TESTIMONY OF WILLIAM C. POWERS, JR.
Chairman of the Special Investigative Committee
Of the Board of Directors of Enron Corporation

Before the Committee on Financial Services
United States House of Representatives

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Mr. Chairman and distinguished Members of the Committee. My name is William Powers. I am the Dean of the University of Texas Law School. For the past three months, I have served as Chairman of the Special Investigative Committee of the Board of Directors of Enron Corporation. I appreciate the opportunity to come and testify before you today.

As you know, during October of last year, questions were being raised about Enron's transactions with partnerships that were controlled by its Chief Financial Officer, Andrew Fastow. In the middle of October, Enron announced that it was taking an after-tax charge of more than $500 million against its earnings, because of transactions with one of those partnerships. Enron also announced a reduction in shareholder equity of more than a billion dollars. At the end of October, the Enron Board established a Special Committee to investigate these matters, and then asked me if I would join the Board for the purpose of chairing that Committee, and conducting that investigation. With the help of counsel and professional accounting advisors, we have spent the last three months conducting that investigation.

Our Committee's Report was filed on Saturday. It covers a lot of ground and will, I hope, be a helpful starting point for the necessary further investigations by Congressional Committees, by the Securities and Exchange Commission, and by the

Department of Justice. A copy of the Executive Summary of our Report is attached to my Statement here.

Many questions currently part of public discussion—such as questions relating to the employees' retirement savings and sales of Enron securities by insiders—are beyond the scope of the charge we were given. These are matters of vital importance, but they are not matters we addressed in our Report.

We were charged with investigating transactions between Enron and partnerships controlled by its Chief Financial Officer, or people who worked in his department. That is what our Report discusses. What we found was appalling.

First, we found that Fastow—and other Enron employees involved in these partnerships—enriched themselves, in the aggregate, by tens of millions of dollars they should never have received. Fastow got at least $30 million, Michael Kopper at least $10 million, two others $1 million each, and still two more amounts we believe were at least in the hundreds of thousands of dollars.

Second, we found that some transactions were improperly structured. If they had been structured correctly, Enron could have kept assets and liabilities (especially debt) off of its balance sheet. But Enron did *not* follow the accounting rules.

Finally, we found something more troubling than those individual instances of misconduct and failure to follow accounting rules. We found a systematic and pervasive attempt by Enron's Management to misrepresent the Company's financial condition. Enron Management used these partnerships to enter into transactions that it could not, or would not, do with unrelated commercial entities. Many of the most significant transactions apparently were not designed to achieve bona fide economic objectives.

As our Report demonstrates, these transactions were extremely complex. I won't try to describe them in detail here. But I do think it would be useful to give just one example. It involves efforts by Enron to "hedge" against losses on investments it had made.

Enron was not just a pipeline and energy trading company. It also had large investments in other businesses, some of which had appreciated substantially in value. These were volatile investments, and Enron was concerned because it had recognized the gains when these investments appreciated, and it didn't want to recognize the losses if the investments declined in value.

Therefore, Enron purported to enter into certain "hedging" transactions in order to avoid recognizing losses from its investments. The problem was that the hedges weren't real. The idea of a hedge is normally to contract with a credit-worthy outside party that is prepared—for a price—to take on the economic risk of an investment. If the value of the investment goes down, that outside party will bear the loss. That is not what happened here; here, Enron was essentially hedging with itself.

The outside parties with which Enron "hedged" were the so-called "Raptors." The purported outside investor in them was a Fastow partnership. In reality, these were entities in which only Enron had a real economic stake, and whose main assets were Enron's own stock. The notes of Enron's corporate secretary, from a meeting of the

Finance Committee regarding the Raptors, capture the reality: "Does not transfer economic risk but transfers P+L volatility."

If the value of Enron's investments fell at the same time that the value of Enron stock fell, the Raptors would be unable to meet their obligations, and the "hedges" would fail. This is precisely what happened in late 2000 and early 2001 when two of these Raptor vehicles lacked the ability to pay Enron on the "hedges." Even if the hedges had not failed in the sense I just described, the Raptors would have paid Enron with the stock that Enron had provided in the first place; Enron would simply have paid itself back.

By March 2001, it appeared that Enron would be required to take a charge against earnings of more than $500 million to reflect the inability of the Raptors to pay. Rather than take that loss, Enron compounded the problem by making even more of its own stock available to the Raptors—$800 million worth. It gave the false impression that the Raptors had enough money to pay Enron what they owed. This transaction was apparently hidden from the Board, and was certainly hidden from the public.

Let me say that while there are questions about who understood what concerning many of these very complex transactions, there's no question that virtually everyone, from the Board of Directors on down, understood that the company was seeking to offset its investment losses with its own stