \$4.5 million. It seems to be a corrupt system.

I am wondering, did you know about what Mr. Fastow was doing with respect to the creation of these partnerships, his stake in those partnerships, and what he was doing with respect to the personal financing?

Mr. SKILLING. All my recollection is that a lot of issues related to LJM2 and LJM1, which were affiliated party transactions, were discussed in depth at the Board of Directors meeting, including the issue that there would be a potential conflict of interest created by having Mr. Fastow participate in that, in those partnerships, and

it was believed that the controls that were approved and put in place for LJM2 would eliminate that conflict of interest.

LJM1 was a little bit different in that the actual transaction, the hedging transaction, was approved, so there was no ongoing issue. That transaction was approved based on a fairness opinion that had been received from an accounting firm, that they said this was a reasonable transaction for Enron Corporation. So I and the other Board members believed that was adequate protection for our shareholders and approved it.

Senator DORGAN. Are you surprised by what you have since learned about Mr. Fastow's compensation?

Mr. SKILLING. I can only tell you what I know. I have read a tremendous amount. I have read conflicting things in the newspapers. To the extent that the compensation was as some newspapers have published, of that order of magnitude, yes, I was surprised.

Senator DORGAN. Let me just ask a brief question of Mr. McMahan. Then I am going to come back on a second round and ask a series of questions of Mr. Skilling and Ms. Watkins.

Mr. McMahan, you are currently employed by the Enron Corporation. We know that there has been shredding of documents going on at the Enron Corporation. Can you tell me what records were destroyed, what kind of internal investigation has been conducted, and what should we learn about and what should we know about the records that were destroyed?

Mr. MCMAHON. Currently, I don't believe we do know what records are destroyed. We, as I understand it, have cooperated fully with the FBI, who has come in and done some work in the building, interviewed a lot of our employees who were on the floors where this shredding may have occurred. As I understand it, our internal legal counsel and external legal counsel are also looking into the document shredding allegations.

So at this point, we don't know exactly the outcome of that. We have secured the building, though, as soon as we were made aware of it, so the shredders were secured and were removed from the building. Prior to that, the legal group, as soon as the investigations began, sent out many emails to all employees requesting them to retain and protect documents.

Senator DORGAN. Mr. McMahan, Mr. Skilling said that he has great respect for you. It is the case, is it not, that you went to Mr. Skilling to express your concerns about what was happening inside the corporation?

Mr. MCMAHON. Yes, it was. In March 2000, I had a conversation with Mr. Skilling.

Senator DORGAN. What was the response to that conversation? Can you describe the conversation generally and tell us what the response was?

Mr. MCMAHON. Generally, at the time—and let me step back and kind of give you the perspective of the organization.

I was, at that point in time, Treasurer of Enron Corp., and I was reporting to the then-Chief Financial Officer, Mr. Fastow. There were two groups reporting to Mr. Fastow at the time. My group was one and then Mr. Cooper's group, which was responsible for structured financing. In that fell the LJM partnerships which Mr. Fastow was a principal in.

The short of it is the conflict of interests, as Mr. Skilling just described, manifested themselves in my area on a daily basis, where we had Enron employees negotiating on behalf of Enron and LJM to do transactions, and it was causing some problems internally within the organization. So after many meetings with Mr. Fastow and many meetings with other members of senior management, I felt that I needed to talk to Mr. Skilling about those conflicts and how I saw that they should be fixed.

Senator DORGAN. So you took your concerns to Mr. Skilling. What happened as a result of that?

Mr. MCMAHON. We had about a 30-minute meeting, as I recall, and Mr. Skilling listened intently to my concerns, and at the end of the meeting he indicated to me that he would remedy the situation and fix the problems.

Senator DORGAN. Did you lose your job as corporate treasurer shortly thereafter?

Mr. MCMAHON. About two or three weeks later, I was offered a job internally to move to a different group.

Senator DORGAN. Do you think it was a result of your meeting with Mr. Skilling?

Mr. MCMAHON. Certainly at the time I did not have that view. I had been approached around the same time by the then-head of that division, who asked to recruit me in there, and I ultimately turned it down. But shortly after meeting with Mr. Skilling, I did have a meeting with Mr. Fastow, who was then my boss, who indicated to me that he had spoken to Mr. Skilling about our conversation and he was concerned whether we could actually work together again. So when that opportunity did arise, I did ultimately take it.

Senator DORGAN. But I mean, you are trying to put an awfully good face on this. It appears to me that you went to Mr. Skilling and said there are real problems here and the result is you were transferred. Do you disagree with that?

Mr. MCMAHON. I think that's a correct statement of the facts. I certainly don't have any knowledge that that was a direct result of that meeting.

Senator DORGAN. Mr. Skilling, do you recall that meeting when Mr. McMahon came to you and said there are serious problems?

Mr. SKILLING. Mr. Chairman, I remember the meeting with Mr. McMahon, yes.

Senator DORGAN. And do you remember the meeting the same way Mr. McMahon describes it?

Mr. SKILLING. Well, you know, everybody—when you have two people that are in the same meeting, each will have a somewhat different recollection. This was about two years ago. It was my recollection that when Jeff came in, there was a concern about the conflict leading to an impact on compensation, and I've stated that before. I've stated that in the House.

And I mean that in no way in a derisory way to Mr. McMahon. He was raising an issue, his concern about compensation, because of this structural conflict issue that we had. As you know, we had procedures within the Board that the Board had approved to eliminate what we believed was the conflict of interest. When Jeff came to me, he was suggesting that he needed my support to ensure

that, in addition to the procedures that were in place, he would need my support to ensure that he was not damaged by this conflict.

It's my recollection that I assured him very strongly, very strongly, that I was totally on his side and that the way compensation was determined at Enron Corporation, it was determined by something called a performance review committee, and there are typically 24 people on the performance review committee. And I said, if Mr. Fastow is concerned, there will be 23 people in that room that are cheering you on, and I said it will not impact and I support you in your compensation.

Senator DORGAN. Well, Mr. Skilling, it seems to me that what Mr. McMahon is saying about that day is at odds with what you are saying when you say: I left that company, I had no idea there was anything going on that was a problem. It appears to me Mr. McMahon said he came to talk to you about these problems, and you are taking us off into a compensation issue. I understand that.

But we need to get to the bottom of it. I'll come back around with a whole series of questions, but it seems to me that this is at odds with what Mr. McMahon said the meeting was about. If Mr. McMahon, in fact, did represent these problems to you, I would like very much for you to tell the Congress: I was aware of them and did nothing. If that is the case, let us hear that.

Mr. SKILLING. Mr. Chairman, I absolutely disagree with that. I think—

Senator DORGAN. You disagree with Mr. McMahon?

Mr. SKILLING. Sir?

Senator DORGAN. You disagree with Mr. McMahon's statement?

Mr. SKILLING. No, I disagree with your statement, if you said that I heard that there were issues and did nothing about them. What I did in my recollection is I absolutely told Jeff that I would support him, as he asked. And I believe—actually, I didn't even remember this until the testimony in the House, I guess it was the testimony in the House, where Mr. McMahon mentioned that Joe Sutton visited him after that. I think I kind of vaguely recollect going to Joe and saying: "Can you please go in there and make sure that this is all taken care of?"

I actually vaguely remember also going to Mr. Fastow and putting him on notice that there was an issue here and asking him to do what he needed to do to ensure that this was not a problem for Jeff.

Senator DORGAN. I will inquire further about that.

Senator McCain.

Senator MCCAIN. I want to thank the witnesses for being here.

Ms. Watkins, you have described Mr. Skilling as an intense, hands-on manager and testified before the House Energy and Commerce Committee that he was aware of the Raptor transactions. Is it possible, in your view, that Mr. Skilling was not aware of the accounting improprieties of the partnerships that led to the collapse of Enron?

Ms. WATKINS. In my opinion, Mr. Skilling was aware of the problems. It was—the Raptors had to be restructured the first quarter of 2001, his first quarter as CEO. The Powers Report highlights that several people recollect that Mr. Skilling was putting this as

one of his highest priorities and had various individual meetings with people to see about that restructuring.

I'm certain that Mr. Skilling is right when he says he's not an expert on accounting matters. However, he did always look to the market as a checkpoint—rationale—to determine what we were doing. I think, in my opinion, he would be very aware that the hedges that we were achieving with Raptor could not have been achieved with an unrelated outside third party.

Senator MCCAIN. Mr. Skilling, I would be glad to give you an opportunity to respond to that statement by Ms. Watkins.

Mr. SKILLING. As I've said, I was familiar with the Raptor transaction as it was approved by the Board of Directors and understood in the terms that were presented to the Board of Directors how that transaction operated. I believed, based on the representations of our accountants, that this was an entirely appropriate structure. And I think there's a representation in the minutes very clearly to that effect.

When Ms. Watkins talks about a restructuring, or the fact that what I knew or didn't know, my only recollection of the restructuring of the Raptors is that I was told that they were restructuring the Raptors. I asked if the accountants had signed off on it, if it looked okay, and I was told that it was and went along with it.

Senator MCCAIN. Was it your responsibility to know?

Mr. SKILLING. Sorry?

Senator MCCAIN. Was it your responsibility to know?

Mr. SKILLING. As I said, Senator, I am not an accountant. These are highly, highly—I think if you'll look in the October minutes at the structure of Raptor, this is a complex, complex structure, and it took, I think, quite some time for Arthur Andersen. As I recall, this was even taken to the Arthur Andersen technical group in Chicago because it was so technical. And they signed off and said that they thought this was an appropriate accounting treatment.

Senator MCCAIN. I'd like to move to the issue of broadband. Are you familiar with Mr. Scott Bolton? He was the manager of government relations.

Mr. SKILLING. I'm sorry, I don't recall him.

Senator MCCAIN. Well, on March 9, Blockbuster and Enron officially called off their movie-on-demand partnership. Do you recall that?

Mr. SKILLING. I don't recall the exact date, but I do recall the Blockbuster transaction unraveling, yes, sir.

Senator MCCAIN. And you remember that the stock price dropped after that?

Mr. SKILLING. I'd have to go back and look, but that's probably right, yes.

Senator MCCAIN. At the Board meeting on March 16 following the March 9 calling off of the partnership with Blockbuster, you noted that analysts and portfolio managers in Boston had questioned you on the decline in the telecommunications market and how it would affect Enron's broadband business. You told the Board that "the development of the business would be slower than originally expected." Do you recall that?

Mr. SKILLING. No, I don't recall that specifically.

Senator MCCAIN. You do not recall that. About the same time, according to Mr. Bolton, you flew to Portland, Oregon, to meet privately with Enron broadband executives and employees. You told him the business “faced a ‘complete meltdown,’” Bolton recalled. There was no demand for high speed internet services and prices were plummeting. Do you recall that?

Mr. SKILLING. What was the date on that, sir?

Senator MCCAIN. Some time in March of 2001.

Mr. SKILLING. March of 2001. Yes, I recall a trip to Portland.

Senator MCCAIN. Do you recall saying that the broadband business faced a “complete breakdown”?

Mr. SKILLING. I think the actual term that I used was that the broadband industry, the high speed data interchange industry, was facing a meltdown. At that time, we believed that that might have been positive development for Enron, because as prices dropped we believed there would be more capacity available to create a traded market in bandwidth.

So we believed very strongly that, in fact, our entire strategy—and people talked about our strategy in broadband—our strategy was predicated on a bandwidth glut. We were a low or modest asset investment strategy, assuming that we could create a market and a tradeable market for broadband. So as this market price started to decline late in the first quarter of 2001, quite frankly, we thought that was a good sign.

Now, the other side—there were two sides of this. That was the trading side of the business, the merchant side of the business. I believed that that would be beneficial for the trading and merchant side of the business. The content side of the business, which is what you’re reacting to or asking about as it relates to the Blockbuster business, the reason the Blockbuster arrangement terminated was that Blockbuster was not able to get some of the content that we thought that they would be able to provide us and we believed we could get that content more effectively by directly contacting the studios.

So it was our belief at that time that we would be able to get the content; we just had to go direct to the studios rather than working through Blockbuster.

Senator MCCAIN. And in New Orleans at the end of the month, you said publicly that the broadband operation was going full-speed, “pedal to the metal.”

Mr. SKILLING. Yes, sir, and we believed very strongly that the traded market, the market of creating a commodity market from bandwidth, was progressing well, was progressing much—

Senator MCCAIN. Was that an accurate assessment?

Mr. SKILLING. The market was progressing much more quickly than the electricity market that I had also been involved in the starting of back in the mid-1990s. So I felt pretty good about the rate of progress.

Senator MCCAIN. Has your good feeling been substantiated by subsequent events as far as broadband is concerned?

Mr. SKILLING. No. Subsequent to that—in fact, in the next several months—this meltdown began to have some very, very serious consequences for credit of counterparties in the marketplace. It got

to the point that you could not sign a long-term deal for bandwidth because there were no creditworthy counterparties.

That is what hurt our business, and at that point we significantly retrenched, cut our capital budget by I believe 75 percent, and began redeploying people. In fact, I believe Ms. Watkins, the reason that she moved from the telecommunications business to Mr. Baxter's area is that we were trying desperately to move our people out of the broadband business once we realized that there was a serious credit problem there that we just really couldn't contain.

Senator MCCAIN. I see that my time has expired, but I want to point out that I understand you told the Board that business would be slower than originally expected, then you went to Portland and said that there would be a complete meltdown, but in New Orleans you said the broadband operation was going full-speed "pedal to the metal."

Mr. SKILLING. Mr. Senator—

Senator MCCAIN. I find those statements contradictory.

Mr. SKILLING. They're not contradictory.

Senator MCCAIN. If I could finish before you respond. And certainly not in keeping with subsequent events, which prove your statement about a complete meltdown throughout broadband was far more accurate than "pedal to the metal."

Mr. SKILLING. Again, I don't think that the concepts are inconsistent at all. We believed—in fact, you can go back further in time and look at all of the representations that we made to analysts—that our strategy in the broadband business was predicated on a glut in bandwidth capacity. You can talk to anybody in the industry. We were the first people to talk about that.

There was a meltdown. Prices were collapsing, starting in kind of that March timeframe, March of 2001. That we believed was exactly what we had predicted, exactly what we had projected, and we thought that that would lead to the growth of the market.

We built the natural gas wholesale business at a time when gas prices were plunging. We built the electric business at a time when electricity prices were plunging. That is not at all inconsistent with the view that we were going to aggressively build this wholesale side of the business, because it was turning out the way we expected.

Now, subsequently, it went from a meltdown to—I don't know that anybody has seen in the history of business—I'm kind of a history of business buff. I'm not sure there has ever been an industry in history that has experienced the change of fortunes that has occurred to the long distance fiber optic business in the last year-and-a-half. That was unforeseen. It went a lot further. And we reacted very quickly to it. By July, we began a significant—June, we began a significant reduction in our capital budget and started moving people as best we could out of that business into other growing Enron businesses.

Senator MCCAIN. My time has expired. I thank you, Mr. Chairman. I thank the witness.

Senator DORGAN. Senator Fitzgerald.

Senator FITZGERALD. Thank you, Mr. Chairman.

Mr. Chairman, I have an advance copy of an article that is going to be published in *Vanity Fair* magazine in their April 2002 edition. It is by Marie Brenner, and I am wondering if I could introduce this into the record. I would like to examine the witnesses about this.

Senator DORGAN. Without objection.*

Senator FITZGERALD. Thank you.

Mr. McMahon, the article that I have just introduced in the record describes some transactions that occurred within Enron back in the late 1980s and it is my understanding that at that time you were employed with the firm of Arthur Andersen. Is that correct?

Mr. MCMAHON. I'm not sure what time period you're talking about in the 1980s, but I was employed with Arthur Andersen from I believe 1982 to 1988 or 1989, somewhere around there.

Senator FITZGERALD. Were you, while you were at Arthur Andersen, involved in an investigation into some misappropriated funds at a company called Enron Oil?

Mr. MCMAHON. Yes, I was.

Senator FITZGERALD. According to Marie Brenner's article in *Vanity Fair*—and Marie Brenner is a Columbia University adjunct professor—the issue with the company in 1987 involved the misappropriation of moneys by two traders at that Enron subsidiary, Enron Oil, and that both the Enron auditors and the Arthur Andersen auditors who looked into the matter were in complete agreement. The auditors adamantly told Mr. Ken Lay that the two rogue traders should be fired.

Is that your recollection, Mr. McMahon?

Mr. MCMAHON. My recollection of that—it's quite some time ago—I was a manager at Arthur Andersen on that subsidiary audit of Enron, which was in New York. And my recollection is that we found that the senior management of that organization had been misreporting its trading activities to the parent in Houston, the corporate parent. We did issue a report expressing the breakdown of controls and the concerns we had. I don't recall whether the report suggested that the senior management should be terminated, but I believe they were terminated the day the problems were discovered, is my recollection.

Senator FITZGERALD. Well, this article claims that the auditors recommended to Lay that the two rogue traders be fired and it was instead decided that those involved would be kept on the Enron payroll. They eventually wound up being convicted of various crimes such as fraud and tax evasion and served jail time and probation time. According to a former Enron auditor quoted in the article, "Lay read the report and he read his budget and estimated how much they, the two rogue executives, made and if they were fired what he could lose. My conclusion was that this guy is a guy who puts earnings before scruples rather than reacting to the dishonesty right in front of him."

But you, Mr. McMahon, you do not have any recollection of both the Enron internal auditors and Arthur Andersen auditors recommending that the rogue traders be fired?

*The information referred to has been retained in the Committee files.

Mr. MCMAHON. My recollection, Senator, is that they were fired as soon as the problems were discovered, because I spent most of my year up in Valhalla, New York, that year, and the two top executives that were accused of this were not in the office.

Senator FITZGERALD. There was not any period of time that they were kept on the payroll after it became clear that there had been misappropriation of funds?

Mr. MCMAHON. Actually, I don't know how long they were kept on the payroll. They certainly were not operating out of that office once the auditors got there.

Senator FITZGERALD. So you did not draw any conclusions about Mr. Lay from that incident?

Mr. MCMAHON. No. I think our view at the firm at the time was that this was, in fact, rogue traders who had violated a corporate policy, and ultimately, that business unit was shut down by Enron, as I recall, and rolled under another senior executive based in Houston.

Senator FITZGERALD. Mr. Skilling, I appreciate your testifying today. You made it quite clear in your testimony before the House and again this morning that you were aware of no accounting improprieties and that you relied on the representation of Enron's auditors, Arthur Andersen, your accountants, in telling you that the accounting was appropriate for the Raptors transactions. And you were aware of the Raptors transactions, but you believed the accounting was appropriate. Is that correct?

Mr. SKILLING. I was aware—yes, that is correct.

Senator FITZGERALD. Were you, on the other hand—leaving aside whether the accounting was appropriate—were you aware that the structure of the transactions entailed a degree of risk for Enron?

Mr. SKILLING. No, sir. What was presented to the Board and the general concept, as I understand it, of the Raptors was that there would be an entity established, there would be value put in the entity, we would attract third-party equity capital into that entity, and that entity would write a derivative that would basically hedge some of our high technology—

Senator FITZGERALD. What was your understanding of how the Raptors were capitalized?

Mr. SKILLING. There was third-party equity from the outside.

Senator FITZGERALD. Entirely with third-party equity? That was your understanding?

Mr. SKILLING. No, it was my understanding that there was some Enron equity involved.

Senator FITZGERALD. What was the Enron equity?

Mr. SKILLING. I don't know, sir.

Senator FITZGERALD. You didn't know? You didn't know what—did Enron put its own stock into the Raptors?

Mr. SKILLING. I believe if you go back to the Board minutes where it was approved, that would have laid out in detail what the specifics—

Senator FITZGERALD. And you were aware Enron had issued its own stock to the Raptors, were you not?

Mr. SKILLING. You cannot issue stock to the Raptors without having approval of the Board of Directors, is my understanding.

Senator FITZGERALD. So you were aware of that?

Mr. SKILLING. If it's in the minutes.

Senator FITZGERALD. You were aware that Enron had issued its own stock. And they issued a lot of stock, did they not, to the Raptors?

Mr. SKILLING. I don't know, sir.

Senator FITZGERALD. Did you ever look into it?

Mr. SKILLING. As I said, I had no reason to think there was a problem. My accountants and internal people told me that the hedges were in place and good.

Senator FITZGERALD. If they had come to you and said they had to double the amount of Enron's allowable outstanding shares so they could issue them all to the Raptors, would that have concerned you?

Mr. SKILLING. I think if they had come to me and said that, probably my first question would have been, is this okay, are the accountants okay with it? If they said it's fine, I probably would have said okay.

Senator FITZGERALD. So you did not see issuing stock as being at all risky to capitalize the Raptors with even an unlimited amount of Enron stock?

Mr. SKILLING. See it as risky? Quite frankly, as long as the accountants had told me that they thought this was an appropriate structure, I felt comfortable with it.

Senator FITZGERALD. As long as the accounting was okay, you weren't concerned about risk? Risk is something different than the accounting.

Mr. SKILLING. Well, no, sir. Senator, I think you can ask anyone, you can ask everyone sitting at this table. If there was anybody that was concerned about protecting the company against economic risk, it was me. I absolutely was concerned about protecting the company from risk.

Senator FITZGERALD. But you saw nothing risky in issuing even an unlimited amount of Enron stock to these other entities?

Mr. SKILLING. I thought the transaction was an appropriate transaction, Senator.

Senator FITZGERALD. I am not asking whether it is appropriate. I am asking whether—

Mr. HILER. Senator, with all due respect. Senator, I am sorry. I apologize for interrupting, but I do not think he has testified that he did or did not see a problem with issuing an unlimited amount of stock. He is trying to give you his best recollection, and he has said that whatever the minutes reflect, he probably would have heard. And I think he can tell you whether he has a recollection of an unlimited amount of stock or a little stock or however much stock was going to be issued, as long as he has a recollection of it.

Senator FITZGERALD. I just want to nail down: In your mind, was it—not whether it was appropriate or not from an accounting standpoint, but was it risky at all to issue Enron's own stock to the Raptors?

Mr. SKILLING. Again, it was my understanding that the purpose and the function of the Raptors was to provide hedges for highly volatile technology investments that we had made. So I believed that we were reducing the risk to the company absolutely.

Senator FITZGERALD. Even though it was backed by Enron's own stock?

Mr. SKILLING. There was third-party equity involved as well, Senator.

Senator FITZGERALD. But that was a small percentage, was it not?

Mr. SKILLING. Again, I know what the concept was that was presented to the Board of Directors. I was not involved in the specific negotiations of the structures, the pricing of the structures. I was under the impression, as were many people in the company, as was the Board of Directors, that this was a hedge of those highly volatile technology investments.

Senator DORGAN. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Skilling, in my opening statement I went through the barrage of warnings that you seem to have gotten from high-level insiders at Enron. I would like to ask some more about what happened after Mr. McMahon warned you. You said this morning that you went to Mr. Fastow. Did you specifically in that conversation with Mr. Fastow talk about the conflict of interest questions in the partnerships that Mr. McMahon talked about?

Mr. SKILLING. Mr. Senator, you said that I'd received a bunch of warnings. I don't recall any of these being—the ones you mentioned, quite frankly—being in the form of a warning.

Senator WYDEN. All those people who said that they were warning you. Ms. Watkins—I went through—

Mr. SKILLING. Ms. Watkins did not talk to me, Senator.

Senator WYDEN. Well, Ms. Watkins said, and I quote here: "Ms. Watkins said that Clifford Baxter told her that he met with you repeatedly to express his concern about the partnerships."

Mr. SKILLING. In my House testimony I've been very clear on my recollection of the discussion that I had with Cliff. As I mentioned in that discussion, Cliff had expressed—Cliff and Andy had a—they didn't like each other. They had a very strained personal relationship, and Cliff's issue had nothing to do with the appropriateness or inappropriateness of the transaction. It had everything to do—

Senator WYDEN. Let us talk about your conversation with Mr. Fastow about whether conflicts of interest at the partnerships were mentioned after Mr. McMahon came to you.

Mr. SKILLING. I'm sorry; say again?

Senator WYDEN. Were conflicts of interest discussed with Mr. Fastow after Mr. McMahon came to you and raised those questions specifically?

Mr. SKILLING. We discussed the conflicts of interest embedded in LJM at virtually every Board meeting of the company, and most of those were subsequent to that meeting. That was in March 2000. That was very early in the process.

There were very few transactions in the LJM transaction or in the LJM structure. So we had lots of discussions and they are documented in the Board of Directors meetings—minutes.

Senator WYDEN. Well, I am concerned because after Mr. McMahon stated his concerns, you continued to put a lot of confidence in somebody who seems to be at the heart of the conflict questions. I think what I would like to ask you is what did you see

in Mr. Fastow that made you have faith in him that he could resolve these questions and protect the interests of all concerned?

Mr. SKILLING. Senator, you can look at the minutes of the October 1999 Board meeting and Finance Committee meetings. We dealt explicitly with the issue of conflict of interest created by the LJM partnerships and put in place a system of controls to offset those conflicts, and I felt comfortable, as did the Board, that those conflict control mechanisms were in place.

Jeff raised a different issue in my mind. The issue was related to how these conflicts of interest might impact compensation of people in his position. I assured Mr. McMahon that it would not impact his compensation, and I think subsequent to that, as I've mentioned—and again, I have only a general recollection of this—I believe I did talk to Mr. Sutton, who was Vice Chairman of the company, and asked him to look into the concerns, any other concerns that Jeff had related to that. And I talked to Mr. Fastow and put him on notice that there had been a complaint and that I expected him to deal with it.

Senator WYDEN. Mr. McMahon, my understanding is that your concerns went to conflicts of interest at the partnerships and not just conflicts of interest involving this compensation issue. Could you clarify that?

Mr. MCMAHON. The meeting I had with Jeff was—again as he indicated, the Board had approved the conflict of interest existing. My issue was really the process internally on how that conflict was managed. You had the CFO of the company who had a personal interest in a partnership outside the company.

People who worked for him were negotiating both on behalf of Enron and on behalf of the partnership, and it created not only a conflict at the CFO level, but it created conflicts within the organization because that CFO had a very large impact on their compensation, on their promotion capabilities, et cetera, et cetera, et cetera.

So that was my discussion with Mr. Skilling, was how that conflict between Mr. Fastow and his partnership manifested itself within the day-to-day operations of the organization. So my issue was process-driven more so than anything else, Senator.

Senator WYDEN. Do you want to respond to that, Mr. Skilling? Because it seems to me that when Mr. McMahon brings you a fundamental issue about conflict you go to the person who has got the biggest conflict.

Mr. SKILLING. I concur with what Jeff just said. He came to me with a process issue and raised some issues about compensation. I believe that I had resolved that by telling Jeff I would totally support him in the compensation issues related to this.

On the issues of people negotiating, or what I might call logistics of the process—as Jeff said, he was concerned about the process—again, I recall I spoke to Mr. Sutton, who was Vice Chairman of the company, and asked him to get with Jeff and see if we could deal with that. Now, in addition to that, I did go to Andy and put Andy on notice that a problem had been raised and I expected the controls to be operated effectively. That's my best recollection of what happened, Senator. I believed we addressed the problem.

Senator WYDEN. Now, in the meetings of the October 6 Board-Finance Committee discussion, Mr. Fastow discussed how to mitigate potential conflicts and “Messrs. Buy, Causey, and Skilling approve all transactions between the company and the LJM funds.” Did you approve all the transactions?

Mr. SKILLING. No, sir.

Senator WYDEN. Now, Jordan Mintz, an Enron lawyer, testified that he tried to get you to sign approval sheets for the LJM deals and reminded you that your signature was required. I understand that you have said that you did not believe that your signature was required; is that correct?

Mr. SKILLING. Well, you’ve asked a couple of questions there. One question was what did Mr. Mintz say. Frankly, I don’t believe that is Mr. Mintz’ testimony, so I’d like you to give it to me again.

Senator WYDEN. That was the testimony.

Mr. SKILLING. Can you give it to me again? Do you have a specific reference, sir?

Senator WYDEN. He testified that he tried to get you to sign approval sheets for the LJM deals and reminded you that your signature was required.

Mr. SKILLING. Do you want to—can we bring forward and pass out to the Members of the Committee Mr. Mintz’s specific memo? Also, Mr. Mintz had another memo, which I have seen subsequently. And by the way, I also thank the staff of the House committee, because I think they have done a pretty good job getting documents, and it’s been interesting to see a lot of the documents.

But there are two memos from Mr. Mintz. The first one lays out what the process is that the Board approved, and if you would like a copy of that I’d like to send it to you.

Senator WYDEN. All right, let us do this, Mr. Skilling. Even if you did not believe your approval was required—

Mr. SKILLING. My approval, Mr. Senator, was not required. In the October 1999 Board minutes there is a very, very clear description of what the approval process is, and my name is not on it. Now, subsequent to that, as Mister—and I think you’ll see it in Mister—would you look at this, rather than—

Senator WYDEN. Sure.

Mr. SKILLING. This is an LJM approval process sheet. This is to Messrs. Buy and Causey, March 8, 2001. So this is subsequent. This is March 8, 2001, subsequent to the October Board meeting. The title of this memo is “LJM Approval Process—Transaction Substantiation.” And this is from Jordan Mintz.

The thing says, and here’s what it says. They have an “Overview” and it says: “In order to address these three critical and overlapping concerns”—the concerns basically related to conflicts of interest—“the Board has previously approved the following procedures and controls.” Now, this is the head of Global Finance, legal:

Number 1: “Enron and LJM are not obligated to one another to transact.”

Number 2: “Enron’s Chief Accounting and Risk officers are to review and approve the terms of all transactions Enron or an affiliate enters into with LJM.”

Number 3: "The Board's Audit and Compliance Committee shall annually review all transactions completed that year and make any recommendations they deem appropriate."

Number 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 affect the best interests of the company."

Period. That is the process. This is the head of the legal department of Enron Global Finance laying out what the Board procedures are. That's what the Board procedures are. Subsequently, there was an LJM subsequent or supplemental approval sheet that was come up with, and oftentimes or sometimes they had my name on that sheet.

Mr. Mintz did not deliver those sheets to me. If Mr. Mintz had delivered those sheets to me and if I had looked at them and I saw Mr. Causey's signature and saw Mr. Buy's signature and saw the appropriate signatures within the company, I absolutely would have signed those and had no problem whatsoever in signing them. I did not receive those documents.

Senator WYDEN. My time is up for this round, but I want to finish with just one question, because it looks to me when you examine the minutes and all of these associated other documents that you had a responsibility as the Chief Executive Officer to understand who was specifically designated by the Board to police Mr. Fastow's activities. Do you disagree that you were given that responsibility as Chief Executive Officer?

Mr. SKILLING. I can't be any more clear about this. You say going through the minutes and going through the documents. Well, let's go through the minutes and let's go through the documents. We did that. I just told you.

Senator WYDEN. I will tell you, having read from the minutes specifically, it says Messrs. Buy, Causey, and Skilling are to approve all transactions with the LJM funds.

Mr. SKILLING. Okay, now back up. Back up. That is the October 2000 Board meeting, is it not? This is Mr. Fastow's representation of the process that was in place. I believe it's a Finance Committee meeting, is it not?

Senator WYDEN. Right.

Mr. SKILLING. And who is making that statement?

Senator WYDEN. I just gave it to you.

Mr. SKILLING. No, who made the statement?

Senator WYDEN. According to the minutes, Mr. Fastow.

Mr. SKILLING. Mr. Fastow represented that that's what the process was. Mr. Fastow was in error. I've got something here from the General Counsel of Global Finance that lays out in absolute clear, clear specific terms what that process was. If you go back to the October 1999, minutes for the Board of Directors where LJM was approved, you will find that that process is very clearly specified, and it's the process I just described to you.

Senator WYDEN. Mr. Skilling, any way you parse this, you had the responsibility as the CEO to watchdog this area of conflicts and I see absolutely no evidence that that was done, in spite of this small barrage of warnings.

We will have another round.

Mr. SKILLING. Mr. Senator, may I respond to that? Mr. Senator, we had two organizational units that were charged with reviewing these LJM transactions and the conflicts generated. One was our internal accounting group. We had 600 lawyers in that internal accounting group. Our Risk Control Group under Rick Buy, we probably had 250 people that worked in that organization. They reported directly to the audit committee of the Board of Directors.

Did I feel comfortable that these transactions were being properly vetted by those two huge organizations? Yes, sir, I did. Did I feel that the process that was in place was an adequate process to eliminate these conflicts of interest? Yes, sir, I did.

Senator DORGAN. Senator Cleland.

Senator CLELAND. Thank you very much, Mr. Chairman.

Mr. Skilling, I am going to give you what in basketball terms is just a free throw here, just a free shot.

Mr. SKILLING. Thank you.

Senator WYDEN. I am just trying to understand all of this. Just literally here, not as an expert in your business—you all are—not as a business person, but as somebody who does represent hundreds of thousands of people, people in my state, that were hurt by actions taken at Enron and by the Enron implosion, on behalf of my school teachers, on behalf of my state employees, on behalf of Enron employees who went bankrupt because they put their 401(k) and life savings into Enron stock and are now sacking groceries at Kroger. On their behalf: In your opinion, what happened to cause this collapse?

Mr. SKILLING. Boy, I'll tell you, I appreciate the question, and I'm surprised that more people haven't asked the question before. I believe that this was a classic run on the bank. There is a problem that I believe is what the economists call a systemic problem that's in our economy today, that I think you all ought to be addressing. What the systemic problem is is there is something called MAC clauses that have started creeping into financing in all levels of organizations in all sorts of different financial transactions.

The derivatives business—you are all familiar with the derivatives business. Worldwide it is probably a couple hundred trillion dollars of contracts that are outstanding. Most of those contracts conform to ISDA standards. ISDA is the International Swap Dealers Association. All of those contracts have something called a material adverse change clause in them.

What's happened is that in the old days, in the 1880s, when there was a run on the bank, it was the bank that went under. What happens now is the banks can pull their money out of a company that is threatened, and if somebody walks in claiming an accounting fraud, is tantamount to walking in, in the business world, is tantamount to walking into a crowded theater and screaming "Fire." Everybody runs for the exits.

And there are these triggers in all of these financial contracts, in all of these loans, that mean that even a modest problem that can be dealt with—these are not big numbers in the grand scheme of Enron Corporation if we had time.

This is my hypothesis. I wasn't there. But I think if the company had some time and had access to some liquidity, I think the company would have been fine. And I think that's the issue. We have

allowed a change in the—when they set up the Federal Reserve Board, the Federal Reserve Board and deposit insurance was to try to keep runs on the bank—the reason you don't want to have a run on the bank is because if there was a run on the bank, the banks started pulling money out of the real economy and they stopped lending or they started taking back their loans.

We have it now automatically built into the contracts, material adverse change clauses, which means if anything happens to the borrower the bank can come in and pull their money back. You know the old story about the bear, the two guys talking about the bear? The one guy says: "If a bear comes, just run like hell." The second guy says: "You can't outrun a bear." The other guy says: "I don't have to outrun the bear; I just have to outrun you."

You have a situation where the banks get an automatic trigger and they start sucking liquidity out of a company. It is very, very difficult to replace that liquidity. If I were in charge of the world, probably what I would do is I would mandate that federally-insured deposit institutions have to strike those contract structures from their lending and from their swap agreements.

I think this is—it's my hypothesis. You may look at it and find out it's just totally not true. But it was a run on the bank. It was a liquidity problem.

Senator CLELAND. But are we not talking a little bit more than about George Bailey, Jimmy Stewart, and "It's a Wonderful Life"? I mean, we are talking a little more about that than I think you admitted to.

Do you see any problem with the whole Andersen relationship that seems to have been part of the whole systemic problem that you describe, so that the people that are supposed to be outside the tent checking the people inside the tent were inside the tent playing the game?

Mr. SKILLING. I, like many other people, relied on the advice that I got from Arthur Andersen. If there is an issue there—and I know you all are looking at it—I think that is clearly something that should be looked at.

Senator CLELAND. Ms. Watkins, you have seen this from the inside. You had guts enough to write a memo. You have described Enron leadership, the leadership culture there, as arrogant, intimidating, but you had enough courage to fight through that. What is your understanding of what went wrong at Enron?

Ms. WATKINS. The accounting questions—on October 16 when we had what was virtually an unexplainable income statement writedown, as well as a \$1.2 billion reduction of shareholders equity, those were related to the Raptor transactions, to LJM2. It was not a typical writedown, where you've paid too much for an asset, it's not worth what you paid for it, and you write it down. It was really effectively unwinding these Raptor transactions.

In my opinion, we could not explain it to the investor community, because to do so would highlight the fact that we really probably needed to restate earnings in 2000 and the first part of 2001.

I think Mr. Skilling is correct that what killed the company was a run on the bank. I don't know that it was from bankers. I think it was actually from our trade creditors, the people that we owed money under gas contracts and power contracts, that closed out the

contracts and requested their cash. They were uncertain about our future. They had a legal right to close those contracts and so they did.

I stated in my earlier testimony, I think if Mr. Lay had been able to recognize the gravity of financial statement manipulation and the loss of trust in the investor community when there's even a hint at financial statement manipulation, he would have better planned for the ensuing crisis that hit the company. We, I believe, went into that crisis in late October totally unprepared. We did not shore up any kind of equity or debt financing. There was a run on the bank. I think we went through billions of cash in a very short period of time, and once we lost our investment grade rating two large tranches of debt became immediately due, and that was the end.

Senator CLELAND. Teddy Roosevelt once said that "the leader works in the open and the boss is covert. The leader leads and the boss drives." One of the problems that I saw initially with the Enron leadership was, as I said at the first hearing here, that in combat, officers eat last, but in this mortal combat of economic competition it seemed that the Enron officers ate first. This whole culture of intimidation of arrogance, covert operations, the off the books, this whole sense of not leadership, but bossism, do you think that got Enron in trouble?

Ms. WATKINS. Yes, I do, because I think it led good people astray in the fact that they did not question structures that they were not comfortable with. I think Senator Fitzgerald has mentioned this *Vanity Fair* article. I understand there are some quotes in that about Mr. Skilling's intimidating practices, and they're worth reading.

Senator CLELAND. Thank you, Mr. Chairman.

Senator DORGAN. Senator Burns.

Senator BURNS. Thank you, Mr. Chairman. I have just two questions.

Ms. Watkins, can you give me what and when triggered your concerns that the company was going down the wrong road; what heightened your concerns that the company could implode if they stayed on the same path? Could you give me a timeframe in there? What triggered your curiosity, what happened at what point?

Ms. WATKINS. Okay. When I was pulling together the economic analysis of our assets held for sale for Mr. Fastow, which began in mid- to late June and continued through August of 2001, there were a number of assets, most notably of ET and the New Power Company, that were hedged with Raptor. The hedged prices were not what the business units said Enron could achieve, and they explained the structure to me, explained that the structures were backstopped by Enron stock. Enron's stock price had declined and the Raptor entities were basically going bankrupt, and they were going to be unable to pay Enron the money that Raptor owed Enron.

Well, it concerned me greatly that you can never use your stock to affect your income statement. I believe that I—before I went to Mr. Lay, I actually also went to Rex Rogers, who is an Associate General Counsel for Enron Corp. under Jim Derek. I told him—I think this might also be in some of the notes—

Senator BURNS. Was that conversation before you had the conversation with Mr. Skilling?

Ms. WATKINS. I did not have a conversation with Mr. Skilling. I had a conversation with Mr. Lay on the 22nd.

Senator BURNS. Okay.

Ms. WATKINS. But when I talked to Mr. Rogers, I told him that when I found this in July my first reaction was to start to hunt for another job. I did not want to work for such an unethical company. My goal was to find a job and get up the courage to go talk to Mr. Skilling and tell him to stop this; he put this in motion; he needs to find a way of fixing it.

When he suddenly and shockingly resigned August 14, I felt compelled that I had to warn Mr. Lay that—Mr. Lay had no idea what was facing the company when this stock would have to be delivered to Raptor some time in 2002 and 2003.

Senator BURNS. Was that the only conversation you had outside your office with that counsel?

Ms. WATKINS. I also met with Mr. McMahon for an hour-and-a-half on August 21. That is when I discovered that Mr. McMahon had had a conversation with Mr. Skilling and that his concerns were not addressed. A few weeks later, he got a new job offer and felt like that was in his best interests to take that offer.

It's notable that Mr. McMahon's replacement was Mr. Ben Glisson, effectively letting the foxes into the henhouse. Mr. Glisson, as we all now know, was an investor in the LJM partnerships.

Senator BURNS. My question now kind of addresses the concerns that most of us around here have, in that we all had organizations in our own states that lost money. And as I made in my statement—the point of my statement—I think we should be looking here to the outcome of this.

Mr. McMahon, you said that there is a chance that Enron can survive and regain some position in the corporate world, that it could survive. What do you point to to base your conclusion?

Mr. MCMAHON. The conclusion that—or the facts that I point to—to base that conclusion on are several. Well, first off, let me state, if there is a reorganized entity here, it will look nothing like its predecessor. For all intents and purposes, the entire merchant business—energy business—of Enron is gone. It was sold recently through the bankruptcy court, and what's left is in wind-down mode.

So what we are looking to is to find the best way to maximize recovery for our creditors and other stakeholders. Both Steve Cooper, who is the CEO, and myself believe that it's a combination of selling certain assets as well as reorganizing around other assets, because we think potentially that there's a more—that there's a higher value creation or preservation in that scheme. And what to reorganize around is still being debated right now internally, but it's likely to be our pipelines and power stations that we have.

Senator BURNS. This may be inappropriate, but what are some of those assets?

Mr. MCMAHON. Well, what's left with Enron outside of wholesale, or outside the merchant business, are interstate gas pipelines. There's a utility in Portland, Oregon. And there's several utility-type assets in South America and Europe.

Senator BURNS. Has Enron completely separated itself from the broadband services?

Mr. MCMAHON. It's certainly in liquidation. We may still have some assets that are left, but they're on the market to be liquidated.

Senator BURNS. Thank you, Mr. Chairman.

Senator DORGAN. Senator Boxer.

Senator BOXER. Mr. Skilling, Senator Cleland gave you a chance to get a softball, and, if I might say, your answer stunned me. This was your chance to tell us what went wrong in the company, how you might do something different. And you know what you said? It's those MAC clauses—that stands for material adverse changes—that allowed the banks—federally-insured banks, Mr. Chairman—to pull out of this company. And you said if you ran the world, you would change that.

Well, you're a good, smart student of history, and we saw what happened during the Depression. That's when our predecessors decided it was important to federally insure banks. I want to say to you, if that's your answer, I hope no one on this Committee takes your advice, because we'd have banks going broke, and we'd have this government going broke because we would force them to stick with a company that was essentially a shell game, which apparently you didn't get. But your Vice President did. I am absolutely stunned with that answer.

When you answered Senator McCain—he was asking you a series of questions—you said: "This is very complex." This is very complex. One of the things I've learned, in years of getting batted around in politics, is that when somebody tells you, "This is very complex," you've got to dig behind that. How complex is it to know what was going on? I want to tell you, if you look at Ms. Watkins' testimony, she says it in a sentence, "My understanding as an accountant," she says, "is that a company could never use its own stock to generate a gain or avoid a loss on its income statement." Is that true?

Mr. SKILLING. Um.

Senator BOXER. Were you aware of that?

Mr. SKILLING. I am not an accountant.

Senator BOXER. I didn't ask you that. Is her statement true?

Mr. SKILLING. I think I'd have to be an accountant to know if it's true. I don't—

Senator BOXER. Wait a minute. You have to be an accountant to know that a company could never use its own stock to generate a gain or avoid a loss in an income statement. What was your education, Mr. Skilling? I know I read that it was pretty good. What—

Mr. SKILLING. I have a master's in business administration.

Senator BOXER. A master's in business administration. And yet you didn't know this simple fact. Is that correct? You're saying you were ignorant of that fact that Mr. Watkins has told us.

Mr. SKILLING. Well—

Senator BOXER. It's not complicated.

Mr. SKILLING. I'll give you two—

Senator BOXER. Even—

Mr. SKILLING. I'll give you two—

Senator BOXER [continuing]. Those of us up here understand very clearly.

Mr. SKILLING. Okay, well—

Senator BOXER. The company can never—

Mr. SKILLING. Well, just a second, Senator. Let me give you—

Senator BOXER [continuing]. Its' own stock to generate a gain or avoid a loss. And you're saying—getting your master's—and where did you go to school?

Mr. SKILLING. Harvard Business School.

Senator BOXER. Okay. In Harvard Business School, you did not know this. Is that correct?

Mr. SKILLING. I did not know that there is an absolute prohibition on it, because I—you know, I—again, I am not an accountant, but I know of at least one case where that's not true—at least one case.

Now, I'd also suggest that you go through Mr. Duncan's notes that he gave to Vinson & Elkins where he described the accounting rationale, and I think you'll find that he has a rationale. And if you want an example of a case where equity can be used—

Senator BOXER. That's okay.

Mr. SKILLING. No, Senator—

Senator BOXER. I—

Mr. SKILLING. Senator, may I answer the question?

Senator BOXER. Yes.

Mr. SKILLING. [Inaudible]. Answer, all right? There are cases where you can use equity to impact your income statement. And the most egregious, or the one that's used by every corporation in the world, is executive stock options. As a matter of fact, I think FASB [Financial Accounting Standards Board] tried to change that, and you introduced legislation in 1994 to keep that exemption.

Essentially, what you do is you issue stock options to reduce compensation expense and, therefore, increase your profitability. That's one exception. So that is clearly a case where equity can be used to impact your income statement.

Are there other exceptions? I don't know. I'm not an accountant. I would guess there are. If you read Mr. Duncan's testimony, I think he—he had a logic—he had a set of logic that was consistent with his view that this was an entirely appropriate transaction.

Senator BOXER. Yes, I think we understand stock options.

I wanted to ask Ms. Watkins—you said that you didn't want to go to Mr. Skilling. Why? What was your issue?

Ms. WATKINS. I did believe it would be a job-terminating move.

Senator BOXER. Say that again.

Ms. WATKINS. I believed that it would be a fruitless effort. And I believe that now even more than I did in late July and early August.

Senator BOXER. Why do you think that Mr. Skilling would have fired you?

Ms. WATKINS. I look at his actions, rather than listen to his words. I mean, I've learned on August 21 that Mr. McMahon went to Mr. Skilling with some very serious concerns. I've seen the notes from the House testimony. He talks about Andy wearing two hats, that his compensation from LJM could be quite high. His testimony is that Mr. Skilling said he would fix it.

Well, there is no evidence that he ever fixed it. In fact, he put Mr. Ben Glisson in charge of, sort of, guarding the henhouse, and that was letting two foxes in the henhouse.

Senator BOXER. So you figured because of what had come before, that had you gone to Mr. Skilling with this very simple statement that you made——

Ms. WATKINS. I——

Senator BOXER. By the way, do you stand by that despite what——

Ms. WATKINS. I do. I believe that Mr. Andy Fastow would not have put his hands in the Enron candy jar without an explicit or implicit approval to do so by Mr. Skilling.

Senator BOXER. Okay.

Mr. Skilling, you didn't have written testimony, but I took some notes, and your opening statement was extremely compassionate to the employees. I want to show you a tape—and I believe we have it ready to go—which was a meeting that took place in 2000. December? Is that the right date?

RECORDED VOICE: I'll be honest with you guys——

Senator BOXER. 1999.

RECORDED VOICE: [Inaudible]. Employees eligible for the employee referral program, and I don't know why they can't be. I don't know that that was ever determined. So I would say, yes, they are, absolutely. [Inaudible.] Should we—listen to this—should we invest all of our 401(k) in Enron stock? Absolutely. Don't you guys agree?

Senator BOXER. Okay. So that, at the end of 1999, you agreed, by laughing and shaking your head, that the employees should, in fact, invest their money in Enron. I think anyone seeing that would say that you were nodding in agreement.

Why is it that you had begun unloading your stock pretty heavily before that date, and yet led the employees to think they should keep buying stock?

Mr. SKILLING. Ms. Senator, I have been a major shareholder in Enron Corporation. I am currently a major shareholder in Enron Corporation. Enron Corporation has constituted virtually 90 percent of my net worth from the entire time that I worked for the company. I was a strong believer in Enron Corporation. Now, you can take the videotape to mean what you want it to mean. I was a supporter of Enron Corporation.

Senator BOXER. Yes, but——

Mr. SKILLING. I believed——

Senator BOXER [continuing]. How much had you unloaded by that point?

Mr. SKILLING. The term “unloaded” I think is a little bit of a——

Senator BOXER. Well, I'll say it in a more direct way. How many shares had you sold up to that point? How much of your own money had you pulled out of that stock at the time that you shook your head and said yes to the question, which was, “Should we buy—put all of our money—all”—and you know what happened to those people. They lost everything. You had a chance to be honest with them, and you shook your head, yes. How much, in your recollection, had you already sold?

Mr. SKILLING. As I—you know, obviously, I feel terrible about what happened to the employees. I think if you—if you—if we want

to do a dueling videos, also there's a videotape of an employee meeting two months later where I go, in pretty excruciating detail, what some of the issues are that the company is dealing with. I think I was open to employees, and I think as long as I was—

Senator BOXER. Okay, but you don't have the answer, so let me put it in the record. In 1999, the same year that tape was recorded—and you can look at it over and over again—you agreed—

Mr. SKILLING. I thought you said it was 2000.

Senator BOXER. This was in 1999—the end of 1999. By 2000—

Mr. SKILLING. You're saying this is December—

Senator BOXER. Yes.

Mr. SKILLING. December 1999?

Senator BOXER. Yes. I'll just put it in the record because my time is up.

[The material is not available.]

The insider records show you had sold more than 513,000 shares of Enron for \$22 million at a time when you were nodding in agreement for those people to put everything in their 401(k) into the company. I just want to get that in the record.

Senator DORGAN. Senator Breaux.

Mr. SKILLING. Excuse me. May I—I would like to see the basis for that number. You're saying in the year 1999—

Senator BOXER. Yes.

Mr. SKILLING. I sold 500,000 shares of Enron stock?

Senator BOXER. Yes. We have the records, sir. We'll send them over to you during the—

Mr. SKILLING. Right, and then we'll send you records, too, because I believe that that number's incorrect.

Senator BOXER. Okay. We'll show you the records.

Senator DORGAN. Senator Breaux.

Senator MCCAIN. Could I ask—

Senator DORGAN. Senator McCain.

Senator MCCAIN. Isn't it true that in the year 2000, you received \$5.6 million as a bonus; and in 1999, \$3 million as a bonus; in 1998, \$2.25 million as a bonus?

Mr. SKILLING. I don't recall.

Senator MCCAIN. You don't recall what you received as a bonus? \$5.6 million?

Mr. SKILLING. I don't recall. I'm sorry.

Senator MCCAIN. Thank you, Mr. Chairman.

Senator DORGAN. Senator Breaux.

Senator BREAU. Boy, I would have remembered mine.

[Laughter.]

Senator BREAU. Thank all of you for being with us.

Mr. Skilling, you said in your testimony that you are somewhat of a business history buff. Can you think of a bigger mess in business than we have here with the Enron situation in recent history?

Mr. SKILLING. In recent history? Or do you want me to go back in time? I think there have been a lot of times when there have been panics that have led to cascading problems in the economy, and I think you see some of the signs of that starting to happen here, as well.

Senator BREAU. But I mean by any measurement. This one of the biggest and largest business failures in terms of the size of the company and the number of people that have been affected, that I can certainly remember. I'm not a business history buff, but it seems to me that—

Mr. SKILLING. I just don't know, Senator.

Senator BREAU. Well, I think it's the biggest mess we've had in business failures in a long time because of the extent of the failures and the number of people and the number of states that have been affected by it and the fact that it's the subject of every talk show in this country today. I mean, we've got a mess on our hands, and how we handle it, I think, is incredibly important.

I'd like to ask you—I mean, Monday morning quarterbacking is generally not a good thing to participate in, but in this case I think that perhaps it could be helpful. You made a number of statements, Mr. Skilling, about, "I don't remember. I relied on advice of attorneys. I relied on the advice of Arthur Andersen," et cetera, et cetera, while you were President, Chief Operating Officer and CEO of Enron. Looking back at all of this, can you tell the Committee what you would have done differently during your period in those various positions?

Mr. SKILLING. Well, it—you know, I've said before—I've gone back and tried to think what I would do differently, given the facts I had at the time. And I—you know, quite frankly, I—there's nothing I can come up with and—that I would think I'd do different, given the facts I had at the time. That—obviously, there have been a whole lot more facts subsequent to—

Senator BREAU. Well, can't you look back and say, "Look, I would have instituted a system to make sure that—as the Chief Operating Officer—that I was given the facts?" You know, it's one thing to say that, "I didn't get the information that I should have."

Mr. SKILLING. Yes.

Senator BREAU. But as Chief Operating Officer, isn't it your responsibility—or CEO or President—to set up a mechanism to ensure that, in fact, you did get the information? It's not enough, I think, to say, "They didn't tell me." Why didn't you have a system that assured you, as Chief Operating Officer, that you were informed?

Mr. SKILLING. I believed we had a good control system in place. In fact, I think if you compare the number of people involved in our control system, the reporting structure for that control system, I think you'll find that it is far more invasive than any other company that I'm aware of. The company spent a lot of time on controls. It turned out that something went wrong.

And in retrospect, what I wish—you know, in retrospect, I wish I'd never heard of LJM. And—but at the time, with the facts we had, the information we had, it looked like something that was in the interests of our shareholders.

Senator BREAU. You mentioned that Enron's failure was due to a classic run on the bank type of situation that had developed. It seems to me if that's true, that you were one of the major contributors to the run on the bank by your abrupt resignation, and the selling of \$66 million worth of stock during a period when you were running the company and claiming the stock was undervalued. As

the Chief Operating Officer, you were selling huge amounts of stock while you were telling the general public and Enron employees that the stock is really undervalued.

Were you not contributing to the so-called run on the bank at Enron by your actions in selling your own stock and abruptly resigning?

Mr. SKILLING. We've talked about the reasons for my abruptly resigning. I resigned—I don't know that most people would characterize it as abrupt, but I resigned for reasons unrelated to Enron Corporation.

And so, in retrospect, you know, I've made clear that when this thing broke out, when we started to see the drain of liquidity in the company that occurred after, I believe it was, October 23, I called Mr. Lay and offered to come back to the company at no compensation to do what I could, if I could do anything, to help remedy the situation.

Senator BREAU. Ms. Watkins, thank you for being with us. You mentioned in the memorandum, the seven-page memorandum that you had sent out, that you were incredibly nervous "that we will implode in a wave of accounting scandals." I guess what I'm trying to figure out, did you think that the accounting structures that the company had entered into in all the offshore investments, the special purpose entities—if you read where they were located, it sounded like you were reading the United Nations' roll call or something. They were all over the world. Were you saying, when you suggested accounting scandals, that the structures themselves were illegal the way they were set up? What were you saying when you were talking about accounting scandals? I think that Mr. Skilling would say that Arthur Andersen said all these things were appropriate and proper and legal. So, what were you talking about when you talked about accounting scandals?

Ms. WATKINS. My concern was with the Raptor special purpose entities. Enron did use a number of offshore special purpose entities in structuring its international assets. I think those are fairly legitimate. Quite often it was to give us all kinds of alternatives—if we ever decided to sell the asset, that we had a subsidiary that might appeal to a European buyer or a U.S. buyer or an Asian buyer. My concern was with the Raptor special purpose entities.

And the problem that—when any company has doubts about whether or not it has manipulated its financial statements, it goes through a severe crisis. Waste Management had such a similar problem. But with Waste Management, if they're rolling down your street and picking up your garbage, you don't mind that they might be in financial trouble. You still pay them the monthly fee.

Our problem was that 90 percent of Enron's business was primarily trading, and that business could dry up in a heartbeat if our trade counterparties were not completely certain of our financial health. The problem is that a customer doesn't know whether they're going to owe us money or we're going to owe them money. It all depends on future gas and electricity prices. So that's why I felt we were particularly vulnerable to a financial accounting scandal.

Senator BREAU. Did you think that the structures, in particular, the Raptor structures, were improperly set up, or were you con-

cerned just about the risk it had put Enron at by participating in them?

Ms. WATKINS. My opinion was that it was—it could not be appropriate. I did vet my concerns with Mr. James Hecker, a former mentor of mine at Arthur Andersen. I spoke to him for approximately 48 minutes on August 20. I hadn't been in accounting for about ten years, so I wanted to make sure that the accounting rules hadn't changed materially since I was last in accounting. And his words to me were, "Any accounting treatment must be clearly defensible if fully exposed." And I felt like these Raptor transactions, if fully exposed—if fully explained to an investor, they would be horrified.

Senator BREAU. And that's what you conveyed to Mr. Lay?

Ms. WATKINS. Yes, and I also participated in a three-hour interview with Vinson & Elkins on September 10. Their interview notes from that were part of the documents released by the House. I've reviewed those notes. And in my opinion, Vinson & Elkins understood my concern about the crisis facing the company.

Senator BREAU. My final point is that it seems to me before all of this you had some of the finest and wisest advisors in the world working at Enron. Arthur Andersen's reputation prior to this certainly was excellent. The law firm of Vinson & Elkins has the same type of reputation. I just can't figure out how, with those advisors, not telling folks at Enron that, "Hey, you can't do this" seemed appropriate. You're paying them a lot of money to give you the best advice possible, and either they were not giving you the best advice, they were totally wrong, or they were so much part of Enron's culture that they were part of the problem, too. I'm not sure which it is.

Thank you.

Senator DORGAN. Senator Carnahan.

Senator CARNAHAN. Thank you, Mr. Chairman.

Mr. Skilling, Ms. Watkins just testified that you always look to the market for guidance. If so, why didn't the fact that the value of Enron stock had dropped by 50 percent not strike you as a problem? And how could you think that Enron, under those circumstances, was perfectly healthy when you left the company?

Mr. SKILLING. Well, Senator, I was, you know, clearly aware of the drop in the stock price, but there are things other than a drop in the stock price to make difference. I mean, the reason the stock price dropped—there were basically three reasons.

The first one was that the collapse in optical fiber stock started in March—February and March of the year 2001. We were viewed as a player in that optical fiber business, and that immediately hit our stock. The second thing was the litigation and temperature related to the India power facility, as I'm sure you've all heard, was growing in ferocity, and there was a great deal of controversy and noise about that, which also hurt the stock. And then the last thing, which I think probably was also important, because of the California power problems, there was a fear that the wholesale markets might put in price caps and re-regulate the natural gas industry, and I think that was viewed as negative for Enron in the long term.

Now, all of those things being said, on the inside, having looked at it, we made some tremendous progress in that time period. First of all, the broadband business, we had staunched the flow. You know, by the time I left, in August, we had significantly reduced the capital budget. We had redeployed a lot of people out of the business. So we had reduced the burn rate, and we felt we could wait it out—you know, that we could wait out this problem in the broadband business.

The India problem—the Prime Minister from India was visiting the United States in September, and there was some thought that he might offer a resolution of that problem that would be acceptable to Enron.

The third thing was that our wholesale business, which is really the core of our business, had had the best quarter in history. I mean, the wholesale business was doing extremely well and, from an earnings standpoint, just was extremely profitable.

So the outside world, I think, was seeing broadband, was seeing India and potential regulatory issues. What we were seeing inside is that we had solidified a lot of our businesses, and our core businesses were extremely strong.

Senator CARNAHAN. But how could you say that the company was in good financial condition when you left, under those circumstances?

Mr. SKILLING. I felt that having made the changes that we made in the broadband business, the strength of the wholesale business, the fact that we were potentially going to be resolving the India situation—all of those things made me feel that the company was in good shape. And I believed, when I left on August 14, that the financial statements of the company were an accurate representation of my understanding of what the financial condition of the company was.

Senator CARNAHAN. When you left, you never really gave a credible explanation—when you left in August. You claimed that you believe that the company was in sound financial condition at the time and that you simply left for personal reasons. Frankly, I don't find that a convincing argument. You had spent a decade working your way up through the company to this pinnacle of power. And yet, on August 14, just six months after you became CEO, you abruptly resigned. It looks suspiciously as if you realized that the company was coming apart, and you jumped ship.

Can you offer this Committee some explanation of what changed in your personal life in August that made you so determined to leave this dream job? Why did you not resign in June? Why did you not wait until October? Why was this the date selected?

Mr. SKILLING. I had personal reasons. You may not find them credible, but they are the reason that I left Enron Corporation.

Now, you say it was the perfect job. To be quite frank, I was tired. I was flat-out tired. This may be a perfect job for some people. It was not the perfect job for me. And there were a lot of people in the company that knew that I was tired and that this was not something that was particularly important.

I had issues in my family that were more important for me. I mean, I had spent, as you said, the last ten years of my life—I think most people at this table will tell you that my car was there

first thing in the morning, and my car was the last car to leave at night—I had spent ten years working very, very hard to build this company, and I had missed a lot. I had a clear imbalance in my priorities in life, and I had neglected some things that needed to be dealt with at that time.

That is the reason I left the company. I did not leave the company because I thought the company was in imminent financial danger.

Senator CARNAHAN. I have one other question. Mr. Skilling, I'm perplexed by your purported recollection of the meeting that you had with Mr. McMahon in March of 2000. Mr. McMahon claims to have told you that he could not continue to work with Mr. Fastow without compromising his integrity. You said that you believed that this was a conversation about compensation. If an employee comes to you and says that his compensation would be higher if he compromised his integrity, doesn't this set off some alarm bells for you? Why did you take no action to rectify the fundamental conflict that was raised by Mr. McMahon?

Mr. SKILLING. There is no time—no time when I've been at Enron Corporation when I have asked anyone to compromise their integrity. It just doesn't happen.

My interpretation—and again, this is just, you know, two people remembering a meeting—a half-an-hour meeting two years ago—my recollection is that Jeff said that he was concerned about the conflicts that were in place as it related to his personal situation, and he asked me for my support for him, and that, if I did that, he was comfortable doing what he needed to do to maintain his integrity. And that's my interpretation of it, Senator. It was a long time ago.

Senator CARNAHAN. Well, according to Mr. McMahon's notes, he—as his talking points to you, he says, "I find myself negotiating with Andy on Enron matters and am pressured to do deals that I do not believe are in the best interests of the shareholders."

Mr. SKILLING. Yes, and I've seen this note, and I think there are two pieces on this page. The first piece is, Jeff relates to an untenable situation. And I am sympathetic to the untenable situation. And he says, "Here are the requests or options." And there were two options that Jeff presented in this paper.

And again, I don't specifically recall this discussion. I just recall my impression or interpretation of what occurred in the discussion. But request for option number one was, "In order to continue to do this, I must know I have support from you and there won't be ramifications—believe it already has affected my compensation—or need to let me out of the situation and move to a different job." I personally—there is no question, given those two alternatives, that I would have suggested to Jeff that I would support him in any way possible for him to carry out any belief—any ethical duties or beliefs that he had as an individual.

I mean, that just—I don't think—I don't think my description of that session or that meeting is at all in conflict with Mr. McMahon. I think we both came out of it—I felt that we had discussed it, and I felt that we had resolved the issue, and I had called people to help resolve the issue. And Mr. McMahon did not come back to me

subsequent to that. Mr. Glisson did not come to me and say that they were having a problem.

As Ms. Watkins points out, Mr. Glisson, as it turns out, had an equity interest in one of the structures. I was not aware of that—I mean, absolutely not aware of that. So I would have expected, if Mr. Glisson had any concerns about any operation of the Global Finance group that he would have come to me, as well, and we would have sorted it out.

Senator DORGAN. The time of the Senator is expired.

Senator CARNAHAN. Thank you. I just fear that you reduced a conversation about character to a conversation about money, and that was my concern. I'm concerned that the bankruptcy of this company does not compare with the bankruptcy of character that occurred in the executive suite.

Senator DORGAN. I thank the Senator.

The Senator from Virginia.

Senator ALLEN. Thank you, Mr. Chairman. I'd like to follow up on Senator Burns' and Senator Breaux's very logical, commonsense statements and questions of you all so that we can maybe draw some conclusions here on what ought to be done in the future to prevent this. I'm not sure you can prevent bad business judgments, but at least let people understand and know what sort of investment they're making and assess for themselves the risks of various corporations in which they may wish to invest.

Now, Ms. Watkins, I'm not going to ask you for a legal conclusion, but do you believe that Enron engaged in accounting practices which, in effect, whether by design or otherwise, hid expensive or underperforming investments from investors by keeping these liabilities off the books?

Ms. WATKINS. My concerns were primarily with what I saw as income statement manipulation. I believe, in the memos that I gave Mr. Lay, I was concerned that Avici within Enron Broadband and the New Power Company, was hedged. That was an Enron Energy Services investment. By hiding the losses that those business units were achieving—or having occurred in those stocks, it made those two business units look more profitable for a longer period of time. It let us enjoy a very large multiple, because those were our growth businesses, for a longer period of time. And I believe investors were hurt by those income statement manipulations.

Senator ALLEN. Now, Mr. McMahon, per Ms. Watkins' memo, did you have any concerns regarding Enron's accounting practices and the use of these special purpose entities to move assets off Enron's balance sheet and, thereby, hide the debt obligation or the profitability of the company from investors? Did you have concerns about that?

Mr. MCMAHON. When Ms. Watkins showed me her memo, actually the items in there I was unfamiliar with, but the allegations that she made in that memo were concerning to me, and I encouraged her, as others did, to see Mr. Lay about it.

Senator ALLEN. At any point in this whole matter could anyone have stopped this from becoming a full-blown catastrophe?

Mr. MCMAHON. That's a difficult question. I think it goes back toward really what caused it and how could it have been prevented. And I became CFO of the company on October 24, when Mr.

Fastow left the company, so my perspective is somewhat limited here, but I would probably echo both Mr. Skilling and Ms. Watkins' testimony in that I think there was a big liquidity draw. I'm not sure what the cause was. I think there's still a lot of facts that are yet to come out about what happened at Enron and what the cause was.

But as—from my perspective, as a finance person, I saw a balance sheet—or a financial condition that was fairly weak and couldn't withstand much stress, and it was getting an awful lot of stress in the market at that point in time.

Senator ALLEN. Mr. Skilling, in your testimony, you said you relied on the advice of attorneys and accountants who told you that these special purpose entities and activities were appropriate. In other words, they were technically legal.

But again, let's get to the lessons learned. Mr. Skilling, do you actually think that during all of this, the true financial condition of Enron was being accurately reported?

Mr. SKILLING. First of all, I think you've made a suggestion or an insinuation that there might have been something illegal.

Senator ALLEN. I'm not saying it was illegal. Let's assume that everything, as far as accounting practices, auditing, and counsel was technically legal. Assuming that's so, were investors who were thinking to invest and maybe did invest in Enron stock getting a true picture of the financial condition of Enron?

Mr. SKILLING. I believe the financial statements were an accurate representation of my understanding of the financial condition of the company.

I'd like to address—as you brought it up, I'd like address one of those issues. There's been a lot in the press, and I think your question suggests, that there's some issue of hiding debt, that—the use of off-balance sheet or special purpose entities had its intent in hiding debt. And all I can do is—I can refer you to page 78 of the year 2000 10-K. There's a section that's called “unconsolidated equity affiliates.” Unconsolidated equity affiliates would be partnerships and special purpose entities that were not consolidated into Enron's balance sheet.

There's a two-page description of the earnings that were appropriate—or associated with those vehicles. And on the second page—

Senator ALLEN. Alright, let me interrupt.

Mr. SKILLING [continuing]. It shows the full balance sheet—

Senator ALLEN. What—

Mr. SKILLING. Senator, please.

Senator ALLEN. I just want—I want you to—

Mr. SKILLING. This chart shows exactly—exactly what the total amount of the outstanding liabilities were that were non-consolidated liabilities. So the whole issue of hiding debt, it's not an—it was in the 10-K. Anyone reading the 10-K would have a hard time missing this page.

Senator ALLEN. Okay. Thank you, Mr. Skilling. A lot of people must have missed it.

Now, to all three of you all—

[Laughter.]

Senator ALLEN [continuing]. What changes in law would any of you suggest—whether it's SEC regulations or rules, whether it's accounting or auditing standards—that would give investors better information?

Mr. SKILLING. Again, I think to the extent that we in management and shareholders relied on our professional accountants, to the extent that we were not getting accurate information from the accountants, for whatever reason, I think that certainly is worthy of investigation by this group.

I also believe that this group should look into this issue of liquidity and how that happened, because there was a serious, severe liquidity drain. And I think a lot of it was imbedded in these derivative contracts in the standard—is the forms that I think just—I don't think that's a real good idea.

I think we've got a systemic problem that's come in the last 10 or 15 years in this country, and we're now starting to see it spread. I mean, now they're going after IBM. They're going after GE. They're going after Computer Associates. They're going after Qwest. And it's okay to go after them and challenge their accounting. That's okay. But if, by doing that, you set off a chain reaction, a nuclear reaction, that drains liquidities from these companies, ultimately a lot of people are going to get hurt.

And maybe we can look at Enron as the canary in the mine field—or the coal mine. You know, they used to bring a canary down to see if there was—yeah. Maybe that's the issue, you know, and something that people ought to be looking at. I personally—I'm concerned about it.

Senator ALLEN. Ms. Watkins.

Ms. WATKINS. My personal opinion, as an investor in the U.S. stock market, is that the accounting firms and their clients have grown too cozy. And I understand there are proposals to limit the amount of auditing and consulting work. But my personal opinion is that I would feel better if public companies were required to rotate their accounting firms for periods as short as every three years.

Mr. MCMAHON. I like—I think—if there is an issue, I think that's something that certainly ought to be—three years might be a little bit tight, but—

Senator ALLEN. What about information, as far as these off balance sheet transactions?

Ms. WATKINS. I think that certain of the special purpose entities that are off balance sheet that have any kind of call back to the company that is of any significance—for instance, right now I think it is a very legitimate structure to pledge your stock as a backstop. You push assets off. You've got debt that should be non-recourse just to those assets in a special purpose entity. But it is currently acceptable to also put a call back into the company's stock and still have that be off balance sheet, and I think that rule needs to be looked at.

Senator ALLEN. Mr. McMahon, do you have any suggestions of improvements to inform prospective investors?

Mr. MCMAHON. Again, not speaking of any particular company, Enron or not, I believe financial statements are very difficult to read right now. I think it stems from management's discussion and

analysis, recurring and nonrecurring earnings, off balance sheet items scattered about the footnotes, guarantees, other places. If I were to recommend anything to this Committee, I would suggest some form of mechanism to improve and actually expedite the investor's ability to read and understand financial statements.

Senator ALLEN. Thank you, Mr. Chairman.

Senator DORGAN. Thank you.

Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman. I want to take the discussion, Mr. Chairman, in a different direction.

There were some 33 public pension funds that had a considerable loss as a result of the fall of Enron's stock, but one in particular that is my state, suffered the loss when the stock was dropping. I'd like to go back to the statement that both of you, Mr. Skilling and Ms. Watkins, testified to, that you thought that the problem was a run on the bank, the fact that the stock was dropping because banks were calling the loans, and you pointed out this material adverse change, or MAC.

So, on the basis of what you said, then it would seem—and also, I think you said something to the effect, Mr. Skilling, that if the company had had time, it would be okay. So the idea would be, as the stock was dropping, there would have been clearly an incentive from the corporate executives or Board members to want to get the stock price back up so the banks would not call in their loans.

So, as we're trying to get into this Florida situation, what I'd like to know from any of you, do you have any knowledge of any communication from the company, from its executives, from Board members, to any institutional investors, including Florida and the Florida Retirement System that said, in effect, "Help us. The company is going to be okay. Buy the stock now so it will get the price back up."

Let's start with you, Ms. Watkins. Do you have any information?

Ms. WATKINS. My concern was with how we fell so fast into bankruptcy has less to do with the stock price and more to do with our trade counterparty payables. We had approximately \$16 billion of receivables on our balance sheet as well as \$15 billion of payables. The problem that you have with uncertainty about our future financial health was that, on the liability side, those customers closed out their contracts—a number of them did—and demanded payment, and several billion dollars went out of the company in a very short period of time.

The only way to combat that is to quantify to the investing public what our problem is. What I wanted to see happen is that we would restate, come clean, explain our problems, accrue a large liability on the balance sheet for shareholder litigation—quantify the size of our problem for the market so that it would become comfortable that we had a life ahead of us and that they would, you know, cease to close out—or seek to close out the commodity trade payables with us.

Senator NELSON. Thank you for your opinion. Did you have any information of any knowledge, any information, any communication being shared from Enron, its officers, its principals, its Board members to institutional investors to buy?

Ms. WATKINS. No. No, I don't think so.

Senator NELSON. Mr. Skilling.

Mr. SKILLING. Senator, I left the company on August 14, so I wouldn't know what happened.

Senator NELSON. Yes, I understand.

Mr. McMahan.

Mr. MCMAHON. I have no knowledge of that kind of communication either.

Senator NELSON. Did you know a fellow named Frank Savage, Mr. Skilling?

Mr. SKILLING. Yes, sir. Mr. Savage is a Board member. I don't know if he's—I guess he's not a Board member now, but he was a Board member of Enron Corporation.

Senator NELSON. Were you aware that, back in August—up until about August, that he was a principal and officer in one of these outside money-management firms?

Mr. SKILLING. I can't tell you which one, but, yes, I believe he was in the money-management business.

Senator NELSON. Tell me about some of these partnerships. At one point, you all were not only going to finance energy, but you were looking into other commodities, including water. What was that all about?

Mr. SKILLING. Well, there were basically two businesses in Enron—three businesses in Enron. There were, kind of, the regulated businesses. There was our international development business. And there was our merchant business, our wholesale business. The rates of return on assets in the international business were not compensatory, and so we were trying to reduce the size of that business.

There was a team of people on the international side that believed that there was an opportunity to do much the same thing, but more profitably, in the water business. And so it was discussed with the Board that this would be an alternative, and we went into that—we decided to try that business.

Senator NELSON. And was there a fellow named Kinder that headed up that subsidiary for Enron?

Mr. SKILLING. No. Rich Kinder was President before I was President of Enron Corporation. The person that headed up the water business was Rebecca Mark.

Senator NELSON. And what was that water business, as it originally related to Florida and the Everglades restoration?

Mr. SKILLING. Oh, I don't know, sir. I was—actually, I was on the Board of the Zurichs, and I can vaguely recollect that they would share with us a number of different projects that they were interested in and that they were pursuing, and I—you know, I vaguely remember something in Florida, but I don't know the specifics.

Senator NELSON. So going back to my original question, I'll conclude with this, Mr. Chairman. With regard to any communication, whether you were at the company or not, your testimony is that you know of no communication from the company, under the conditions in which the stock was dropping in October, to purchase the stock by outside investors—in particular, institutional investors. Is that the testimony of each of the three of you?

Mr. SKILLING. Yes.

Ms. WATKINS. Yes.

Mr. MCMAHON. Yes.

Senator NELSON. Thank you, Mr. Chairman.

Senator DORGAN. Senator Hutchison.

**STATEMENT OF HON. KAY BAILEY HUTCHISON,
U.S. SENATOR FROM TEXAS**

Senator HUTCHISON. Thank you, Mr. Chairman. I apologize for being so late. I was the author of a bill called Transitions to Teachers and had an event with the First Lady this morning to announce a program in the District of Columbia. So I'm very sorry.

But I am advised by my staff that several of the questions that I had have been asked already, so I'm going to try not to duplicate questions. I would like to focus somewhat on where we are now and on the future, Mr. McMahon, since you are in charge now.

I have met with the Enron employees, and I've heard their concerns. Certainly I've listened to much of the testimony from other hearings, but this is my line of questioning today. And it is, what is the company doing now with regard to the employees who were not able to get even their severance pay?

Obviously, you have given retention bonuses to people to keep them, and that's not an illegitimate thing to do to try to keep the company going. But thousands of people were not even able to get the severance pay to which they were entitled under the company rules. They have no standing in court, I'm told, because they are the very last in line as an unsecured creditor.

Is the company going to try to give the severance pay that is owed to the former employees? Is that even on your radar screen?

Mr. MCMAHON. Well, there's no question. I think what's happened to, obviously, the former employees is a tragedy, and we are very concerned about that. The ability for the company to pay any amounts under severance is a matter of law. It's in the bankruptcy court, so it's not necessarily within our control.

We are looking at, from a legal perspective, what options we have and what ability we have to make some type of severance payments to the employees. That work is ongoing currently as we speak. That would ultimately have to be discussed with the Creditors Committee, as well, and then that would have to be approved by the court.

So it's a process that's not completely in the company's control. And as I understand it, as we've advised from the legal counsel, the severance plan that Enron had terminated upon the bankruptcy. And that's what has prevented us from making payments to the employees, as I understand it. And so we are exploring all the options we have, now that we're under the bankruptcy rules, to try and do something for these employees.

Now, above and beyond severance, we are holding some programs in Houston for job fairs and what-not, so we're doing everything we can as an institution, short of making these payments, which, at this point, we're prohibited from making.

Senator HUTCHISON. But you are looking at a possibility of trying to keep that commitment, if you can get the other creditors to work with you in the bankruptcy court?

Mr. MCMAHON. Yeah—

Senator HUTCHISON [continuing]. To those who were terminated by the bankruptcy?

Mr. MCMAHON. Correct. The way I would characterize it is, we're exploring all the options that we have as a company, under the bankruptcy laws, to be able to make severance payments. And once we finish that legal work, the analysis, we'll bring it to the Creditors Committee with a recommendation. But unfortunately—

Senator HUTCHISON. Are you going to make an effort to try to put them in a first-in-line situation rather than a last-in-line situation?

Mr. MCMAHON. Well, again, unfortunately that's a bankruptcy law question which I can't control. What we are trying to do is to—

Senator HUTCHISON. But are you going to try to do that? Is that what you want to do if it can be done legally?

Mr. MCMAHON. Absolutely. We want to do everything we can do for the former employees who were severed as part of this process. And unfortunately, we're in the box of working through the bankruptcy process, and we're going to have to do that.

Senator HUTCHISON. Well, let me ask you this. How many employees were let go before the filing of bankruptcy?

Mr. MCMAHON. I'm not sure if I understand your question. The vast majority of the employees were let go a day or two after the bankruptcy.

Senator HUTCHISON. Is there anyone else on the panel who could tell me if there were a number of employees who were severed before the bankruptcy, that might have a better case for the company to meet their commitment? Does anyone else on the panel know?

Ms. WATKINS. I'm not really aware, but I think, as Mr. McMahon points out, that there were—and Mr. Skilling, as well—there was some downsizing going on in the broadband group. Those people, if they still have outstanding severance payments, I guess, would have a claim in the bankruptcy estate for those payments.

Senator HUTCHISON. But the company would have the ability to meet its commitment if they were severed before the bankruptcy? Or did bankruptcy eliminate all of your options?

Mr. MCMAHON. Unfortunately for those employees, the obligation—they were—anyone severed prior to the bankruptcy—again, as I understand it; I'm not an attorney—but they have—since the severance plan was active when they were terminated, they are due their severance. The bankruptcy, though, puts them as a general unsecured creditor, and all those obligations right now are stayed as part of the bankruptcy, as any other obligation for Enron is.

Senator HUTCHISON. Let me ask you, I'm not sure if anyone asked this before, but I have introduced a pension reform bill that includes more transparency and more information to employees, but does not discourage companies from offering 401(k)s, because I think 401(k)s are a great vehicle for retirement security for millions of Americans. But my bill also addresses the issue of auditing and consulting.

And I was general counsel of a bank holding company, and it was just a policy that we didn't have the auditors also giving us consulting advice. And I just wanted to ask you—also you, Mr.

Skilling—if you think that we ought to pass a law that would prohibit that mix as a conflict or potential conflict.

Mr. MCMAHON. I think the relationship between audit clients, from an independent audit perspective, as well as separate accounting consultation, is something that I think that the Senate should look at, frankly. It would appear to be a conflict from the outset. And how that conflict is managed between the firms is probably something that should be reviewed.

At Enron, going forward, we are looking to institute some best practices in a variety of places. And this is one where we're looking. Obviously, we're in need of new auditors. We've replaced our accounting personnel internally, as well. And we want to go forward with something that's best practices. So we're, as an institution, looking forward to that, as well.

Senator HUTCHISON. Are you, in your company, doing what several other companies are doing voluntarily, are you going to make a policy not to have the same firm do your auditing function and your consulting?

Mr. MCMAHON. We're unfortunately not that far in the thought process, because we don't have auditors yet. And actually, the person who we just put in charge of our accounting has only been doing it for a week or so. But, the thought process we want to go through is, what type of areas, going forward as a new company, as a reorganized company, can we have best practices?

Senator HUTCHISON. Do you have an opinion, as the CEO of the company? Are you going to make a recommendation to the Board on that subject?

Mr. MCMAHON. My personal opinion, at this point in time—and this is subject to, I think, a lot of internal discussion as well as external. Ms. Watkins testified earlier that auditor rotations is something that she recommends, and I tend to fall in that camp as well. Every X amount of years it probably makes sense to bring in a new set of eyes and look through the books.

One area that I think Enron historically could have done better is—as I understand, we outsource most of the internal audit function to our external auditors. And I think on a go-forward basis, that's not something I would recommend either. As far as consulting, if you change over your auditors every couple of years, maybe that's not as big of an issue. So that's the kind of discussion we're going to have internally.

Senator HUTCHISON. I know my time is up. Could I just ask Mr. Skilling and Ms. Watkins or anyone else to address that last question?

Ms. WATKINS. What I've said previously is that I would like to see public companies rotate their accounting firms for periods as short as once every three years. I think the largest deterrent to problems such as what Enron has faced is another pair of eyes—a second, you know, look. You are likely to be more conservative and less aggressive in the accounting treatments you adopt when you know another accounting firm is going to be taking over your client and your work in less than three years.

Senator HUTCHISON. You think rotating alleviates the need for the division between the firms doing the consulting and the auditing?

Ms. WATKINS. Yes, I do.

Senator HUTCHISON. Mr. Skilling.

Mr. SKILLING. I agree with Ms. Watkins. I think there are a lot of efficiencies—or at least I think the accounting firms—Jeff and Sherron both work for accounting firms, so I'm not as familiar with them, but the argument they've made is that if you can do consulting and the auditing, it's much more efficient, because the people know what's going on. And so I don't know that that's a huge problem, but I would agree with Ms. Watkins that now, in retrospect, I think it would be a good idea.

I think three years may be too short, because in something like Enron, it was a huge company, and you'd have to have hundreds of people going out and hundreds of people coming, and I don't know quite how you'd manage that every three years. But some sort of rotation is probably a good idea.

Senator HUTCHISON. Thank you, Mr. Chairman.

Senator DORGAN. Senator Snowe.

Senator SNOWE. Thank you, Mr. Chairman. I'm sorry that I was unable to be here for the entire questioning, but I've got dual responsibilities.

Mr. Skilling, I'm interested to know what was the role of CEO at Enron, I heard you say that you're not an accountant, but that you relied on accountants for their advice and pretty much presumed that they were correct. There was no skepticism and there was no questioning. You were at Board meetings obviously, as the CEO, you were present at the Board meetings that had been referred to—for example, the one in February 2001. Is that correct?

Mr. SKILLING. February 2001?

Senator SNOWE. Yes.

Mr. HILER. Senator, can I just—for purposes of clarification, please, I think you indicated something about that he may have indicated that accounting practices were not questioned, or there was no skepticism, or as to whatever the auditor said, and I don't believe he testified to that. I just wanted to make the record clear, because there are a lot of questions, as there were in the House, where there are double premises to the questions or characterizations with which we don't agree, and then my client is asked to answer a question yes or no, and it unfortunately could appear that he's agreeing with the characterization.

Senator SNOWE. Well, we're just asking questions about these particular partnerships and accounting practices, whether it's LJM or Chewco or Raptors or whatever. So would it be correct to say that there was any questions about them, or not?

Mr. SKILLING. It would be my assumption—we had an accounting organization of hundreds of people. I would assume there are all sorts of questions that were asked of the auditors about all accounting issues inside of the company.

Senator SNOWE. I guess what I'm trying to understand—because I'm having difficulty understanding how this all worked, is what was the role of your position in the company [inaudible]. Generally, I would presume that a Board of Directors meeting is a pretty important event for a CEO. Is that not correct? I mean, you had four or five meetings a year?

Mr. SKILLING. A Board of Directors meeting, yes—I mean—

Senator SNOWE. Right. So some of these issues obviously were raised. I mean, some of—and you were in and out of some of these meetings. Is that correct?

Mr. SKILLING. Which issues?

Senator SNOWE. Concerning some of the LJM transactions and Raptors.

Mr. SKILLING. Absolutely. As I testified, I think we talked about the LJM structures in multiple Board meetings and conflicts and the process we put in place. The Board of Directors actually approved the structuring of the Raptor transactions. So, yes, there was a tremendous amount of time spent on those.

Senator SNOWE. Okay. So you were familiar with the agenda and what was going to be discussed at these Board of Directors meetings. Is that correct?

Mr. SKILLING. I think technically the Chairman of the Board sets the agenda for the Board meetings. But—

Senator SNOWE. Yes, but doesn't generally the CEO work with the Chairman of the Board prior to that meeting?

Mr. SKILLING. Well, typically—you know, we had committee meetings. And then you'd have the Board meeting. I believe the agenda for the Board meeting was determined by the Chairman of the company. And I believe the agenda of the subcommittees was set by—I don't know this as fact, but I believe it was set by the—whoever the Chairman of that subcommittee was. So if you had the Compensation Committee, the head of the Compensation Committee would set the agenda for the meeting.

Senator SNOWE. But would you go over the agenda? I'm just—you know, for example, in some of these meetings—and I know it might have been prior to the—I might be wrong in this, but when Mr.—when the power went out, and you were in and out of the room, and Mr. Fastow was making his presentation—I don't know if it was LJM2 partnership and you were in and out of—

Mr. SKILLING. It was actually a presentation proposing an LJM3 partnership, which, in fact, never occurred.

Senator SNOWE. Okay. But generally, the CEO is very well aware of what's going to be discussed.

Mr. SKILLING. I was not the Chief Executive Officer at that time for that meeting. I became Chief Executive—

Senator SNOWE. Chief Operating Officer. You're right.

Mr. HILER. For the record, if I might, and so we're all clear, that was also a Finance Committee meeting, I believe that October 2000 meeting that he testified about the lights being in and out. He was not a member of the Finance Committee, although he may have been there. So in terms of distinguishing that from a Board meeting, it may be important.

Senator SNOWE. Okay. But, I guess the point is here that there's a question of whether or not—to what extent you might have been aware of the nature of these transactions that might imperil the company. But you're generally saying you had no awareness. Is that correct?

Mr. SKILLING. No, I didn't say that. I said that, at multiple Board meetings, we spent a lot of time—it's in the minutes. You'll see that there's an enormous amount of time that was spent discussing—for example, in LJM1, the actual specifics of the trans-

action that was approved by the Board. When LJM2 was approved, there was a long discussion of the potential conflicts of interest that would be created and what sort of process we needed to put in place to eliminate those conflicts of interest.

In the Raptor transactions, there's—I think it's in the Board minutes, you'll see that there's actually a Board—what do you call it? It's a resolution, thank you—a full resolution that actually put in place the mechanics or the structure in place—

Senator SNOWE. Right.

Mr. SKILLING [continuing]. Of Raptor. So, yes, the Board spent a significant amount of time—

Senator SNOWE. And you're saying in the Raptors that you were obviously directly involved in that, were you not?

Mr. SKILLING. I was—yeah, I was in the Board meeting, yes.

Senator SNOWE. Were you directly involved? I mean, obviously, you were at the meeting.

Mr. SKILLING. I was at the Board meeting, I would have been involved.

Senator SNOWE. Okay, because the Powers Report said the Raptors were created in response to Skilling's desire to divide the mechanism that would allow Enron to hedge a portion of its merchant investment portfolio.

Mr. SKILLING. Yes.

Senator SNOWE. And you're saying that your signature was not required for—

Mr. SKILLING. Well, what the—I think what the Powers Report is referring to, which is absolutely true, is we had a large portion of our business was mark-to-market or fair-value accounting. For any of the mark-to-market or fair-value accounting areas of the company, I insisted that we hedge those positions. And we used to have discussions about the mechanics of hedging our natural gas portfolios, our electricity portfolios—we got in pulp and paper, how we hedged that—our telecommunications portfolios.

And this related to the equity investments we were making, and I was very interested in getting a hedge on those, because I believed that—I mean, we'd made some tremendous investments. We'd invested—I don't even know what the number is, \$40 or \$50 million—and they were worth half-a-billion dollars. And so, I was very adamant that we needed to come up with some mechanism to hedge those.

And we looked at a couple of different alternatives for hedging those and decided, upon discussions with our technical people and our accountants and lawyers, that the Raptors structure was the best one.

Senator SNOWE. But I guess the fact is that you had no question—I mean, you might have had some questions on the mechanics and so on, but not in terms of what these partnerships might represent—and the fact that you deferred to accountants, with respect to their recommendation. Is that correct?

Mr. SKILLING. We looked, as the Board and management always looks to their accountants to tell us what the accounting structure is, as we look to our lawyers to approve whether the contracts are correctly drafted and enforced—yes.

Senator SNOWE. Well, there was an article that was written in *Fortune* magazine back in December by Bethany McClain, and she talks about a meeting—I gather it was an analyst conversation—in which she raised, I think—she said, “fairly standard queries in an effort to understand fairly incomprehensible financial statements. The response from Enron was anything but standard. Skilling quickly became frustrated and said the line of inquiry was unethical and hung up the phone.”

I guess the point is, here, you relied on accountants for their best analysis of these partnerships. Why would you question an analyst or a reporter with respect to your financial transactions that they may be relying on accountants or other experts to try to understand Enron’s financial statement?

Mr. SKILLING. Is what you’re asking is why did I call Bethany McClain unethical? Is that the question?

Senator SNOWE. Yes.

Mr. SKILLING. Um.

Senator SNOWE. Obviously, she had some legitimate inquiries. The line of questioning was unethical.

Mr. SKILLING. There’s—and I don’t know if we want to——

Senator SNOWE. And she made the——

Mr. SKILLING. I don’t know if we want to waste the time of this Committee. It’s——

Senator SNOWE. Well——

Mr. SKILLING. I am under oath in the House describing that telephone conversation. There have been a number of things that have happened subsequent to that, so I guess I have some additional information. But Ms. McClain had been working on the article—I said, in my testimony at the House, for a week. I think she came out in *Fortune* magazine the next week and said, no, that she’d actually been working on it for a month. So I’m sorry, it was a month that she was working on it, not a week.

She called up and said that she wanted my comments as she was finishing that article and needed 15 minutes of my time. And as I recall, that meeting was set up—it was on a—I think it was a Monday or a Tuesday, and we carved 15 minutes out of my calendar, which sometimes is a very tough thing to do. So we carved 15 minutes out of my calendar.

Ms. McClain called me and started asking some very technical questions about our accounting. I said, “Look, you know, I’ve got 6 minutes left now before I have to leave for a meeting, and I’m not an accountant. I think we need to get our accounting people and our risk-management people and our finance people together with you to describe the specifics of what you’re asking.” And she said, “Well, we’re going to run the story anyway.” And I said, “If you do that, I think that’s unethical.”

And she said that she would give us one more day—I think either she did or our PR people followed up afterwards. And we sent our Chief Accounting Officer, our Chief Financial Officer, and our head of Government Relations to New York to meet with her personally to answer. They spent, I think, a full day, or four or five hours that day, discussing the specific questions she had.

I believe that that was ethical at that point, to listen. You know, not—I mean, you all, I’m sure, in your business have been am-

bushed by reporters before, and this struck me as a potential ambush. I asked them to please give us time and let us get the appropriate people to answer the question to New York to answer questions.

Senator SNOWE. Well, I guess it gets back to the whole issue of why none of these events raised a red flag. I think it's just very difficult to comprehend, to be honest with you. And, you know, these rewriting of losses—I mean, just shortly after your departure—I mean, significant write-downs. And not to be aware at all, in any way, at any level about the impact of these partnerships on the financial picture of this company is just really hard to understand. You may well say that you didn't understand, you didn't know, you didn't realize, or whatever, but it's such a massive scale, and I think that's the difficulty understanding—comprehending your lack of awareness.

Mr. SKILLING. Senator, I think you can go back again and look at the dates. I left Enron Corporation on August 14. Ms. Watkins had not yet made public her concerns. You can look at the Vinson & Elkins interview of the head of Arthur Andersen's account of Enron. And I think that was in early September—and he said that it was entirely appropriate and done properly. So the fact that I had no reason to believe that there was a problem there is not particularly surprising, I don't think.

Senator SNOWE. Thank you.

Senator DORGAN. Mr. Skilling, did you have any equity shares or any investment in any of the partnerships that have been discussed?

Mr. SKILLING. No, I did not.

Senator DORGAN. None.

Mr. HILER. Excuse me. I'm sorry. Could we—

Senator DORGAN. Oh, yeah. Yeah, let's all be specific.

Mr. HILER. Which ones? LJM? Raptor?

Senator DORGAN. Did you have any investment in any of the partnerships, the SPEs, that were affiliated with the company?

Mr. SKILLING. No, I did not.

Senator DORGAN. Alright. Mr. Skilling, I've sat here now for a couple of hours, and I'll tell you, it is unbelievable to me what we've heard. Let me describe a bit of it to you.

You say: "I left Enron on August 14, 2001, for personal reasons." You're quoted in two different places as saying that. Well, Mr. Lay says that he pressured you about that, and you said that you were under a lot of pressure. Enron's stock price was dropping, and you could not do anything about it. And you said to *The Wall Street Journal*, "I don't think I would have felt the pressure to leave if the stock price had stayed up." Does that sound like somebody who left for personal reasons?

Mr. SKILLING. Senator, I think I'd like to see Mr. Lay's testimony, because I think it's very clear in the discussion that Mr. Lay had with the Special Committee that I had confided in him a number of personal reasons that were important for me, and that's why I was leaving, and he accepted those reasons.

Senator DORGAN. Did *The Wall Street Journal* misquote you, then?

Mr. SKILLING. I talked to *The Wall Street Journal* probably two—I think it was two days after I had left, and we had a discussion that lasted probably a half an hour, probably—

Senator DORGAN. Is it a misquote?

Mr. SKILLING. I'm sorry?

Senator DORGAN. Is it a misquote?

Mr. SKILLING. I think it was a mis-context. A personal decision takes into account many, many factors. I absolutely can admit to you that I was frustrated with the stock price. I thought the company was in good shape and could not—it was bothering me that, in spite of the condition I thought the company was in, the stock price was going down. I found that—

Senator DORGAN. You've told us that. But let me just say—you said, "I did not believe the company was in financial peril." Let me read to you from the Powers Report, just a bit. Here's what the Board of Directors, which is the best face you're going to put on this—the Board of Directors of the company commissioned this study. This is a best-face study. Here's what they say: "The partnerships [inaudible] LJM1 and 2 were used by management to enter into transactions it could not or would not do with unrelated commercial entities. They were designed to accomplish favorable financial results, not to achieve bonafide economic objectives or to transfer risk. Some transactions were designed so that had they followed applicable accounting rules, Enron could have kept assets and liabilities, especially debt, off its balance sheet. But the transactions did not follow the rules. 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—that is that a third party was obligated to pay Enron the amount of the losses—when, in fact, the third party was simply an entity in which only Enron had a substantial economic stake. We believe these transactions resulted in Enron reporting earnings from the third quarter of 2000 through the third quarter of 2001 that were almost \$1 billion higher than should have been reported."

Mr. Skilling, what is unbelievable to me is that a CEO says, "When I left, things were just fine," and, "I have no knowledge of any of this." Is it the case that you have no knowledge that any of this was going on, that Mr. Fastow was a renegade running off by himself? You didn't know that Chewco didn't meet the 3-percent test?

Mr. SKILLING. [Inaudible].

Senator DORGAN. Do you tell us that you were in charge of the company but had no knowledge of this?

Mr. SKILLING. Okay, let's—

Senator DORGAN. Is that what we're to believe?

Mr. SKILLING [continuing]. Let's go through the specifics. Start with Chewco. Did I know that Chewco was undercapitalized? No, sir, I did not know Chewco was undercapitalized.

Senator DORGAN. So did someone lie to you about that? If so, who?

Mr. SKILLING. The accountants believed that it was properly capitalized. And, as I understand it, Enron's—and this—I've just—

Senator DORGAN. The accountants have said that they were lied to.

Mr. SKILLING. You'll have to ask the accountants. I can't speak for the accountants. I did not know.

Senator DORGAN. But you can speak for the company.

Mr. SKILLING. I can speak for myself. If you asked me did I know—

Senator DORGAN. You were the CEO of the company. You can speak for the company at that point.

Mr. SKILLING. I can speak for myself. I can speak as Chief Operating Officer of the company. I did not know—personally did not know that Chewco was undercapitalized.

Senator DORGAN. Now that you know, was your exit statement an appropriate one?

Mr. SKILLING. I'm sorry?

Senator DORGAN. Your exit statement, that things were just fine when you left Enron—was that appropriate, now that you know what you know?

Mr. SKILLING. Well, in fact, dealing specifically with Chewco, what ended up happening is they reconsolidated Chewco. That would have no—essentially all you're doing is bringing—it's an accounting adjustment. It wouldn't have an impact on cash flow or earnings.

Senator DORGAN. I'm not talking just about Chewco. I'm talking about the Board of Directors report. The Board of Directors report said that you were heading a company that was reporting earnings that it didn't earn and keeping debt off the books that, in fact, related to risk for the company.

Mr. SKILLING. Mr. Chairman, all I can tell you is that the accountants signed off that they were accurate records. I believed they were the accurate representation of the financial—

Senator DORGAN. Ms. Watkins, what's wrong with that statement: "Gee, the accountants told me it was fine, so it was fine"?

Ms. WATKINS. The concern I have is that I do agree with Mr. Skilling that he was quite concerned about the risk inherent in our merchant equity portfolio. If we made an investment, that investment went up and we wrote that up. He was very concerned that we might also have to write it down.

I worked with him on a committee in 1996 where we tried to devise equity hedging methods for our investments. We tried things like puts on the S&P, shorting a basket of expiration and production companies. Nothing quite got us dollar-for-dollar coverage.

After I left that position at the end of 1996, my understanding is that several other people, at Mr. Skilling's behest, tried to find a way of hedging our equity investments. When you attempt to go to outside third parties in 1996 and 1997 and 1998, and you can't find a way of doing it, and then miraculously you've got a dollar-for-dollar hedge from Mr. Fastow's related-party partnership that would have been a very, very high risk venture. I find it hard to believe that Mr. Skilling was not aware that something was amiss, that this could not be legitimate.

Senator DORGAN. Mr. Skilling, let me ask if you are aware of a May 6, 2001, piece—it's called Off Wall Street—in which—

Mr. SKILLING. I'm sorry, I can't see it, Senator.

Senator DORGAN. Alright, I can send it to you. But Off Wall Street recommended a strong sell position for Enron, a target of \$30 per share. Were you familiar with that in May of 2001?

Mr. SKILLING. Who was it?

Senator DORGAN. It's called Off Wall Street Consulting Group.

Mr. SKILLING. I don't know them. May I ask a favor?

Senator DORGAN. Yes.

Mr. SKILLING. May I address the comments Ms. Watkins just made?

Senator DORGAN. Alright.

Mr. SKILLING. Ms. Watkins is correct, that we would not have been able to go outside and directly hedge the high-technology investments. It had nothing to do with the fact that that wasn't available. It had everything to do with the fact that we were under hold agreements with those stocks because we had made venture capital investments.

So we had two alternatives at that point. One was to do what we call a low-correlation hedge, which is what Ms. Watkins is talking about—that we used to execute in the oil and gas business. That means you can't do a one-for-one tie. And so, what you do is, if you own a bunch of high-technology fiber optic companies, you short a basket of fiber optic companies. And it's not a one-to-one correlation. In retrospect, it would have been a fantastic correlation. It would have completely hedged the position.

At that time, we also had people working on other alternatives. And the other alternative was the Raptor structure. A Raptor structure is a different kind of hedge. In most hedges, if you go to Goldman Sachs and you buy a put on a company, they effectively go into the marketplace and offset that with a direct transaction that is an offset transaction to that.

There's another way that you could write a derivative, and that is if you put capital into a business, and they're basically writing—in the industry, it's called a “naked hedge.” A naked hedge.

So we—basically, we could either do a low-correlation hedge, which would have worked out fine, or we could have done this thing, which was called a “naked hedge.” And you take credit risk on a naked hedge. And we just looked at the two of those and decided—our technical people thought that that was the better hedge to enter into.

So, did I believe this was an appropriate hedge? Yes, I absolutely did. And if the accountants had ever, at any time, suggested that this was inappropriate for any reason, we would have just gone to a low-correlation hedge, as we did in the oil and gas business. That was the standard hedging structure that we used at that time.

Senator DORGAN. Mr. Skilling, you seem to know more about accounting and finance than you let on when you describe these hedge transactions.

Mr. SKILLING. I know about the derivatives. I know about the finance business, because I spent a lot of time in the finance business. I do not—I'd like to say one other thing. We were asking about what needs to be done. I also agree with Ms. Watkins in her testimony in front of the House that the accounting profession has gone through a morphing. It's gone from a morphing of logic to something that looks more like the tax code. And it's gotten to the

point where I think someone in anyone's position has to be a specialist to understand the mechanics of what's going on, because there are so many rules that have been promulgated. And that's something you might want to think about. We ought to go back to the European structure, where it's more what makes sense than what the specific rules are that govern transactions.

Senator DORGAN. But, Mr. Skilling, with due respect, I'm not going to ask you what needs to be done. I'm much more interested in asking you what was done and was not done inside that corporation. I'll get advice on what we ought to do in the future from others.

But let me ask a question about compensation that relates to your resignation and other things that were going on inside the company. I described the Powers Report, which I think is the best face you can put on what was going on in the company, and it described something rotten, in my judgment. Now, during that period of time, February 1999 to June 2001, did you convert stock worth \$66 million at that point? Did you sell \$66 million in stock sales?

Mr. SKILLING. What was the timeframe?

Senator DORGAN. February 1999 to June 2001.

Mr. SKILLING. 2001. I don't know, but—I don't have the records with me.

Senator DORGAN. Would that be surprising to you learn that you did that?

Mr. SKILLING. No, that would—no, that would not be surprising.

Senator DORGAN. And do you consider \$66 million a great deal of money?

Mr. SKILLING. Yes, it is, sir.

Senator DORGAN. Do you still have most of that?

Mr. SKILLING. Yes, I do.

Senator DORGAN. Uh-huh. And how do you feel about that and the employees, one of which wrote me recently—they had \$330,000 in his 401(k) account—his entire life savings—worked many years for your company, lives in the State of North Dakota—that \$330,000 is now worth \$1,700. You still have most of your \$66 million. That family has lost their life savings. How do we reconcile this? How is it that the people at the top got wealthy, and the people at the bottom got broke?

Mr. SKILLING. Well, if—I guess a couple of answers to it. I had a—I had a program for many, many years of selling a modest portion of my stock. And over many years that's added up to that number that you've talked about, Senator.

I think most employees also sold stock options and stock as those became due, as they—you know, as they matured. So I would guess that most people did, in fact, over the years, if they were diversifying and prudently managing their investments probably did sell some of their Enron stock. I feel terrible that people that held the stock held the stock at the beginning of this year.

I had stock and options worth \$170 million, which is a whole lot of money. And I sold \$15 million under an SEC 10(b)5 plan between January and when I left the company on August 14—\$15 million out of \$171 million. I think if I thought that there was a concern, I would imagine any economic advisor would say you probably should have sold more, diversified more.

But I think it's very tough. I mean, I don't know what to say to the employees.

Senator DORGAN. Have you donated any of that money to the employees' fund?

Mr. SKILLING. I can't do anything at this point. I think at this point I have 36 separate plaintiffs' lawsuits against me. It's my expectation that I will probably spend the next five to ten years of my life battling those lawsuits. I don't know if I'll have anything at the end of that, and I can't transfer anything now, because at this point that would be considered—it's a legal issue that I'm going to have to deal with, but it's going to be a long, drawn-out process.

Senator DORGAN. One final question. I assume you probably regret the joke that you told in Las Vegas about the Titanic and the State of California. You were quoted as saying: "You know the difference between the Titanic and the State of California? When the Titanic went down, the lights were still on," which I assume you regret saying now.

But it occurs to me that, at least from those of us who are examining what happened at Enron—if one were to make a similar comparison, in the Titanic, the captain went down with the ship. In Enron, it looks to me like the captain first gave himself and some friends a bonus, then lowered himself and the top folks down in the lifeboat, and then hollered up and said, "By the way, everything is going to be just fine."

Do you now regret what you said about the Titanic and California, given what's happened with Enron itself?

Mr. SKILLING. Okay, two issues. One on regretting the joke, and I will address that.

The second one is—I think is a pretty bad analogy, Senator, because I wasn't on the Titanic. I got off in Ireland because I was on vacation in Ireland, and the Titanic went on to run into some troubles later on. I think that's a better analogy.

As far as the joke related to the Titanic, all I can say is that that was at a time of very, very frayed tempers as a result of the situation that was going on in the State of California. One week prior to that meeting in Las Vegas where I made that statement, the highest law official in the State of California, Attorney General Bill Lockyer said, and let me quote: "I would love to personally escort Ken Lay to an 8-by-10 cell that he could share with a tattooed dude who says, quote, 'Hi, my name is Spike, honey.'"

That was May 22, 2001. That was the kind of stuff that was going on. Can you imagine what tempers were like? I know Mr. Lay. I've worked with Mr. Lay for a long time. Mr. Lay doesn't deserve a prison rape or the suggestion by the top law enforcement official in the State of California that he be raped in prison when he hadn't been charged with anything and hadn't been found guilty of any issue.

Senator DORGAN. Let me inquire before we continue, is there anyone on the panel that would require a 5-minute break at this moment? If not, we will continue.

Senator Fitzgerald.

Mr. HILER. Mr. Chairman—

Senator DORGAN. Pardon me?

Mr. HILER. Can we take a 5-minute break?

Senator DORGAN. Alright, we'll stand in recess for 5 minutes.
[Recess].

Senator DORGAN. The Senator from Illinois.

Senator FITZGERALD. Thank you, Mr. Chairman.

Mr. Skilling, I was glad that you recognized the issue about stock options and the expense for them not having to appear on the income statement. I've actually introduced a bill that would require companies to expense those options.

I wanted to ask you a little bit about the budgets within Enron. Were there earnings budgets within Enron? And, if so, who put together those budgets and who enforced those budgets or tried to make sure the various divisions met their budget numbers?

Mr. SKILLING. The process we had, I think, was probably—

Senator FITZGERALD. Could you pull the microphone close? Thank you.

Mr. SKILLING. I think the process we had was fairly standard. We'd do an annual budget for the upcoming year where each of the business units would build up, you know, from what they thought they could accomplish in the upcoming year. And all those were consolidated, and that was approved by the Board of Directors as the budget for the upcoming year.

And then every quarter, we had a forecast, and the forecast was a basically a rolling forecast so that as each day passed by and there was updates on how the markets were working and how we were doing in the markets, the forecasts would be adjusted so that, for example, if one of the business units was having trouble—like in Brazil, for example—we had a lot of troubles in Brazil—as their numbers went down, but somebody else was doing better because of whatever—

Senator FITZGERALD. Were you ever involved in approving any budgets for any of the divisions of Enron?

Mr. SKILLING. The budgets went to the Board of Directors for approval.

Senator FITZGERALD. Did they go to you first?

Mr. SKILLING. We prepared—we, meaning Ken and I, would sit through all the budget—each of the individual business units would come in, and they would—

Senator FITZGERALD. Did you and Mr. Lay ever ask any of the divisions to budget to earn more monies than they had proposed?

Mr. SKILLING. Yes, sir.

Senator FITZGERALD. You did. Often? Or was that a rare occasion that you would ask them?

Mr. SKILLING. Well, I think—you know, you use business judgment, and there were some times—there's a term in the budgeting process that's called "sandbagging," you know, and if you had a reason to believe that a business had better prospects, you'd say, "I think you guys are undershooting what you can actually accomplish." But it didn't mean that they were stuck with that. During the upcoming year, then, as each forecast was done, if it turned out that there was a problem in the business or there was an opportunity in a business, then those numbers would be adjusted.

Senator FITZGERALD. So you and Mr. Lay would approve the budgets and then they would go to a Board for further approval?

Mr. SKILLING. Yes, sir.

Senator FITZGERALD. And were there ever occasions when certain units weren't meeting their budgets?

Mr. SKILLING. Yes, sir.

Senator FITZGERALD. And would you ever—what would you do if certain units weren't meeting their budgets? Would you just say, "That's okay," or would you ever ask them to—you know, "Come on, meet your budget. You guys got to get the revenues up, the sales up. You've got to meet your budgets for the year."

Mr. SKILLING. Well, what we would do is—I would typically meet, and Ken would meet, and others of top management would meet with each of the individual strategic business units. These are the product-market businesses in each of them. And if one product-market group was not performing, there would be a review, either by their boss or their boss—depending on how—you know, what the situation was.

Senator FITZGERALD. Did you and Mr. Lay ever pressure any unit to—

Mr. HILER. Senator, I'm sorry. With all due respect, I apologize for interrupting. Could he answer that? I think it's important to go through the whole—

Senator FITZGERALD. Yeah, but he's answering more than I've asked, and I have other questions. I'd like if he could answer my question specifically and not waste the five minutes I have getting off onto irrelevancies.

Mr. SKILLING. I don't believe it's irrelevant, because the purpose of these meetings that I was just describing is—there's one of two things going on. Either the business unit has a problem in the marketplace or a business unit has a problem in execution. And what we were trying to do is just separate those.

If there's a problem in the marketplace, there's nothing you can do about it. And so you just—okay, fine. If it's an execution problem, it might mean that they needed more people or they needed more resources or you needed to change management.

So what you would try to do is divine what's the basis of the problem if there was a problem and then come up with a remedial action to—

Senator FITZGERALD. Did you ever pressure any units to increase their earnings to as to meet their budgets?

Mr. SKILLING. I would not use that term at all. I think what we did is—we went through—in the budgeting process, if a business unit had a problem and they were working hard on the problem, that was fine. And then what we did is—we'd look elsewhere in the organization for someone whose market was doing better than we expected, to offset that.

Senator FITZGERALD. Would compensation be affected with any unit if they didn't meet their budget?

Mr. SKILLING. We had a compensation system that did not have a formulaic component. In other words, the specific profitability of a business unit did not dictate what your bonus was. In fact, if you look at the people who are in our number one category, our best people, my recollection is that probably half of them were in business units that were losing money. And we'd put good people in businesses that were just starting up or businesses that had prob-

lems. And if we didn't pay them because they were in one of those businesses, they'd leave, and we didn't—certainly didn't want our good people to leave.

Senator FITZGERALD. Now, also—another area I want to ask you about, Mr. Skilling, is valuations. There's been a lot of testimony that the LJM's and other partnerships were set up in order to—both to hedge certain investments in Enron's portfolio, but also to buy certain assets from Enron. Enron would, from time to time, sell assets to these partnerships. Who would ensure that the valuation of the asset sold to the partnerships was appropriate and fair, from Enron's standpoint if you're selling an asset to a partnership?

Mr. SKILLING. The process that was established left it to Rick Causey, who was head of our accounting group, and Rick Buy, who is head of our Risk Assessment and Control Group, to determine the reasonableness of the transaction. The Risk Assessment and Control Group had several hundred—I don't—maybe 300 analysts. They would do the analysis of the assets to determine—

Senator FITZGERALD. Was there a maximum level of authority for those two?

Mr. SKILLING. I'm sorry?

Senator FITZGERALD. For Mr. Causey and Mr. Buy. Did they have a—could they value any sale of any asset that Enron owned and no one else would have to review that?

Mr. SKILLING. Under the terms of the LJM process, they had to review and sign-off on those transactions. If the transaction involved a cash outlay of a certain amount or a sale of a certain amount, there was a hierarchy of sign-off within the company that would be necessary. So—

Senator FITZGERALD. At what level did your sign-off kick in?

Mr. SKILLING. Oh, it changed over the time I was there. I'm guessing probably, at the end—I don't know the exact number—say \$50 million or \$60 million.

Senator FITZGERALD. So \$60 million. Now, on the sale of the Enron—

Mr. SKILLING. I'm sorry. That would be for a purchase. For a sale, I don't—I think that the authority levels were higher, because, you know, we tended to prefer sales to purchases.

Senator FITZGERALD. And you're not sure what that was.

Mr. SKILLING. I don't remember.

Senator FITZGERALD. Now, do you recall the sale of Enron's business with Blockbuster Video—the Enron broadband video business that they sold to the partnership called Braveheart?

Mr. SKILLING. Was LJM involved in Braveheart?

Senator FITZGERALD. Pardon?

Mr. SKILLING. Was LJM involved in Braveheart?

Senator FITZGERALD. No. I didn't say that it was.

Mr. SKILLING. Oh, okay. I thought you said—I thought that it was a sale to a partnership.

Senator FITZGERALD. No. No, I'm just wondering if you recall the sale of Enron's broadband video business with Blockbuster to the partnership known as Braveheart.

Mr. SKILLING. No, I didn't know that it was sold to a partnership named Braveheart, but I am familiar—

Senator FITZGERALD. Who did you think it was sold to?

Mr. SKILLING. I just didn't recall. But I am aware of the sale of a portion of the content business.

Senator FITZGERALD. Were you aware that it was sold to a partnership, Braveheart, that apparently had received an investment of \$115 million from the Canadian Imperial Bank of Commerce?

Mr. SKILLING. No, sir. I would have been aware of the fact that a sale was made and—I don't—I wouldn't typically be involved in the details of negotiating the transaction—

Senator FITZGERALD. Enron took \$110 million in earnings over two quarters for that transaction. You wouldn't have been aware of a transaction that would have comprised \$110 million worth of Enron earnings?

Mr. SKILLING. No, I didn't say that. I was aware of the sale of the content business—a portion of the content business. I thought what you were asking me was—did I know that it was being sold to a specific partnership and there's a specific financial institution involved. That would not be a level of detail that I would typically—

Senator FITZGERALD. Alright, you were aware it was sold, but you didn't know it was sold to.

Mr. SKILLING. I wouldn't know the specifics of the transaction.

Senator FITZGERALD. Okay, and have you heard of the Braveheart partnership?

Mr. SKILLING. Yes.

Senator FITZGERALD. Are you—

Mr. SKILLING. I have not heard of the Braveheart partnership. I've heard of a term—I've read in the newspaper, like everyone else—where they call it Braveheart. I did not know it was its own stand-alone partnership.

Senator FITZGERALD. Well, I guess my time is up. Thank you.

Senator DORGAN. Senator Wyden.

Senator WYDEN. Thank you.

Mr. Skilling, over the last four hours, you've essentially made two arguments to the Committee. You said that you moved aggressively to manage economic risk, and you said that you relied on your people. Those are essentially the two arguments that you've made to us.

My question to begin this round with is, given the fact that the stock price essentially fell by half during your watch, wouldn't that have been the point where you would stop relying on other people and go out and independently investigate all of these problems and try to get to the bottom of them?

Mr. SKILLING. Well, as I said, Senator, my assessment of the reason that the stock price was going down in that time period was three things. One was the meltdown in the broadband business. The second one was the problems we were having with our India project. And the third one was the situation in California—the California energy situation.

On all three of those things, I personally got very involved. In the broadband business, we worked to reduce the capital expenditures in the business. We ended up redeploying a large portion of the people from that business. On India, we had meetings, I think, probably every week-and-a-half to two weeks to talk about what our approach would be to the project and how we would manage

that. And in California, we spent enormous amounts of time trying to understand what our positions were—risk positions were in California and how we would manage them.

Senator WYDEN. What's troubling to me about that is, you're essentially saying all of these reasons that the company collapsed are external—they're outside the company. Yet all of these high level people in Enron are saying there are internal problems.

Mr. SKILLING. No, sir. I—

Senator WYDEN. Do you still believe there weren't any internal problems that you should have been tackling?

Mr. SKILLING. No, sir. I believe that this—when I mentioned this run on the bank—I mean, a run on the bank just doesn't happen. Subsequent to when I left the company, there was a loss of confidence in the company that led to the run on the bank. Was that related to the LJM partnerships and some of the off-balance-sheet vehicles? I think that probably had a significant piece to do with it, because it seemed to be what the press was focusing—

Senator WYDEN. Let's stay with your role, then. That's helpful.

Mr. McMahan, you did bring to Mr. Skilling your concerns about the various processes and your concerns specifically about the shortcomings involved. Mr. Skilling has said today that he went to Mr. Fastow, and he felt that those concerns were addressed. What evidence did you see that Mr. Skilling, on his watch, adequately moved to address these conflict-of-interest issues?

Mr. McMAHON. Well, there's a couple of issues. One, I know firsthand Mr. Skilling—well, I guess not firsthand—secondhand that Mr. Skilling did, in fact, have a conversation with Mr. Fastow, as Mr. Fastow, as soon as that conversation was over, called me to his office immediately to tell me that he was concerned whether we could continue to work together anymore. So clearly there's—a conversation was had between Mr. Skilling and Mr. Fastow.

And even prior to that, Mr. Sutton, who was Vice Chairman of the company, a day after I met with Mr. Skilling, called me into a meeting and said that he had been delegated by Mr. Skilling with the job of dealing with this conflict. So I do know he had some conversations with people after our meeting.

Senator WYDEN. Are you saying, then, to the Committee, you are satisfied that Mr. Skilling moved to deal with these conflicts-of-interest questions?

Mr. McMAHON. I don't think I'm saying that. Frankly, within three or four weeks after all that, I found myself in a different job in the company, and a new treasurer was brought on, and I just wasn't close to the situation anymore. So I really don't know what occurred after that point in time.

Senator WYDEN. Mr. Skilling, again using the Powers Report, it contrasts pretty sharply with what you've said about the processes for dealing with conflicts, and the processes that were in place with respect to the company overall. The Powers Report says that company insiders were enriched by tens of millions of dollars at the expense of shareholders. That doesn't sound to me like the conflict-of-interest processes and other processes were working particularly well. Do you? You said the processes were in place, that you trusted them.

Mr. SKILLING. Yes, sir, that's what I've said. If it turns out that one penny was taken from Enron shareholders that was not deserved by anyone, I would be angry about that. I have no more information about the specifics of the numbers you just mentioned than you do. I read the same newspapers.

I think—I think it ought to be looked at. And if, for any reason, Enron's shareholders were abused, then there ought to be appropriate action taken.

Senator WYDEN. With respect to your duties at the company, at this point, it is not clear how you spent your time. I mean, you have talked, for example, about how this was a new company, this was a company with, "light assets," and certainly there are a lot of people in my home state now that wish they had hard assets and had seen some hard profits. But, you talked about this being a new company. You said that, in effect, you relied on others, that there were processes in place.

Tell us what you did, in your view, to make these substantial sums. I've gathered there are some reports that you made \$100 million as the top officer of Enron. I don't know whether that's correct or not. But what, in your view, given the fact that you didn't do any independent inquiry of the conflicts of interest, that you relied on what people were telling you, we saw working-class people get shellacked by it—what did you exactly do to earn these very significant sums at the company?

Mr. SKILLING. Senator, I described this to the Securities and Exchange Commission. Let me see if I can do it quickly, because I know you're in a rush on this. But I would say, by the time I became CEO, probably 40 percent of my time was involved in strategic business decisionmaking. I tried to meet with each of our strategic business units, each of our businesses.

And I think at that time, if you look at—we had five segments, there were multiple businesses within each of those segments—we probably had 40 to 50 businesses that were operating inside the company. I would try to meet with those businesses on a frequent basis to understand what was going on, which markets they were going after, what problems they had, what resources they needed to be successful, and so forth. And that involved enormous travel. I was probably out of town 50 percent of the time visiting businesses. We had operations in Europe. We had operations in Asia, operations in South America. That was 40 percent of the time.

Thirty percent of the time was various policy issues. Our trading controls policy, for example, was a very complex, very time-consuming process where we were managing the positions and exposures that could be taken by various groups within the company, and that had to be reviewed on a daily basis to understand what the issues were so that we could manage that.

Also, with those policy issues, personnel—I would imagine of that 30 percent on policy, 20 percent of the time was spent in discussions with our key people or trying to attract new talent to the company or redeploying people from one organizational unit to another to help keep the businesses growing. So that was about 70 percent of the time. And I'll tell you, that was a lot of hard work.

The third component, probably 30 percent of the time are what I would call special issues that were kind of timely issues that

needed to be dealt with. And when I became Chief Operating Officer, that was primarily JBLOC, which was a large contract we had some serious problems with in the United Kingdom that needed to be negotiated in 1998 and 1999, reducing the amount of capital we were spending in the international markets because we were not earning compensatory rate of return on that business. 1999 and 2000, it was the startup of our broadband business and trying to get that up and running and a number of new businesses. In fact, Jeff ran our new industrial products business where we were starting to take the same business model—we had natural gas and electricity—and move it to some new—some other businesses.

And then in the year 2001, dealing with California, dealing with the broadband business that we had an issue with, and trying to sell and monetize international assets so we could bring more liquidity to the company.

Senator WYDEN. Well, those all look like useful strategic kinds of matters, but it sure looks to me like they're nowhere near as important as having in place a strategy for dealing with these conflicts of interest that look like they were just oozing all over the place. And—

Mr. SKILLING. Sir, we—I mean, we did. We had a control system in place that we believed—the Board and we believed would manage it. And you, again, go back to the minutes, and you'll see that we spent a lot of time talking about it. We were aware of it. We spent a lot of effort to manage that conflict. We did spend time on it.

Senator WYDEN. I want to ask one other question. You'll obviously have to convince a lot of courts and a lot of governmental agencies, but it certainly runs contrary to those people who were inside the company, who ticked off warning after warning. I outlined that four hours ago, and that's why it is so hard and so implausible to believe what we're hearing today.

One question for you, Ms. Watkins. I wrote a law a number of years ago that requires accountants to look for fraud and to have in place rules to bring it to the attention of government regulators. Now, you had some dealings with accountants all through the process, and you thought, by your words, that Enron was going to implode in accounting scandals.

I'm not going to ask you to comment on the law and be a lawyer, but does it sound to you like the company was complying in a, sort of, conceptual way with a set of rules and laws that say you've got to look for fraud and bring them to the attention of management and, if not corrected, to the regulators?

Ms. WATKINS. Well, what concerns me about some of the things that have come to light since this past fall, mainly from the documents from the various congressional inquiries into Enron, is that Enron itself had as one of its main risks associated with the Raptor deals is accounting scrutiny. Additionally, we have discovered that Arthur Andersen had a memo to the files dated February 2001 where they were concerned about the propriety of this. I do not understand why Andersen did not go to Enron's Audit Committee with their concerns. I am concerned any time that accounting scrutiny is at the top of the list of a risk associated with a structure.

Senator WYDEN. Well, what is important about that is there is a Federal law on the books, it was on the books all through that, that requires that when Arthur Andersen has any reason to believe that there is questionable activity, potentially fraudulent activity, that they do just what you were talking about. I appreciate your confirming certainly my opinion at this point that they should have done it and it was not done.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Boxer.

Senator BOXER. Thank you.

Mr. Skilling, you worked very hard at Enron; and given your own testimony, night and day. One of the reasons you left, you were working too hard. We understand what that is to not have enough time for family, et cetera. You're also very smart. And that's why I do not believe you when you say you did not know what was going on, because you had people with lesser education; you had people with less access to the documents, less access to the meetings, to the people making the decisions, who knew exactly what was happening.

I showed you a videotape where you and Ms. Olson tell employees in December 1999 to put all their 401(k) plan monies into Enron. She turned to you after she said absolutely do it, you smiled and nodded very, very clearly. At that time, you had sold over 500,000 shares of stock for \$21,928,000.

When I said that, you questioned me. We got the actual SEC filings with your signatures on them. I would like to put those in the record if I might, the SEC filings. That was a third, Mr. Skilling, a third of the stock you would eventually sell. So it was not just a little bit of the stock. At the time when you were telling your hard working employees, for whom you profess to feel much grief and sorrow right now, to put all their 401(k) monies into Enron, you had already sold a third of the stock you would eventually sell.

And I want to point out that Ms. Olson, Mr. Chairman, Ms. Olson, who led the cheering rally there for Enron stock, two months after she told people to put their money in Enron stock she started to sell off her stock as well. I ask unanimous consent to put that filing into the record.

Senator DORGAN. Without objection.

Senator BOXER. Mr. Chairman, as a Member of the Consumer Affairs Subcommittee of the Commerce Committee, I care about the little guy. And I will tell you if you look at this, it is asymmetry here. The people who put their money into the 401(k) plans lost about a billion, the insiders gained about a billion. That is asymmetry. That is an unfair share of pain, suffering, and loss of dreams, and that is why I think it is so important that we hold this hearing. Let us not forget why we are here.

Now I just want to follow up on my Chairman's comments on the Off Wall Street Consulting Group. Mr. Skilling, do you know this group? Have you ever heard of them?

Mr. SKILLING. I do not.

Senator BOXER. You've never heard of them?

Mr. SKILLING. I do not think so. I do not recall.

Senator BOXER. You do not recall. Did anyone in your company talk to you about what they said? This was May 2001, before you

left the company in August 2001. They put out a scathing evaluation of the company which I'll read a little synopsis of.

Mr. SKILLING. I may have seen it, I do not recall.

Senator BOXER. You may have seen it?

Mr. SKILLING. Yeah.

Senator DORGAN. If you'll refrain, let me ask that a copy of that be delivered, because I did ask a question about it, as well. And let us just ask that a copy be delivered.

Senator BOXER. There is a really important reason why I'm talking to you about this. Maybe your lawyer has that.

Mr. SKILLING. I'm sorry? Oh.

Senator BOXER. I'm asking you about this because you left the company in August. You said it was in great shape. You kept on selling your stocks before that time. You had really unloaded everything you were going to by that date. And here comes this analysis, and if I could show you page 4 at the top—we'll start at page 3 at the very bottom, because you keep saying it is complex, what happened. Well, this is a clear explanation of what happened.

Mr. SKILLING. I've got no page 4.

Mr. HILER. Excuse me. We do not—

Senator BOXER. I'm sorry. It says "Because margins"—it's actually—

Mr. SKILLING. I've got page 1, 2, 6.

Senator BOXER. Oh, he is missing page 3. Well, it is okay. I'm only reading one sentence on page 3 and then we'll get to page 4.

Mr. SKILLING. I'd like to see that if that is possible.

Mr. HILER. We do not have page 4.

Senator BOXER. He needs page 3 and 4.

Mr. SKILLING. I've just got pages—

Mr. HILER. We have 1, 2, 6—

Mr. SKILLING. I'm missing 3, 4 and 5.

Senator BOXER. Sorry about that.

Mr. HILER. That is okay.

Senator BOXER. We apologize.

Mr. HILER. While we're waiting for that, ma'am—

Senator BOXER. No, it is right here. I just do not want to lose my track.

Mr. HILER. Okay. Sorry.

Senator BOXER. Page 3. This is the analyst writing: "Because margins on Enron's incremental business are so thin, and because it now takes"—follow this—"about \$2.1 billion in additional revenues—"

Mr. SKILLING. I'm sorry, I'm—

Senator BOXER [continuing]. "Just to generate—"

Mr. SKILLING. We were having a little altercation over here.

Senator BOXER. All right. I'll start again.

Mr. SKILLING. Start over again.

Senator BOXER. Page 2 bottom.

Mr. SKILLING. Yeah.

Senator BOXER. "Because"—this is the analyst from this—I understand that it is a very well respected group. "Because margins on Enron's incremental business are so thin, and because it now takes about \$2.1 billion in additional revenues."

Mr. SKILLING. I'm not catching it. On page—bottom of page 2?

Senator BOXER. It is the bottom of page 3——

Mr. SKILLING. Page 3, Okay.

Senator BOXER [continuing]. The last——

Mr. SKILLING. All right. Okay, gotcha.

Senator BOXER. I'm going to just start again. I hope I can add on a couple of minutes here.

Mr. SKILLING. Okay.

Senator BOXER. "Because margins on Enron's incremental business are so thin, and because it now takes about \$2.1 billion in additional revenues just to generate an additional penny of after-tax earnings, it probably should come as no surprise that Enron management appears to have resorted to a variety of transactions that are of questionable quality and sustainability to manage and to boost its earnings. These transactions appear to be purposely obscured in Enron's public reporting."

I would ask unanimous consent that the summary of the report be placed in the record.

[The information provided follows:]

SUMMARY

Enron's business model has been evolving toward trading and risk management services mainly for the energy market. Enron has been abandoning its energy producing physical assets in favor of trading assets.

Recently, Enron has had the best of both worlds. Booming energy markets have maximized the value of its remaining physical assets, while high prices and increased volatility have created trading opportunities that have allowed the company to increase revenue very substantially. After growing revenue by about \$10B year over year in both 1998 and 1999, revenue growth exploded in 2000, as revenue rose to \$100B from \$40B in 1999.

When revenue increased by \$11B in 1998 versus 1997, gross profit increased by \$2B. When revenue increased by \$9B in 1999 versus 1998, gross profit increased by \$0.5B. However, when revenue increased by \$60B in 2000 versus 1999, gross profit rose by only another \$0.5B.

Gross margin as a percent of sales dropped from 13.3 percent in 1999 to 6.2 percent in 2000. However, the incremental gross margin dollars generated by the incremental sales year over year was just 1.52 percent of the incremental sales. Gross margins have not been released for Q1 01, but operating profit rose by just \$429M, only 1 percent of the year over year sales increase of \$37B.

Enron's Wholesale segment accounted for 95 percent of Enron's \$100B of revenue and 71 percent of its IBITDA in 2000, versus 90 percent of revenue and 55 percent of IBITDA in 1999. In Q1 01, Wholesale was 97 percent of revenue and 95 percent of total IBIT. ENE total IBIT was just 1.6 percent of total revenue in Q1 01 versus 4.7 percent in Q1 00.

Wholesale, and trading in particular, has clearly become the Enron story. The Wholesale division combines the results of Enron's trading and risk management business with results of various physical assets that the company own or controls. Enron does not break out gross margin or operating profit by these two types of Wholesale operations. EnronOnline, the company's on line trading division, was clearly a principal driver of revenue growth in 2000.

"Street" analysts expect ENE to generate about \$54M of incremental net income for the balance of the year 2001 versus the last nine months of 2000. However, the "street" also estimates only \$20B of incremental revenue for the balance of 2001 versus 2000. In our opinion, "Street" analysts may not have grasped ENE's business model. By our estimate, ENE would have to increase revenue by \$45B over the comparable period in 2000 to make consensus estimates. This would be \$7B higher our current estimated increase of \$38B.

For 2002, "street" analysts expect ENE to generate incremental net income of about \$475M versus 2001. This is based on total revenue estimates of just \$126B, which is only a \$12B increase over current 2001 estimates of \$112B. The "street's" 2002 projection is \$60B under our revenue projections for 2002, but consensus EPS estimates are much higher than ours. We estimate that ENE would have to increase revenue by about \$90B (based on 2001 analyst expectations for revenue of \$112B)

to meet their EPS estimates. We expect Enron will miss this \$215B of needed revenue by approximately \$30B in 2002.

Actually, there are few "street" revenue estimates for Enron. "Street" analysts prefer to estimate operating profit, although it is not clear how they obtain their results. The revenue estimates that do exist appear to be far too low, as we have shown. Analysts have not understood to what extent trading would become the main driver of Enron's business. This may also lead them to miss evaluate the company.

If analysts understood that increased volume of trading was driving much of the bottom line increase, they would need to think about the huge revenue increases needed to meet their earnings targets. They would begin to realize, as we have shown, that increased trading appears to result in lower margins. It has diminishing returns. Investors would then also see how slim margins have become and they would understand that if trading increases still more, which it will have to do to increase profit, profit margins should become slimmer still. Such low margins have important implications for the company's balance sheet, its return on assets and invested capital and, importantly, on its risk profile. We think an understanding of Enron's business model would lead investors to award a much lower multiple to Enron's forecasted EPS.

Industry sources say that Enron traders make large directional bets, and that they think that Enron is especially long gas and power. Enron's portfolio of long and short positions is "globally" balanced, that is to say that individual positions may not be specifically offset with an opposite position. These sources say that this is the main source of the risk, and that counterparty risk is not a major issue in general (though the PG&E receivable may be a problem, as we discuss). We note that a \$21B long position and a \$20B short position in the Wholesale division sits on top of total company equity of just \$11B. Total assets are \$65B. Hedge fund managers know that it is possible to lose money on both long and short positions at the same time. Enron's Wholesale portfolio is about 200 percent long and 200 percent short and leverage is increasing. According to energy traders, some of these positions could experience swings of 25 percent of their value. Notional single position sizes can be in the hundreds of million of dollars.

Very high revenue increases are largely generated by increased opportunities that result from high prices and by very high volatility in energy markets. Although the risk of less volatility, with the result that ENE would experience a significant decrease in its earnings, may now seem remote, the peak in volatility may occur this summer. We doubt that volatility can increase after this summer, even in the West. Industry observers predict high volatility to remain for a couple of years in the West, until more supply comes on line. However, they expect volatility in other parts of the country to decrease. Even this summer's widely anticipated New York energy crisis may not live up to expectations. It depends on the weather. But even if New York's energy market is volatile this summer, it should be temporary. Over all, except in the West, volatility will probably decline, though New York may remain tight. Declining volatility is a major risk for Enron, as it reduces the opportunity for trading profits. We will discuss volatility and prices in detail.

There is also risk in doing longer duration deals to make up for lower trading profit. Longer deals are more profitable because the total value of the discounted cash flows is higher. However, as the duration gets longer the risk also increases. The future cash flows become less predictable. As money managers know, a 30 year bond is more volatile than a two year bond. The changes in the value of the securities held by Enron pose a risk to future earnings.

Because margins on Enron's incremental business are so thin, and because it now takes about \$2.1B in additional revenues just to generate an additional penny of after tax earnings, it probably should come as no surprise that Enron management appears to have resorted to a variety of transactions that are of questionable quality and sustainability to manage and to boost its earnings. These transactions appear to be purposely obscured in Enron's public reporting. They include related party transactions whose total earnings impact is difficult to gauge, and they include gain on sale items that are of questionable quality and where the buyer appears to have recourse. In the past, when Enron management has been questioned about some of these transactions, it has not been forthcoming.

By our estimate, about \$0.41, or 28 percent, of EPS in 2000 came from gains on sale of securitized assets, some or all of which may have recourse to Enron, and related party transactions. Gains on sale of securitized assets accounted for about \$0.33, or 22 percent of 2000 EPS, by our estimate. About \$0.08 of the \$0.33 appears to be due to an unusual related party, called Whitewing, which we discuss below. Other related party transactions accounted for another \$0.08 of the \$0.41, or 5 percent of EPS in 2000. The fact that many of the gains on sales transactions also appear to have recourse to Enron casts their quality into doubt. Enron's balance sheet

reflects swaps that insure the buyer of these securitizations against some amount of loss. We go into detail on these transactions below.

Finally, we come to the issue of ENE's valuation. Some estimates of Enron's value seem simply arbitrary, while some others attempt to use a "market driven" price to earnings multiple based on future earnings by segment. First, we can not agree with "street" analyst EPS growth projections because we expect lower prices and lower volatility. However, even if Enron were to generate the massive revenue increases required to hit EPS expectations, given the added risk from the balance sheet and from decreased volatility, the very high so-called "market multiples" that are being awarded to the business are inappropriate.

For example, one analyst estimates that the Wholesale group will produce about 82 percent of total year 2001 IBIT. He then extrapolates that Wholesale will earn \$1.48 of his \$1.80 2001 estimate. The analyst applies an arbitrary 35x multiple to those earnings, though even by his aggressive estimate they will grow at 20 percent per year in 2002. He thus values Wholesale at \$52 per share in 2001, which is still only 58 percent of his total valuation of \$90. He then adds Broadband, which is even more arbitrarily valued at \$30 in 2001 and \$34 in 2002, even though it loses money. This so-called analysis is typical of current "Street" thinking.

Goldman Sachs, by contrast, sells for just 16x 2001 estimated EPS, 16x 2002 EPS, and 7.65x EBITDA. Few would argue that Enron has a business franchise equal to Goldman. However, using Goldman as a yard stick, as we explain below, we estimate that ENE might be worth between 7.65x TTM EBITDA, or about 15x EPS. That would put Enron's total value between \$23 and \$30 per share. We also do a separate segment analysis below. By this method, we estimate that the Wholesale division might be worth \$19.50 per share. Retail, pipeline, and Portland General may be worth \$9. We value Broadband at about \$1.75. We deduct \$3 for the cost to operate these businesses at the corporate level. We arrive at a value of \$27 per share by this method.

Senator BOXER. Now this is not complicated to read this, and this is a respected company. Do you recall ever having seen this, seen excerpts of it, heard it discussed in any way by your colleagues or others?

Mr. SKILLING. Senator, I do not recall specifically. I do not know if they are respected analysts. I do not know, I'll take your word for it that they knew what they were doing, but—which may end up being a mistake, but this is just absolute, absolutely, fundamentally incorrect.

Senator BOXER. What is incorrect?

Mr. SKILLING. The concept of declining margins. It is fundamentally incorrect.

Senator BOXER. So this analyst who predicted the demise of Enron was incorrect?

Mr. SKILLING. No, this analyst said—and because—and this has been something—and I do not know this specific firm, but there are a number of firms that began to comment on a drop of margins in the company. And the reason that they got that is when energy prices quadrupled, natural gas and electricity prices quadrupled. We do not own generating facilities, or own very few. We do not own oil or gas production.

Senator BOXER. Sir. Mr. Skilling, I appreciate that you do not agree with this. I'm not asking you that.

Mr. SKILLING. No, no, wait. Our margins—

Senator BOXER. You—no, no, no, sir. I have a reason—

Mr. SKILLING. I want—Senator, you have—

Senator BOXER. My question—

Mr. SKILLING [continuing]. Asked me a very—

Senator BOXER [continuing]. Had nothing to do with whether you agree.

Mr. HILER. Senator, I'm sorry. With all due respect—

Senator BOXER. I simply asked if you recalled it.

Mr. HILER. He is trying to answer your question.

Mr. SKILLING. I'm trying to answer.

Senator BOXER. No, no, that was not my question. My question simply was—

Mr. SKILLING. The question is this is absolutely in error. I think—

Senator BOXER. But I did not ask you—

Mr. SKILLING [continuing]. The intent is to suggest that I have some information from reading this that impacted my decision—

Senator BOXER. No, that was not—

Mr. SKILLING [continuing]. To sell stock.

Senator BOXER [continuing]. What I asked.

Mr. HILER. Senator, my—Senator, with all due respect, my—

Senator BOXER. Mr. Chairman, I've asked a simple question.

Senator DORGAN. Let us let Senator Boxer ask the question—

Senator BOXER. Let me ask it again. I never asked what you thought of this. I asked if you had seen it, discussed it, heard it discussed with your colleagues. That is all I want to know, not whether you—

Mr. SKILLING. No, I do not recall specifically seeing this document. I have seen documents and analyst comments that similarly raised an issue of declining margins which I fundamentally disagree with.

Senator BOXER. I respect that. Okay. Now are you aware that the person who wrote this was demoted?

Mr. SKILLING. Demoted?

Senator BOXER. Yes, demoted in his company.

[Mr. Skilling shakes head].

Senator BOXER. Okay. Mr. Chairman, my time is up. Can I stay for another round?

Senator DORGAN. Of course.

Senator BOXER. Thank you.

Senator DORGAN. Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman.

Ms. Watkins, I have a series of questions that I'd like to get for the record, so if I could address you.

Ms. WATKINS. Okay.

Senator NELSON. Could you specifically describe the difference between the so-called off-the-books partnership and other Enron partnerships that may have been publicly traded, of which we're told that they number several thousand?

Ms. WATKINS. Are you referring to the special purpose entities that Enron routinely uses to fund certain assets?

Senator NELSON. I'm talking about a number of partnerships. In some cases the on-the-books ones were the ones that were traded on stock exchanges. And I wanted you to describe the difference between the off-the-books and the on-the-books partnerships, of which we've been told there were about 3,000.

Ms. WATKINS. Well, there are—we had equity investments. Typically those were in public or private companies, not always partnerships, but those were in our merchant portfolio that we would fair value, or write up to their fair market value.

As to the numbers in the press, about 3,000, you know, special purpose entities, I'm not specifically aware. All I can speak to is different transactions that I might have worked on. We might set up as much as three or four for an international investment. And, as I mentioned before, it was to give us all kinds of alternatives if and when we ever wanted to sell that investment that we had a company that a buyer would be—would find attractive, you know, whether they wanted to buy a Cayman company or a U.S. company. So a lot of that was just—we did hire the best and the brightest, and it was strategically planning how we bought assets.

Senator NELSON. Okay. There may be some semantics here, but I'm particularly thinking about partnerships that were created whereby they would be publicly traded on a stock exchange. You're familiar with those kind of partnerships?

Ms. WATKINS. No, sir, I'm not. That Enron held? No, not that were publicly traded.

Senator NELSON. Well, let me ask you about in a partnership that was publicly traded, was there an opportunity whereby Enron would allow partners to buy additional interest in that partnership as a way of supporting the partnership's ability to distribute the minimum quarterly dividends to its investors or limited partners?

Ms. WATKINS. I think you might be referring to some of the master limited partnerships that Enron had, I think, in the liquid pipeline area and possibly EOTTs, but I do not have any firsthand knowledge of the way those partnerships worked.

Senator NELSON. Mr. Skilling, do you?

Mr. SKILLING. I'm really not familiar with the mechanics on the master limited partnerships.

Senator NELSON. You're not familiar with whether or not the partnerships would allow limited partners or others to buy in instead of buying publicly-traded shares of those limited partnerships?

Mr. SKILLING. Senator, I just do not know what that means. Can you say it again?

Senator NELSON. All right.

Mr. McMahan.

Mr. MCMAHON. And I'm afraid I'm going to have to be a little bewildered, as well. The publicly traded partnerships that I'm aware of that Enron somehow associated with are EOTT, which is the master limited partnership, and Northern Border Pipeline. There may be others, but I do not—none come to mind. In the EOTT partnership, if I think I understand your question, there is some sort of obligation in which Enron as the general partner has an obligation to EOTT limited partners for dividend distributions. I'm not precisely sure how all that works or how that obligation manifests itself.

Senator NELSON. So I'm really seeking information here. In a publicly traded partnership then that Enron could allow private parties to buy into that partnership instead of through purchasing on the public traded stock market. And if so, it was a way to support the partnership's ability to distribute the minimum quarterly dividends in that partnership?

Mr. MCMAHON. I'm not familiar with the first point, which if I'm understanding your question, that somehow off-exchange purchases

and sales can happen. I'm not familiar with that capability. But on EOTT in particular, there is some sort of credit support that Enron gave EOTT which would assist it, as I understand it, to make its quarterly distribution from time to time.

The reason I know this is it occurred post bankruptcy when EOTT tried to ask Enron to make good on that promise, and obviously post bankruptcy we were not able to. I'm afraid that is really all I know about that.

Senator NELSON. Well, as we get on into this in further discussions, I'm given to believe that there were certain partnerships set up that could meet their cash requirements by issuing additional limited partner interest with the partnership. And that Enron would contribute to that partnership in exchange for additional partnership interest to support the partnership's distribution of the minimum quarterly distribution. And if that is the case, and that is what I'm asking, there is absolutely no risk to someone investing in that partnership, because then Enron will come in and support it so that the partnership distribution is there, the minimum quarterly distribution is there.

So none of the three of you, save for your general knowledge, are aware of this particular mechanism?

Ms. WATKINS. No, sir, I am not.

Senator NELSON. Okay. Let me ask you this, Mr. Skilling. Earlier we had talked about—well, let me ask you. Enron Energy Services—that was a partnership. And was it consolidated on Enron's books?

Mr. SKILLING. Yes, sir.

Senator NELSON. Okay. Now earlier I had asked you if you had any information about any information or communication being transmitted from Enron, its officers, its directors, encouraging pension funds to acquire Enron stock, and you had indicted that no, you did not have any information of that.

Mr. SKILLING. Well, I—no. I thought the question you were asking was, you know, sometimes when the stock was dropping. I think you were saying that they were buying stock in October or something, was there any communication. I was gone, so I would not know.

There would—in the normal course of business we had an investor relations group. And I would imagine, you know, over the last decade I'm sure that they probably have talked with most of the large pension funds in the country and talked to them about Enron as a potential investment candidate. But I, after I left on October 14, I would have no information about that. August—I'm sorry, August 14 of 2001. I would have no information.

Senator NELSON. All right. But before that you would have some knowledge of those pension funds investing in Enron stock?

Mr. SKILLING. Well, not really. I mean there—we used to get a printout, I do not know, once a quarter or once a half, that just showed who the largest shareholders were in the company. I do not—it would be the list of like the top 25 holders. And then I would typically see that, but to be in the top 25 you had to own a lot of stock. I mean the top 25 holders of Enron stock would—I forget what the threshold is, but it was probably 10 million shares, 5 or 10 million shares.

Senator NELSON. Do you have any recollection back in 1998 that you talked to the Ontario Teachers' Pension Fund of getting them to invest in EES?

Mr. SKILLING. I'm sorry, say again.

Senator NELSON. The Ontario Teachers' Pension Plan.

Mr. SKILLING. Yes, sir.

Senator NELSON. Getting them to invest.

Mr. SKILLING. In—but I did not hear—

Senator NELSON. In EES, Enron Energy Services.

Mr. SKILLING. But what was the date, sir?

Senator NELSON. 1998.

Mr. SKILLING. I do not remember the specific meeting, but the Ontario Teachers' Pension Fund became—bought a portion of Enron Energy Services. And I believe CalPERS bought a portion of Enron Energy Services in late 19—would have said it was 1997, but was it 1998?

Senator NELSON. January of 1998.

Mr. SKILLING. January of 1998, okay. All I can say is that I do not recall specifics, specifically talking to them, but they were our partner in EES. We sold, I think, 7 percent of the company, and I think Ontario Teachers took, this is my recollection, like 3 percent. I think CalPERS took 4 percent of the business.

Senator NELSON. And what was your role in getting the Ontario Teachers' Pension Plan to invest?

Mr. SKILLING. I do not recall specifically. I would imagine that for an investment like that they would have sent their representatives to Houston and asked what the business strategy was of the business. And I do not know if I gave that presentation or if somebody else did, but we would typically give a presentation on what the markets were that we were going after and how we were going after those markets, and that sort of thing.

Senator NELSON. Okay.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Hutchison.

Senator HUTCHISON. Thank you, Mr. Chairman.

Mr. McMahan, I am a lawyer, but I'm not a bankruptcy lawyer. But after my last line of questioning a bankruptcy lawyer did call my office and suggested that there are ways that a company in bankruptcy can help severed employees. And that is by either hiring former employees back for a temporary period or listing some of the severance costs as administrative expenses.

My question to you is would you talk to your bankruptcy lawyers to see if you can do anything for the severed employees who have lost so much? This would not affect their pensions, but many of them would feel so much better if they at least had their contractual severance obligations met. Would you make that commitment today?

Mr. McMAHON. Absolutely, Senator. You have my personal commitment. This is a very high priority for existing management of the company to deal with this. And I'm not an attorney, but I'm becoming a bankruptcy expert unfortunately, and a lot of these things we have pursued.

The administrative claim as an issue for pre-petition severed employees, as I understand that, that is a matter of getting that pa-

perwork done. Post-petition employees it is a little, as I understand, it is a little bit tougher matter because of the termination of the severance plan. But we are actively researching everything we can do for these employees and we're going to be working with the Creditors' Committee on this, as well.

Senator HUTCHISON. I appreciate thus far your commitment to do that. I think it is important. You have a certain amount of assets left, and I would like to see a more favored treatment of people who have been left in the lurch.

Second, if this bankruptcy lawyer is correct and people can be temporarily rehired and then made to be administrative expenses later, I would at least like to see the employee's status the same as attorney's fees, for instance. And I think that would be some small amount of help that might be given in these circumstances.

I would like also to ask you, Mr. McMahan, if the nature of the business that is left of Enron, in that are there any other off balance sheet partnerships and is that an ongoing concern that we should address?

Mr. MCMAHON. What is left of Enron we are having internally, in connection also with our external counsel, Skadden, Arps & Weil, Gotshal, exhaustive investigation of all the corporate structures that the company has. Most of these partnerships or finance structures have creditors. So, as part of the bankruptcy, we are determining who they are, how it was structured, et cetera. And it is my understanding that we are fairly far along in that process, and to date have not discovered anything that would cause us concern, a lot of these other partnerships, but that is a process that is still under investigation right now.

Senator HUTCHISON. Okay. Thank you, Mr. Chairman.

Senator DORGAN. Senator Hutchison, thank you.

Mr. Skilling, on January 22, 2001, the Enron Board of Directors awarded you an additional 125,000 shares of stock roughly, at no cost to you. Is that accurate?

Mr. SKILLING. Shares of stock or stock options?

Senator DORGAN. Stock options, I'm sorry. Options for shares of stock.

Mr. SKILLING. I do not remember the exact number.

Senator DORGAN. The 125,562 shares, or options rather for Enron stock, why would a Board do that in a January meeting?

Mr. SKILLING. Well, January was typically our compensation meeting. What we would do is calculate how the business had done for the prior year, and then based on that we would determine what our overall bonus pool was and allocate that to our employees. So that occurred simultaneous with management.

Senator DORGAN. Now, when you were testifying before the House of Representatives, you were asked if you dumped stock because you knew there was some financial trouble in the company. And, I just pointed out that you sold \$66 million worth of stock in a period of time. You said, "No. In fact, when I left Enron holding almost the same number of shares that I held at the beginning of 2001." But, you did not tell the House of Representatives that, in fact, during that period you received 125,000 shares, options for shares of Enron. Is that true?

Mr. SKILLING. The shares count that I gave is shares, not options. So those options—

Senator DORGAN. Yeah, but you were busy selling. You sold 500,000 shares for \$15 million a month after you left Enron; you, from January 3 to June 13, sold 10,000 shares every Wednesday for a total of 240,000 shares. The point you were making to the House was, “Look, I did not dump anything. In fact, I ended up with about the same amount as I started with.”

But, in fact, when you take a look at what was sold, you converted options to shares and sold them. It appears to me you did not tell the whole truth to the House when you answered that question.

Mr. SKILLING. Well, this is—I think that gets to Senator Boxer’s question. I do not know how you want it presented. I mean the statistics are there; you have to file them with the SEC. You guys can get them and present them however you want.

Mr. HILER. I would also just—I would like to point out for the record, I believe that was in my client’s opening statement. And what he was showing, I believe, was that he did hold shares—

Mr. SKILLING. At the end.

Mr. HILER [continuing]. Significant shares at the end, at the period when he left the company, and he had significant shares at the beginning of the period.

Mr. SKILLING. I’ll give you an example, Senator.

Senator Boxer said that I sold 500,000 shares. There was a little confusion there because there was a stock split that occurred in 1999. So her number was calculated different, you might have to adjust for that. But I started the year 1999 with 262,000 shares that I owned. I ended the year 1999 with 906,000 shares. So I actually had an increase of over 600,000 shares during that time period. Yes, some shares were sold during the period, but in terms of share ownership, the share ownership increased. So I do not, you know, you can present it a number of different ways. I do not know—I mean I’ve presented it every way I can and you guys have the statistics and you can—

Senator DORGAN. Well, and I think I represented what we have, and it suggested something different than you’re now saying, but let me ask about another report. I do not have any basis for knowing about this, I just ask you to respond to it. There was a report in the Dow Jones news wires that you and Ken Lay stage-managed a fake trading room to impress analysts, jokingly referring to it as “The Sting.” You wanted the room to look like a Wall Street trading floor, so you got the best equipment, tore down offices. You would tell the analysts “This is how we structure a deal.”

“And we painted phones black to make it look like a slick operation. We held a rehearsal with Skilling and Lay the day before, and Skilling said he wanted to play the Paul Newman character in the movie ‘The Sting’ when the analysts came through. But they said it really was more of an elaborate charade because there was not much going on there.”

How accurate is this?

Mr. SKILLING. Any suggestion that the trading floor in EES that was developed was not for specific business purposes and did not

significantly advance the conduct of the business is preposterous. It is absolutely preposterous.

Senator DORGAN. Did you try to deceive analysts when they came to that floor?

Mr. SKILLING. Absolutely not.

Senator DORGAN. Did you paint phones black and invite other people to come sit at those desks—

Mr. SKILLING. I do not know how you paint phones black. We—I mean we have standard telephones in the company. I'd imagine they're the same phones that we have everywhere else. If someone painted a phone black, I certainly did not know about it. Was the trading floor a legitimate effort to put together a better risk management and better business process? Absolutely.

Senator DORGAN. I understand that, but I was asking about a circumstance they alleged you created in order for analysts to be able to see something that did not actually exist in operation, but I think you've answered that.

Let me ask you something on a chart that I had used previously. This chart shows subsidiaries of major corporations. And it may be hard for you to see, but I'll describe what it is. It talks about the rank in Fortune 500, the first 10 companies, 10 largest companies, and over on the far right it says "Subsidiaries and Offshore Tax Havens, Enron, 872."

The next largest company is General Motors. They had 14 subsidiaries and offshore tax havens; Enron, 872.

The reason I ask the question is, you know, some people think that this was a culture in which you stretched the rules, bent the rules, then broke the rules; and that part and parcel of all of this is to be as aggressive as is possible to do a lot of things, including avoiding paying taxes. How is it that the company would have 872 subsidiaries and offshore tax havens? Any response to that?

Mr. SKILLING. Senator, I do not know. If you look at the total subsidiaries the company had, I'm guessing 3,000 subsidiaries.

Senator DORGAN. You had 2,832, far more than any other. The biggest company, General Motors, had 316. But of interest to me is how many of them were in tax havens, Cayman Islands and so forth. I do not think I've ever seen anything quite like this, and it reinforced for me, at least, that there was a culture here of—

Mr. SKILLING. Yeah, but—I'm sorry, I cannot see—

Senator DORGAN [continuing]. A lot of unusual—

Mr. SKILLING [continuing]. The chart from here. My eyes are not as good as they used to be. Do you have any—

Senator DORGAN. Let me ask someone to come down there and show it to you.

Mr. SKILLING. Do you have any banks on the list? Do you have General Electric on the list?

Senator DORGAN. Those are the 10 largest corporations in the country.

Mr. SKILLING. Then why is not General Electric on the list?

Senator DORGAN. Well—

Mr. SKILLING. Is this—okay. Let me see them, yeah.

Senator DORGAN. Yeah. You'll see the list.

Mr. SKILLING. Okay.

Senator DORGAN. General Electric is on the list and they had 24 subsidiaries. But I'd like you to——

Mr. SKILLING. Now wait. Now, you know, I hate to be skeptical, but——

Senator DORGAN. Well, in this room it is a common thing these days.

Mr. SKILLING. Yeah.

Senator DORGAN. Especially today.

Mr. SKILLING. Certainly is. General Electric, GE Capital Corporation had multiple investments with us in subsidiaries. I would imagine they had more investment subsidiaries in partnership with Enron than 24. I mean what is this chart? Is this General Electric Corporation, or have you picked up all of the subsidiaries? How can you do business—General Electric does business in several hundred countries around the world. They would have to have a separate incorporated business in each——

Senator DORGAN. Yeah. Well, Mr. Skilling, this——

Mr. SKILLING [continuing]. One of those countries.

Senator DORGAN [continuing]. Is a report off their 10-Ks. But I, you know, we can have another hearing on General Electric.

Mr. SKILLING. Well, I mean just think about it logically.

Senator DORGAN. I'm very interested in Enron at this point.

Mr. SKILLING. Just think about it.

Senator DORGAN. So if you could describe for me as the CEO of Enron, former CEO of Enron, your subsidiaries, and especially those subsidiaries in tax havens.

Mr. SKILLING. I guess all I can say is I would imagine that if you got the accurate numbers there, I would imagine you would not see as much difference between Enron and other companies. I do not know what the specific purpose of each offshore subsidiary was, but I know, for example, in every single country where we operated we had to have a separate subsidiary. We had to have a separate subsidiary for every single project we entered into. And there is no way that General Electric operates in fewer than 24 countries. I mean it just—it does not make any sense.

Senator DORGAN. Well, we'll have further dialog about that. I'll submit some questions to you.

Mr. McMahan, I just have two other questions, then we'll finish.

Mr. McMahan, I know that the company offered bonuses to get people to stay just prior to bankruptcy. And that also is controversial, especially because so many people lost so much money. I believe you were given a \$1.5 million dollar retention bonus; is that correct?

Mr. MCMAHON. That is correct.

Senator DORGAN. And was that common? How many people in Enron just prior to bankruptcy got bonuses to convince them to stay? And was a million-and-a-half necessary to convince you to stay at Enron?

Mr. MCMAHON. Let me answer your first question first. I believe the number of retention bonuses ranged into the hundreds of employees. I'm not precisely sure of the exact number. And at the time, the Board authorized this; I was not part of this decision. But frankly, it probably was not necessary for me to receive that amount to stay.

Senator DORGAN. Ms. Watkins, did you receive a bonus to stay?
Ms. WATKINS. No, I did not.

Senator DORGAN. You understand why some people down at the bottom would be furious with all this? I mean, there is a lot of money flying around if you look at the history of this company in recent years, a lot of money moving around quickly.

Mr. Skilling has said nothing about Mr. Fastow today really, but if I were Mr. Skilling, I think knowing what I know—and I've read a substantial amount about what happened here, I would think that Mr. Fastow deceived people inside the corporation, or they knew what he was doing and acquiesced to it, but one of the two. But yet, I do not hear anybody talking about who did something inside the corporation that was inappropriate, except the Board of Directors.

The Board of Directors issues a best-case report that is scathing about what happened inside this company. And now, you know, I'm going to mention the bonuses. I'm sorry to do that, Mr. McMahon. I know that no one has raised any questions about your role. You say you went to see Mr. Skilling to complain about the circumstances in a very similar way that Ms. Watkins complained and Mr. Skilling turns that discussion into a discussion about compensation whenever we raise this issue. I assume it was more than compensation, it was what you said it was.

But Mr. Skilling says Ms. Watkins is wrong, Mr. McMahon is wrong, the Powers Report is wrong, the market is wrong. You know, Mr. Skilling, I have great difficulty believing your testimony. I wish I could believe your testimony, but somebody was not home at the Enron Corporation.

Mr. SKILLING. Is that a question?

Senator DORGAN. Well, no, it was a statement. I regret having to make the statement, but you're sure welcome to respond to it if you like. I can put it in the form of a question if you'd prefer.

Mr. SKILLING. I think if you're suggesting that—well, let me start off. I do not think that my description of the meeting is radically different than Jeff's.

Senator DORGAN. It is.

Mr. SKILLING. Everybody has a meeting. It is not. I have said that Jeff raised the issue of conflicts of interest. I did not say it was strictly a compensation issue, he raised an issue of conflicts. We had a process in place that was approved by the Board and he was raising some other issues. My recollection—and, you know, Jeff probably has a better recollection because he probably thought about it more than I did in retrospect. But my recollection is that compensation was a key part of that discussion. And I believe that I followed up and I believe that I—I hope that I put his mind at ease that he should do what he believed was ethically correct, because I believe in that. I have heard—

Senator DORGAN. See, you've done it again, Mr. Skilling.

Senator DORGAN. You just created a transition into a new subject.

Mr. SKILLING. I have heard Ms. Watkins' comments, and I cannot for the life of me see what basis she would have for suggesting that I would know some of that. I mean, how would she know that? And I do not see that it is at all inconsistent that there would be some

things I do not know if some people purposely kept me from knowing some things, which I guess goes to the beginning of your comment. I do not see why that is so hard to understand.

Senator DORGAN. Well, I would say this. I'm not a stockholder and I'm not an employee, but if I were and somebody at the top was getting \$66 million selling shares of stock, I'd surely want them know everything that is going on inside that company. Especially when key people, including Vice Presidents, say what was happening was common knowledge, and especially when after the Board of Directors issues a report that says what was going on inside that corporation was, "appalling." I think there is an expectation that people in that position would have known.

Mr. SKILLING. You now say that you did not know. I regret very much that testimony, because I think it is at odds with what Mr. McMahon said, despite the fact that you pivot that every time you talk about it. It is at odds with Ms. Watkins, it is at odds with the market assessment of that company, and it is at odds with the Powers Report.

Mr. Fitzgerald.

Senator FITZGERALD. Thank you, Mr. Chairman.

Ms. Watkins, I have not had a chance to ask you any questions today. As I'm sure you know, I have great admiration for your role in bringing to the attention of superiors what you thought were grievous errors in the way Enron was accounting for earnings and hiding losses. And I think the whole country has a great deal of admiration for you, because it took a lot of courage to stand up and speak out when you did.

And everything that I've heard you say, both before this Committee and the House, has made perfect sense to me. The only thing I'm troubled with is the notion that Mr. Ken Lay was somehow duped. And I want to ask you a few questions and go back over why it is that you think that Mr. Lay was duped. You gave him your letter shortly after Mr. Skilling left the firm. He left the firm on August 14, 2001. What day did you give him your letter?

Ms. WATKINS. I gave him the anonymous letter on August 15, 2001, and then the full set of memos when we met on August 22, 2001.

Senator FITZGERALD. And you had the meeting for a half hour on August 22?

Ms. WATKINS. Yes.

Senator FITZGERALD. And at that time, you recommended to him—and in your memo you clearly recommended to him that they should conduct an investigation; that the investigation should be handled by a law firm different than Vinson & Elkins because they were clearly conflicted. They were at the center of setting up all these partnerships. Is that correct?

Ms. WATKINS. Yes.

Senator FITZGERALD. And did you also not recommend to Mr. Lay that they review the propriety of the accounting for all the transactions?

Ms. WATKINS. Yes. At the heart of my concern was an accounting concern.

Senator FITZGERALD. It was an accounting concern. Now when Mr. Lay ordered the investigation though, is not it correct that he

told Vinson & Elkins to do the investigation? He hired them to do the investigation and that he specifically told them not to review the accounting issues that you raised.

Ms. WATKINS. Well, I learned with the release of documents that the House did a couple weeks ago that Vinson & Elkins' investigation had been limited and they had been told to not second-guess the accounting treatment. They did not indicate that they had any limits in their review when they met with me in September.

They also met with me October 16, 2001, in the afternoon. We had released earnings that morning. We had written off \$1.2 billion in shareholders' equity. They told me that—they did not show me their report, but they said that the conclusion had been that the accounting, when done, was proper. So they made accounting conclusions to me. It seems at odds with the fact that they say that they were not second-guessing the accounting. It all appears to be somewhat of a whitewashed report to me.

The reason I think Mr. Lay did not get it was he gets this report from V&E October 15th saying "It's all okay, the optics are bad." And he just decided "Let's unwind it. Let's write it off, let's get it behind us." If he truly understood the magnitude of manipulating your financial statements I think, you know, if it were me, I'd do a lot more contingency plans. I would know that that would upset the market, what would be our backup on equity and debt finance, what were we going to tell our investors, what were we going to tell our customers.

We were radio silent for roughly two weeks and we hid behind the SEC inquiry. When investors would call and say "What's this about the unwind? What's this about Raptor?" The response was always, "Well, the SEC is investigating, so we're not going to be able to answer questions about Raptor." My understanding is the SEC phoned us and said "Do not hide behind us. If your investors have questions," you know, "answer them." We had no ready answer to explain that write-off, which makes me think he did not get it.

Senator FITZGERALD. But, Ms. Watkins, is not it true that Mr. Lay specifically instructed Vinson & Elkins, "Do not follow Ms. Watkins' recommendation and review the accounting propriety. Do not review the accounting." On page 176 of the Powers Report it says that "The result of the Vinson & Elkins review was largely predetermined by the scope and nature of the investigation and the process employed."

Isn't it possible that Mr. Lay was contributing to burying your concerns by putting in the restriction that they not review the propriety of the accounting?

Ms. WATKINS. That restriction should not have been there, in my opinion, and it concerns me that it was.

Senator FITZGERALD. It concerns you that it was? I mean it is like you have raised accounting issues; and it would be like somebody having some trouble with their car and taking it to the dealer and say "Please fix the car, but do not look under the hood." It is a real problem.

And certainly if he had been duped prior to your meeting with him on August 22, do not you think you de-duped him in that meeting?

Ms. WATKINS. I would think so. I mentioned in my opening statement that I had been extremely disappointed by the company's reaction and response to my concerns. And I was incredibly frustrated, because I do think Mr. Lay missed a small window of opportunity to salvage the company by ignoring the obvious, as indicated in the Powers Report.

Senator FITZGERALD. And Mr. Lay is a bright man, is he not? Do you have an opinion on that? Do you think he is a bright man? Maybe you do not.

Ms. WATKINS. Not after this fall.

Senator FITZGERALD. Did you hear Mr. Skilling's discussion about his description of the budget process at Enron? Is it your understanding that Mr. Lay and Mr. Skilling would meet with the various units to discuss their budgets?

Ms. WATKINS. Yes. There was an annual budget process that occurred in the—typically in the fall of each year for the following year.

Senator FITZGERALD. Was it your impression that units felt some pressure to meet their budgets and contribute to Enron's overall earnings as they had been expected at the beginning of the year?

Ms. WATKINS. Yes. In fact, you know, Mr. Skilling referred to two alternatives by which we accounted for our equity, merchant equity investments, that we could hedge them with a local relation hedge, or we could choose to hedge them with Raptor. Well, we also had a third alternative, which was to take normal prudence reserves. In many of those investments, Avici, I think, Enron invested maybe as little as \$5 to \$10 million. The company went public, it—the value rose up into the \$170-\$180 million range. We took all of that into earnings at Enron Broadband when we had hold restrictions. The prudent thing to do was to put a prudency reserve and maybe just take 30 or 40 percent of that gain.

Senator FITZGERALD. Did Mr. Lay and Mr. Skilling ever tell units to be prudent in their earnings and not to push the envelope?

Ms. WATKINS. I think the business units were under pressure to meet their earnings targets. So if that was a mechanism by which they could meet it, they would choose to write up their equity investments to the maximum amount. And then we were forced to turn to something like a Raptor vehicle to lock in that value, and that Raptor vehicle was not a real, true economic transfer of risk.

Senator FITZGERALD. Mr. Chairman, I know my time is expired, but I wonder what the—I certainly have many more questions and I do not want to hold up the other Senators. Do we want to do another round, or—

Senator DORGAN. Why do not we proceed to Senator Boxer.

Senator FITZGERALD. Okay. Thank you.

We'll come back. Thank you.

Senator BOXER. Thank you. Mr. Chairman, we all know that we are not prosecutors here; we're not a court. Yet, we know that it is illegal to sell shares based on insider information. It is not for us to decide whether that happened. However, I want to get back to this just to give my own opinion, as it ought to be examined.

You know, you can talk about number of shares from night to morning. I used to be a stockbroker. We know if there is a three-for-one split, you start out with a share, you wind up with three.

You can sell two and still have the one and say “I still have as many shares.”

I think the important thing is what the Chairman said. Mr. Skilling, you and others sold multi-million—almost a billion dollars worth of insider stock. The fact of the matter is that you sold \$20 million worth before you told those employees sitting in that room who looked up to you in more ways than one, to put their money into Enron.

They looked up to you, they looked up to Ms. Olson. And it was like a pep rally—you had already sold. You should have told them that. And you should have, if you felt any fiduciary responsibility when they asked, said, you know, “Look into diversifying.” You mentioned that today in an offhand fashion, but that is not what we heard.

I want to get to the California case. During the electricity crisis on Front Line in June 2001, they asked you “What do you,” you know, “the generators seem to be making so much money.” And, you said, “We’re the good guys. We’re on the side of the angels.” That was in June, 2001. In that same month, you made your now-famous joke referring to the Titanic, when the Titanic went down, the lights were on.

Today, you give this very good excuse for this horrible statement here to the California Attorney General with whom you were so upset. You could have taken him on in a dignified way. I think it is a little kindergarten for a person in your position to say “Well, I’m going to tell a joke against all the people in California because your Attorney General told a bad joke about Kenneth Lay.” I’m sorry, I do not buy it. This is—

Mr. SKILLING. You think the Attorney General’s comment was a joke?

Senator BOXER. I did not agree with his statement that he made.

Mr. SKILLING. Thank you.

Senator BOXER. That is not the point, and it is not the point to change the subject. You took on the State of California when you, in talking to the press, described the company’s condition, which was going down. You said that Enron faced terrible problems because California’s electricity crisis had been solved. That is a direct quote from *The San Diego Union Tribune*.

And in the SEC filing in November 2001, at the height of the money coming into your corporation to keep it alive while insiders were selling like mad, the SEC filing from Enron’s words, “The power and gas intermediation business both benefited from price volatility in 2001.” So we see what California meant to you. California was keeping—

Mr. SKILLING. Can I respond to that? Those are not inconsistent comments.

Senator BOXER. I will let you respond, of course, as soon as I finish what I’m saying.

Mr. SKILLING. Keep the—

Senator BOXER. I will stop and let you say as many things as my—

Mr. SKILLING. Thank you.

Senator BOXER [continuing]. Chairman thinks is appropriate.

The fact of the matter is, Mr. Skilling, you told our state in 1994, California would save billions of dollars by deregulation. You even put a number on it, Mr. Skilling, \$8.9 billion per year. But, that did not happen. Let us see what happened. Okay? Let us see what happened.

We went from 1999, \$7.4 billion total to keep our lights on and keep our seniors cool in the summer and warm in the winter, and our agriculture business going, and Silicon Valley going. If it were a country, California would be the fifth largest country in the world. Manipulation of a company and an industry is just wrong, because it hurts the whole country. Electricity costs went up \$27.1 billion in one year. By the way, demand up 4 percent. Demand up 4 percent.

However, you said we were going to save over \$8 billion a year. Well, the overcharges are way more than that, and the long-term contracts were a ripoff also. So it is many more billions that we lost, this transfer of wealth from the people of my state to the robber barons of the 21st century. That is what I think. So the bottom line is we paid a huge amount, and the electricity cost was not related to demand.

Now I want to go to FERC for a minute, because FERC was the only thing between you and total deregulation. What did you do? You wined and dined a lot of people at FERC, did you not? We have here the list of the best recollections of FERC people, decision-makers.

On December 7, 2000, you treated these folks or had lunch with these folks and with this Daniel Larcamp, Director of Markets, Tariffs and Rates at FERC, along with seven other FERC employees. He says "Several other Enron employees participating in showing Enron's trading room." So was that in Texas that that occurred?

Mr. SKILLING. I have no idea, Senator.

Senator BOXER. Well, he said he had lunch—you were present at the lunch in Enron's trading room. Would that be in Texas if this gentleman is correct, his calendar is correct?

Mr. SKILLING. Well, we have a number of different trading floors, but I just do not recall that. We had a lot of people from government that would come through, because this was all new and people were trying to understand it. So I would not be at all surprised—

Senator BOXER. Do you remember your lunch with Thomas Herlihy on December 7, 2000, Executive Director and Chief Financial Officer of FERC?

Mr. SKILLING. Who? There is a—

Senator BOXER. H-E-R-L-I-H-Y. Do you remember anything like that?

Mr. SKILLING. No, I'm sorry, I do not.

Senator BOXER. Do you know this Daniel Larcamp? Do you remember who he is?

Mr. SKILLING. No.

Senator BOXER. Had lunch with him. Okay. Well, Mr. Chairman, I will submit some more questions for the record regarding this series of meetings that Mr. Skilling does not remember.

Mr. SKILLING. Have you gone through—

Senator BOXER. Do you remember any other meetings with FERC employees or decision-makers at all during the time when Californians were asking FERC to intervene? Do you remember any other meetings?

Mr. SKILLING. While California's—

Senator BOXER. Yeah.

Mr. SKILLING. No, I had—

Senator BOXER. The last six months you were—

Mr. SKILLING. I had meetings with FERC commissioners, but I do not remember in the last six months that I was with the company that I met with FERC commissioners.

Senator BOXER. Okay. I have one last question and then I am done. You will be very happy to know that.

Mr. SKILLING. You have not asked any questions yet.

Senator BOXER. Well, I will. I said I'm done with my part.

Mr. SKILLING. Oh, Okay.

Senator BOXER. I'm making some statements. I just asked you a question. You just answered that you did not recall.

Now I want to talk to you about overbooking lines. These are two traders, T-R-A-D-E-R-S. Here is what they say: "What we did was overbook the transmission line we had the rights on and said to California utilities, 'If you want to use the line, pay us.' By the time they agreed to meet our price, rolling blackouts had already hit California and the price for electricity went through the roof."

Another one said: "We would overbook the lines, which would cause congestion. The price of power would go up on the other end and—where the power was being delivered to."

Do you have any knowledge that this was happening?

Mr. SKILLING. What is the—

Senator BOXER. By Enron traders.

Mr. SKILLING [continuing]. Reference to?

Senator BOXER. It is about the transmission lines in California being overbooked by Enron.

Mr. SKILLING. Is this the result of the ISO [independent operating system] loading testimony that was held in, I believe—I think it was the spring of—

Senator BOXER. Well, let me explain. I'll explain what it is, because it is in an article here. The trader said: "Enron held the transmission rights on path 26, a key transmission line connecting Northern California to Central California, and also connecting to path 15, a major bottleneck grid pathway in Northern California owned by PG&E, which no one broke as a result of all of this."

So my question is are you aware that the traders were, in fact, overbooking the line and congesting these transmission lines? Were you aware of that at all?

Mr. SKILLING. The only thing that I'm aware of, Senator, is there was a difference of opinion on the rules of the independent system operator. It was just set up. Well, you know better than I do when the independent system operator came into effect. But there was a question as to how you could schedule and nominate power onto the system. And it turns out the way it works, it is like, you know, in the New York Mercantile Exchange. In the New York Mercantile Exchange, in a typical day probably 200 to 300 BCF of gas is traded. The settlement location for that is Henry Hub.

You can only move 300 million cubic feet, so you're trading something on the order of 700 times the amount of volume that can physically be moved through a delivery point. So there would be many cases where you would schedule, nominate capacity, in anticipation of an offsetting nomination that was going to be coming later. That is absolutely standard industry practice. And the ISO looked into one specific case. They said that their—it is my recollection of what they said, is the rules were not quite clear.

Senator BOXER. Okay.

Mr. SKILLING. And they ended up, I think we resolved it, said that we would change the rules.

Senator BOXER. Well, Mr. Chairman, I just want to say that, again, it is changing the subject. We have traders here from Enron who are saying they did something wrong, but you do not see anything wrong. And if I could just close and leave.

There was a whole advertising campaign against Governor Gray Davis. The ads were sponsored by an organization called American Taxpayers' Alliance. The Governor Gray Davis Committee has had to file a suit because the people behind these ads will not come forward. Do you know anything about those ads that blamed the Governor for the grayouts it was called?

Mr. SKILLING. No, I do not, Senator.

Senator Boxer: You do not know anything and you never talked to anyone who contributed to that fund and—

Mr. SKILLING. I—

Senator BOXER. We're going to find out eventually.

Mr. SKILLING. I do not know.

Senator BOXER. But you do not know that Enron contributed or any of your traders, like—

Mr. SKILLING. I do not know.

Senator BOXER. Dynegy or—you never—you did not know about this ad campaign?

Mr. SKILLING. I knew there were all sorts of ad campaigns going on in California.

Senator BOXER. Did you know about that one?

Mr. SKILLING. What is it called again?

Senator BOXER. It was called out "Grayouts from Gray Davis." They began June 18, 2001, before you left.

Mr. SKILLING. I do not recall, Senator.

Senator BOXER. Okay. Thank you very much.

Senator DORGAN. Senator Nelson.

Senator NELSON. Senator Boxer, do you need some more time?

Senator BOXER. No.

Senator NELSON. You're certainly welcome to mine.

Senator BOXER. I think I did what I had to do.

Senator NELSON. Mr. McMahon, let me pick up where we left off. You were describing the master limited partnerships, and you specifically mentioned EOTT. Are you aware of any other master limited partnership?

Mr. MCMAHON. The only other one I'm—that I'm aware of is Northern Border Pipeline. And I'm not 100 percent certain that that actually is a master limited partnership.

Senator NELSON. Well, in your opinion, can you explain to the Committee a description of how a master limited partnership is structured?

Mr. MCMAHON. I really cannot with any degree of accuracy. I'm just vaguely familiar with EOTT as it came across my area of responsibility over the last month or so when EOTT's management asked Enron to perform under a credit support agreement.

Senator NELSON. Mr. Skilling, can you provide to the Committee a description of how a master limited partnership is structured?

Mr. SKILLING. I'm sorry, Senator, I cannot. I think it's a tax structure and they're pretty complicated. I do not know.

Senator NELSON. Okay.

Ms. Watkins, we were trying to get the specific label on this when we were talking earlier. Do you have any information you can share with the Committee?

Ms. WATKINS. No, I do not. I'm not familiar with how master limited partnerships work.

Senator NELSON. Okay. Let me ask Mr. Skilling. We were talking earlier about CalPERS and Ontario and how in 1997 and early 1998 there was a successful involvement of getting CalPERS and Ontario Teachers' Pension Plan to invest in EES. We had talked about that. Now, at the same time, you had a financial stake in EES, did you not?

Mr. SKILLING. I do not know. I did not have a—well, I had a—we had something that was called phantom equity, which was—you could—when we started new businesses back in the early 1990s we tended to give a piece of the business to the executives. We started EES, I believe in 1994, and I was given a piece of phantom equity in that. We converted that to—we did away with the plan and converted everybody onto standard Enron stock and options, and I do not recall the specific date of that conversion.

Senator NELSON. Well, what begs the question is—and we're looking at this from a standpoint of legislation—is it a conflict of interest for an officer of a company that has an interest in an entity of that company to go out and to get others to purchase into that company in which the officer has an interest?

Mr. SKILLING. Well, you know, it was standard and is standard industry practice. For example, in the development business, when you're developing a power plant, typically you give the developers a percentage of the power plant. And then they're out finding additional investors because you typically only want to keep a small sliver. So that would be a standard industry practice, Senator.

Senator NELSON. Do you think that needs to be changed?

Mr. SKILLING. I, quite frankly, have not really thought about it. I'll think about it and—I do not think it is a problem. I do not know, I'd have to think about it.

Senator NELSON. Well, you know, we live in a different world then, because I can guarantee you if any of the Members of this Committee were trying to get people to buy into something that they had an interest in there would be people questioning the conflict of interest. I think that is something we're going to have to look into, Mr. Chairman, from the standpoint of the protection of consumers.

Mr. SKILLING. No, but I think if the issue is one of disclosure, I mean my experience has been—and when we would bring in outside private equity to participate with us, typically they would insist that management have some sort of an equity interest in the company. They would insist on that, so that they had some sort of an incentive. That was the last plan, to my recollection, where we had that.

And, in fact, we had looked at a number of other businesses where—in fact, Mr. McMahon was involved in a business where we were trying to bring in some outside equity and the outside equity parties demanded that management have a percentage of the business. And I ended up personally terminating the discussions or telling them we're not going to do the deal, because I said, "We will not put our employees in a position where they're not working for Enron Corporation."

So, I think typically it is the private equity partners that like it. I think from Enron's standpoint, it is a good way to incent people. So I think it is probably a little different, but I'll think about it and—

Senator NELSON. Did you have any other financial interest in any other entity in the company?

Mr. SKILLING. When I started with Enron in 1990, I was given a partial—or one of these phantom percentages in the wholesale market, when we started that wholesale market. And then I converted that. In fact, I believe the conversion of that plan was at my insistence also into just standard Enron stock and options, I believe in 1994 or 1995, something like that.

Senator NELSON. Would you provide a list to the Committee of the entities in Enron that you had a financial interest in?

Mr. SKILLING. It is just those two.

Senator NELSON. So state those two then again please for me for the record.

Mr. SKILLING. It is what we called Enron Gas Services, which later became Enron Capital & Trade; the name changed. And the other one was Enron Energy Services. They were both kind of standard phantom plans.

Senator NELSON. Would those entities include private partnerships as well?

Mr. SKILLING. Those were—well, Enron North America, our merchant business, was 100 percent owned by Enron Corporation. We never sold an interest in that business to anyone. Enron Energy Services we sold 7 percent to CalPERS and Ontario Teachers. Then we ended up buying that back, I believe a year later, at what turned out to be, I think, a very good investment for CalPERS and for Ontario Teachers. I think—I mean the business was great for them. It was a good investment on their part.

Senator NELSON. I'm sure it was.

Mr. SKILLING. "We" meaning Enron bought them out.

Senator NELSON. I'm sure it was, but my question was were you involved in any of those private partnerships? Did that include your investments in those two entities? Did that include any private partnerships was the question.

Mr. SKILLING. I do not—Senator, I do not think so. I do not know. Enron North America, or Enron Gas Services was a 100 per-

cent-owned subsidiary. And Enron Energy Services was 100 percent-owned, except for that piece that was sold to CalPERS and Ontario. And we bought it back, I think after—do you remember if it was a year? It was a relatively short period of time.

Senator NELSON. Thank you, Mr. Chairman.

Senator DORGAN. It is my intention to recognize Senator Fitzgerald for 10 minutes. I will follow that by 5 minutes, and we will then adjourn the hearing. You have been with us for 5 hours and have been very patient.

Senator Fitzgerald.

Senator FITZGERALD. Thank you.

Mr. Skilling, I wanted to return to the transaction with the Braveheart Partnership again. That was a situation in which Enron had a video business, a broadband video business. It entered some kind of an agreement with Blockbuster. Blockbuster was going to provide video content, movies, and Enron was going to beam the movies to people's homes via their broadband video network. And that business was a fairly new business. My understanding is it just existed, at its height maybe had 1,000 customers. Is that your recollection?

Mr. SKILLING. I do not know what the final number was. We were in a beta test in Portland, Oregon; Salt Lake City; New York City; and one other city, I forget which. But, at that point it was a beta test.

Senator FITZGERALD. And that was the point in time in which Enron sold that business?

Mr. SKILLING. Sold a portion of the business.

Senator FITZGERALD. Just a portion of the business?

Mr. SKILLING. Yes.

Senator FITZGERALD. What portion of the business did you sell?

Mr. SKILLING. I think it was—I cannot tell you exactly, but I think it was the first 10 years of—it was a share in the first 10 years of cash-flow in the business, something like that.

Senator FITZGERALD. Okay. And you were not sure who it was sold to? You did not know who it was sold to. You said that before.

Mr. SKILLING. No. No, I knew the name of it was Project Braveheart, was internally what the project name was. I do not know who the counterparty, the specific counterparty was in the transaction.

Senator FITZGERALD. Now my understanding based on newspaper accounts—and I do not have the original documents—is that the Braveheart partnership was created to receive, I guess that 10 years of earnings or revenues on that Blockbuster video business. And that partnership went out and found an investor in Wood Grundy, the investment banking arm of the Canadian Imperial Bank of Commerce.

And my understanding is that Canadian Imperial Bank of Commerce, Wood Grundy, was going to take the earnings of that business, maybe it was for the next 10 years, in return for supplying the partnership with \$115 million. My understanding is also that Enron promised to guarantee that Wood Grundy would get back the \$115 million that it put into the deal. If for some reason the video business did not pan out, Enron would insure that the bank in Canada would get its money back. Is that your recollection?

Mr. SKILLING. I do not know the specifics of the transaction, Senator. I mean, I would have known that there was a sale. I mean, you know, you'll pick up—it is a big company, but I knew that we were in the process of selling a portion of what we called our content services business, which is what you're describing. And I believe we ended up selling. I do not know the specific nature of the transaction, the specific terms and conditions, or the pricing of it.

Senator FITZGERALD. We discussed earlier that Braveheart paid \$110 million to Enron, which Enron booked into earnings over two quarters, \$54 million in the fourth quarter of 2000 and \$54 million in the first quarter of 2001. Do you recall that?

Mr. SKILLING. I've read the newspaper account, so, yes.

Senator FITZGERALD. But you do not recall when you were at Enron booking \$54 million in earnings from that during your first quarter as CEO of the company?

Mr. SKILLING. Yeah. If you'd asked me, I would not have remembered the number, but I have subsequently read in the papers what the number is.

Senator FITZGERALD. Now that business that you sold 10 years worth of the revenues from, was that worth \$110 million? It did not really have any paying clients, did it, at that point? Did it have any paying clients?

Mr. SKILLING. I—we were in beta test, so I do not know offhand. Was it worth that much money? Yeah. I mean if you look at the enthusiasm that there was for broadband applications at that time. We had the only working online, effective video on demand platform in the country. And video on demand was a very exciting concept.

It is a very exciting concept where it is like a simulated VCR, where you can buy a movie from Blockbuster or from a studio, you can stop it, you can fast forward it, you can return it, rewind it, but you do not have to return it to the store. I mean, all you do is you just call it up on your screen. We had a whole list of movies. You could pick which movie you wanted. When you picked that movie, it stayed in a server close to your home for 3 days, and at the end of the 3 days, it would be taken back. So it was very, in my opinion, and I think most people in the industry, this very powerful—

Senator FITZGERALD. So you thought it was reasonable to take into earnings \$110 million based on the sale of 10 years worth of revenues?

Mr. SKILLING. Yeah. Selling a piece of that business right then, I think I—my guess is—

Senator FITZGERALD. Thought that was reasonable, yes or no?

Mr. HILER. Excuse me. Let me just make sure you answer the question. I think he is already answered that he did not know the figure that was—

Mr. SKILLING. Right, the specific—

Mr. HILER [continuing]. Taken in earnings. He answered you.

Mr. SKILLING. Was—I do not know the specifics of the transaction. Was there a tremendous hunger on the part of investors for access to investment vehicles in video—

Senator FITZGERALD. Okay.

Mr. SKILLING [continuing]. Absolutely.

Senator FITZGERALD. Were you aware that Enron Corporation had made some kind of a promise to pay the Canadian bank back if that business did not earn back the bank's investment?

Mr. SKILLING. No, I did not know that.

Senator FITZGERALD. You were not aware of that. So somehow the corporation gave some kind of a guarantee, something akin to a guarantee, and you as a CEO were not aware of that. Somebody could guarantee a \$115 million debt without the CEO knowing?

Mr. SKILLING. Yeah. I would imagine that the approval authority for a credit guarantee would be lower than for a cancellation. I just do not know. I do not recall, Senator.

Senator FITZGERALD. It was a pretty good way to create earnings though, is it not, if you can effectively have a partnership borrow money. Enron can guarantee it so that the partnership can borrow all the money it would like, and then pay it to you and you'd just report that borrowed money as income. Does that make sense to you, Mr. Skilling?

Mr. SKILLING. You would have to talk to the accountants about that. I mean I, if the accountant said, you know, and I'm sure—

Senator FITZGERALD. This is not an accounting issue. This is a valuation issue. I'm not questioning the accounting. I think the accounting may have been 100 percent according to—

Mr. SKILLING. Right. If you're saying was it worth something, asolutely.

Senator FITZGERALD. This is a valuation issue, not an accounting issue. I want to—

Mr. SKILLING. The valuation of the partnership interest, I mean at this time, this—people were so enthusiastic about this.

Senator FITZGERALD. Well, how did Enron get \$110 million? Why not \$50 million? Not what—why not \$500 million? How did they pick the \$110 million value?

Mr. SKILLING. I do not know, but I would guess that they were looking—my guess would be they were looking at comparable technology companies at that stage of development to see what they were selling for.

Senator FITZGERALD. As CEO, did you want any procedures in place to insure that Enron got fair value for assets that it sold?

Mr. SKILLING. We had lots of procedures in place. We had a group that was called a risk assessment and control group that would have done absolute strip-down of that transaction to see if we were getting fair value for it. That would be standard operating practice inside the company.

Senator FITZGERALD. Now it turns out in that case you got more than fair value; is that not right? Because ultimately, that business fell apart completely and wound up being worthless; is that not correct? And that was before you departed the company.

Mr. SKILLING. Well, in retrospect, I think it turns out that we all, not just me, but I think several million people significantly overestimated the opportunities available in the broadband business and the electronic delivery business.

What the problem was, I mean the problem turned out to be the last mile. We could not get enough direct access over the last mile. We had enough backbone to provide the video on demand. We had plenty of backbone and capacity and fiber to get the movies out to

the extremities of the network, but we could not get through the last mile.

Senator FITZGERALD. Mr. Skilling, it is not just that video business that you sold to partnerships. You sold lots of other Enron assets to partnerships and were paid lots of money for it, and in many of the cases it appears that Enron—or the partnerships had borrowed the money to pay Enron for those assets and that Enron had either guaranteed the borrowings or provided some kind of credit support for it.

Mr. SKILLING. Was providing some portion—

Senator FITZGERALD. So that it looks to me—

Mr. SKILLING. You do not have to go through specific transactions. I'll give you an example, Senator. If you sell your house, a lot of people when they sell their house provide seller finance. And it is still a sale, I mean, once you've sold and you're taking a credit risk on the counterparty that has purchased that house. That can be entirely appropriate in many, many circumstances. To the extent that we were providing financing, we had a finance company.

Senator FITZGERALD. Did you consider these seller financing?

Mr. SKILLING. To the extent that I—we'd have to look at the very specific transaction and what the structure of it was, but if someone had said to me that someone was buying something from us and we were financing a portion of that purchase, I would have said, "That's no different than General Electric financing washing machines." It is a natural—

Senator FITZGERALD. And was the seller financing all disclosed in your filings with the Securities Exchange Commission?

Mr. SKILLING. The balance sheet would show every time we had an accounts receivable. Yes, sir.

Senator FITZGERALD. That you had, in fact, financed the purchaser's purchase. That is all disclosed?

Mr. SKILLING. Senator, we did, in a typical year, I would imagine we did 30,000 or 40,000—maybe more than that, maybe 50,000—transactions. Did we separately disclose every single transaction? You could not do it. I mean, you'd be sending the investors a phone directory, you know, something of that size that had the information in it.

Senator FITZGERALD. Is this typical seller financing though when it is not really an independent third party, when it is really a partnership that you own 97 percent of? Are not you really just doing seller financing almost to yourself?

Mr. SKILLING. Senator, you're—you have to ask the accountants what the logic is that they used. But when they came to us, they believed that our—

Senator FITZGERALD. It is not an accounting issue.

Mr. SKILLING. Why is that not an accounting issue?

Senator FITZGERALD. That is not the issue I'm raising. I'm just saying—

Mr. SKILLING. Okay, then I'm missing something. Try it again.

Senator FITZGERALD. I mean you're selling assets to something that you own 97 percent of.

Mr. SKILLING. Right.

Senator FITZGERALD. And you're booking revenues based on those sales.

Mr. SKILLING. Right. So they—

Senator FITZGERALD. Even though you are liable contingently for the indebtedness incurred by the partnership.

Mr. SKILLING. Well, I'll give you an example of where that would be entirely appropriate. Let us say that I had a mortgage pool; I had a pool of mortgages. And I put them into a pool and I put 3 percent sliver of equity in and I sold it. Now, once you've done that, you have transferred risk, 3 percent risk. Turns out mortgages are real safe. You know, the default rates are pretty low. And so the accountants look at that once that risk transfer has occurred. They look at that and they say has the risk transferred? If the risk transfers, you have to account for it as a sale transaction.

So I would have to look at each of the individual transactions. I cannot. I'm not an accountant, so I would not be able to look at it. But was it appropriate to book revenue? Ask Arthur Andersen. If it was inappropriate, we would not have done it. If it was inappropriate, if there was any time that there was anything that I was aware of that was inappropriate, we would not have done it.

Senator FITZGERALD. Now were you aware that the company built up \$20 billion in off balance sheet indebtedness in this manner? And that is why you had to file bankruptcy, is it not, because those debts were coming due and you could not pay them?

Mr. SKILLING. I refer you again to the 10-K on page 72. It actually—it lists it out in detail.

Senator FITZGERALD. So you were totally aware of it, of all the off balance sheet indebtedness?

Mr. SKILLING. And so was everyone else. So were the rating agencies, so was everyone else. There was no attempt to hide—

Senator FITZGERALD. It never occurred to you that this was too much debt to be—you were not concerned about how much debt you were incurring?

Mr. SKILLING. We went to the rating agencies and we would show them what our balance sheet was. We would show them those same disclosures. They would go through and they'd look at it. And they looked at it and they said we were BBB plus. Now is that a reasonable number? I think so. We had a great business. We were a major, major player in a very fast growing business in energy wholesaling. That business was highly, highly profitable. We would have made—if this catastrophe had not occurred, I believe strongly that we would have made \$220-\$225—\$2.20-\$2.25 per share of real live earnings in the year 2002. Put any kind of multiple against that. Put a 20 multiple, put a 10 multiple against that. The stock price at a minimum should have been in the \$20 to \$30 range.

Senator FITZGERALD. Enron just experienced a liquidity problem last fall?

Mr. SKILLING. We had a run on the bank based on a loss of confidence that was related to all of this.

Senator FITZGERALD. But when they went into the bankruptcy it turns out that people are not going to get 100 percent back on the dollar, are they, creditors are not?

Mr. SKILLING. Any time you go into bankruptcy, all accounting, all balance sheet transactions assume an ongoing business. Once

you put a company through bankruptcy, I guarantee you you are going to get a haircut on every asset that you have.

Senator FITZGERALD. Mr. McMahon, what percent on the dollar do you think that creditors of Enron are going to get in the bankruptcy? Are they going to get over 50 percent on the dollar?

Mr. MCMAHON. Senator, I'm afraid it is way too early to even make that analysis yet, but it is certainly less than 100 cents on the dollar. We've recently disclosed that we believe the recovery on the equity to be—

Senator FITZGERALD. Unattached.

Mr. MCMAHON. Basically zero, right. No—

Senator FITZGERALD. On the equity, well, certainly the equity's wiped out, but what about on the debts?

Mr. MCMAHON. Right. Well, that is my point. Since the equity's not going to get anything—

Senator FITZGERALD. Think it will be more than 50 cents on the dollar?

Mr. MCMAHON. It is just too early to tell.

Senator FITZGERALD. Mr. Skilling, I dispute the notion that if it is a solvent bank, if it were liquidated that it could not pay off all its depositors. A solvent bank would liquidate its government bonds. If its loans were what they said they were and it was a solvent bank, they would liquidate and sell the loans, and they would have capital and surplus left over and everybody would get paid off. You only have a problem and cannot pay off creditors if, in fact, your liabilities exceed your assets. And my understanding from what I've read is Enron's going to be paying somewhere like 35 cents on the dollar back to its creditors.

Mr. SKILLING. Senator, you may be a great Senator, but when it comes to understanding what happens in bankruptcy, I would suggest that if you put General Motors into bankruptcy tomorrow, they are not going to be able to sell their machine tools for 100 cents on the dollar. That is just not what happens. When we used to have runs on the banks in the late 1880s, as soon as that run began it was, "Katie, bar the door," because then the lenders, the people that had borrowed the money decided they did not have to pay it back; they were taking liquidity away from the corporation.

It is almost impossible—that is why it is so important that the company got a couple of months. If the company had a couple of months of breathing space, I think things would have turned out okay. The company was solvent. The financial statements suggested the company was solvent. It was illiquid, not insolvent.

Senator FITZGERALD. Mr. Skilling, one of the first bank boards my father was on in the 1950s, in those days they used to liquidate banks, and it was because the owners just wanted to get their investment back. And they simply liquidated the bank and they paid off everybody and paid their shareholders a return. I submit to you that if a company is fully solvent, it can pay all its debts back and pay back its retained earnings against capital and surplus. I agree that—

Mr. SKILLING. In 3 days? If—in 3 days, if your creditors are saying I want the money right now, you cannot do that.

Senator FITZGERALD. Obviously you cannot do it right away, but over a period of time you can. And Enron got a timeout from the bankruptcy and it is only going to pay back 35 cents on the dollar.

Mr. SKILLING. Enron has now got——

Senator FITZGERALD. It has way more liabilities than assets.

Mr. SKILLING. Enron has got lawsuits from any of a number of claims. Once this thing happens, once you cross that corner, it is very hard to turn around and go back the other direction. I mean that is just the——

Senator FITZGERALD. All right.

Mr. SKILLING. That is the way it is always been.

Senator FITZGERALD. If I could go to Mr. McMahon, I'm going to wrap up. I want to let all of you out. And my good Chairman, Senator Dorgan, who has been very indulgent, I appreciate it.

Mr. McMahon, Ms. Watkins was in the company in the CFO's office for what, six weeks, Ms. Watkins, before you figured out that it was all a house of cards?

Ms. WATKINS. Probably four to six weeks.

Senator FITZGERALD. Mr. McMahon, you were at Enron for many years. You were treasurer from 1998 to March of 2000. Did you not figure out it was a house of cards in all that time?

Mr. MCMAHON. No. Frankly, the first time I saw Enron having financial problems was when I took over as CFO in the middle of the crisis. And it was very clear at that point in time that there was, in fact, an inability for the company to access capital in the capital markets, in the bank markets. That was my first clue that there was a major financial crisis at this company.

Senator FITZGERALD. So this all just went right over your head all those years that you were there as treasurer?

Mr. MCMAHON. Even as Treasurer, I thought we had strong businesses, and was not until I saw it in late October that—it was not long before that that our CFO had told quite a lot of management that the balance sheet was in extremely good shape.

Senator FITZGERALD. And finally, wrapping up the first question I asked you. I have some more details about that report the auditors gave in April 1987 to the Enron Board. They recommended to the Enron Board in April 1987 that the two rogue executives who had misappropriated money in New York, that they be terminated immediately, and they were kept on at least three or four months after that. And during that time, a control officer from Enron was supposed to go out and watch them, and somehow he was delayed several months in going out to watch them. And then during these three to four months that these rogue traders remained at Enron Oil, they ran up \$1 billion in bad trades.

And then Rudy Giuliani, who was U.S. Attorney at the time, started a prosecution investigation in the fall of 1987. The two eventually pled guilty to over \$100 million in bad trades and fraud. One served time in jail and the other was put on probation. And I said in that *Vanity Fair* article that I introduced into the record earlier, that Mr. Lay was the one who resisted terminating these employees, even though it was the unanimous recommendation of the team of internal auditors and external auditors. And my understanding is you were on the term of external auditors at Arthur Andersen at that time; is that correct?

Mr. MCMAHON. Yeah. In 1987, I was a—I think a junior manager at Arthur Andersen.

Senator FITZGERALD. But you were—did go to New York?

Mr. MCMAHON. Yes.

Senator FITZGERALD. Do you remember the recommendation to the Enron Board?

Mr. MCMAHON. I do not recall. I mean, I know there was an internal control recommendation made, but I, you know, that was prepared by the partner and the senior manager on the job.

Senator FITZGERALD. So you were not involved in that—

Mr. MCMAHON. Well, I was involved in the detailed audit work at the offices in New York.

Senator FITZGERALD. And you never heard anything about: Boy, they were awful slow to terminate those two execs who apparently just took money and put it in their own account that was Enron money?

Mr. MCMAHON. I do not recall. I mean, it is 15 years ago.

Senator FITZGERALD. Okay, okay.

Thank you very much, Mr. Chairman and all the panelists.

Thank you for being here. Thank you.

Senator DORGAN. Let me just finally ask Mr. McMahon. Have you read the Powers Report?

Mr. MCMAHON. Yes, I have.

Senator DORGAN. Do you agree with it?

Mr. MCMAHON. I do not think I know enough of the details or agree with one or the other. It raises some very, very serious concerns which we are investigating currently. We've made some very significant personnel changes as a result of it.

Senator DORGAN. Have you fired people as a result of it?

Mr. MCMAHON. Yes, we have.

Senator DORGAN. How many?

Mr. MCMAHON. Well, the Chief Accounting Officer and Chief Risk Officer have been discharged. The General Counsel has resigned, and we've made some internal moves within the accounting department to give it new leadership, as well as our auditors have been discharged.

Senator DORGAN. You fired employees because there was something wrong, something going on wrong that the Board of Directors' report steered you to. Is that the basis of the dismissals?

Mr. MCMAHON. Yeah. I believe those—the Chief Risk Officer and Chief Accounting Officer were discharged for cause pursuant to a Board request.

Senator DORGAN. Is that at odds with what Mr. Skilling is telling us today, that really things were fine?

Mr. MCMAHON. I mean I—obviously the Powers Report brought to light some things that I do not—well, certainly the Powers Report brought things to light that needed some changing.

Senator DORGAN. Were they the things that you were attempting to bring to Mr. Skilling's attention many, many months before that?

Mr. MCMAHON. Well, the Powers Report clearly talks about the conflicts of interest that I was concerned about, but I think it obviously goes on to specific transactions which I was not aware of at the time I brought that up to Mr. Skilling.

Senator DORGAN. And do you believe Mr. Skilling was unaware of all of this?

Mr. MCMAHON. I really do not know.

Senator DORGAN. But you believe you made Mr. Skilling aware of some of it?

Mr. MCMAHON. Oh, clearly as far as the structure of the conflict internally. You know, I recall very clearly our conversation. It was a very big event in my life at that point in time. So my meeting with Mr. Skilling was, after several meetings with my boss and then the Policy Committee above my boss and going to Mr. Skilling, I have a vivid recollection of that.

Senator DORGAN. That recollection is different than Mr. Skilling's recollection. Mr. Skilling testified in the House that you came to see him about compensation, and he had no recollection of discussion beyond the issue of compensation; is that correct?

Mr. MCMAHON. That is the understanding—that, to me, is Mr. Skilling's testimony. And I did mention compensation as a symptom in that meeting, but I obviously had wider concerns than compensation.

Senator DORGAN. Let me ask Ms. Watkins, if I might. The import of your testimony before the U.S. House was to suggest, I think, at least as it was interpreted by the media, was that Mr. Lay was sort of the unwitting, innocent victim here, ran the company but did not really know very much. Was that your intention when you testified? Is that a fair assessment of Mr. Lay's role in the corporation?

Ms. WATKINS. I'm drawing that conclusion based on my eight years at Enron, where I worked with a very hands-on Rich Kinder as COO and a very hands-on Jeff Skilling as COO. I never had very much interaction with Mr. Lay. This fall, when I did have interaction and when I conveyed my concerns, I was extremely disappointed by his inability to grasp the dire situation the company was in. His actions of writing this off with just no contingency plans reaffirms my opinion that he did not get it.

Senator DORGAN. Did not want to get it or did not get it? I mean you actually served it to him.

Ms. WATKINS. Well, could be a little bit of both, could be a little bit of both.

Senator DORGAN. But you actually served it up on a platter, did you not, to say "Here is the situation as I see it. And by the way, do not ask Vinson & Elkins to look into it." And what he did is he asked that particular law firm to look into it, and then restricted the law firm's view with respect to the accounting pieces. I'm just trying to understand what you're saying about Mr. Lay's role. Mr. Lay came here and did not testify.

Ms. WATKINS. I'm just giving you my opinion based off my interactions with the people that I worked with at Enron. And this was such a grave issue, and to see it written off and unwound, and we did not even have an explanation ready for investors. October 23, at an all employee meeting to address the write-down, Mr. Lay likened this crisis to poor investment decisions we had made, to the Peruvians nationalizing our oil company in the 1980s. It is completely different.

Senator DORGAN. We are trying to get the names of the investors in all of the partnerships and having an almost impossible time getting them.

Mr. McMahan, you're the President and COO of the company at this point. I assume those records exist somewhere. I have talked to the interim CEO, his attorney has called us back; I received some piece of information that was indecipherable to me a couple days ago. But this Committee intends to search for the names of all of the investors in all of the partnerships, and I'm wondering if you, as a President of the corporation, will be helping us in achieving that goal.

Mr. MCMAHON. We'll—Senator, we'll obviously cooperate, as we have been, fully. But please keep in mind these partnerships were not sponsored by Enron, they are outside. So those documents would not typically reside in the Enron offices, although as I understand our internal investigation sought—searched for those. So we'll continue to cooperate.

I do understand there is one particular one on LJM2; the limited partners have filed a lawsuit in the State of Delaware. And so, I think part of their lawsuit, those who've filed motions against the general partner, I think that is a matter of public record on the court's website.

Senator DORGAN. But let me ask you, if an accountant comes to you today as President of the company and says, "All right. Here is a partnership, an off-the-books SPE partnership, and Enron owns 97 percent of it, I want to see the records. I want to verify that the other 3 percent is non-Enron. Show me the records." What are you going to show the partner, nothing? You're going to have to have the records, are not you?

Mr. MCMAHON. Sure. I think on these partnerships you're talking about today, the LJM, et cetera, the—I do not know what due diligence was done by the accounting group at the time. Clearly going forward, whether we ever do another SPE again is another question, but clearly, due diligence efforts for Enron going forward would be much more stringent.

Senator DORGAN. Well, I must tell you that reading the Board of Directors' report, it appears to me that due diligence is a term that is totally unknown inside that corporation. The construction of some of these partnerships according to the Board of Directors report itself, paid no attention to due diligence.

But let me make a final point.

Mr. Skilling, at the start of today you were credited for testifying. I will similarly give you credit for coming. I must say that it was disappointing to me that Mr. Lay would not testify. He has every right not to testify.

I appreciate your testifying, Mr. Skilling, but I must tell you that as I listened to your testimony, there are times when that Harvard MBA shows through very well. You are articulate, incisive in your analysis of complex financial transactions, and then, when pressed on the Board of Directors investigative report you seem to me to lapse into utter confusion about accounting. And somehow, it just does not fit.

I do not know that we've gotten much closer to the truth today. We have to keep digging, it seems to me. This is a miserable way

to spend a Tuesday, as a matter of fact, but then it is a small price to pay compared to the loss of people that have lost their life savings and lost their jobs and lost their investments. So, we have to continue this process.

It is not pleasant for you to come and sit at a table for five-and-a-half hours. The Committee appreciates the fact that you are here today, and we will be conducting about four additional hearings dealing with other aspects of this. You have been very patient for five-and-a-half hours and the Committee appreciates your attendance.

This hearing is adjourned.

[Whereupon, at 5:37 p.m. the hearing adjourned.]

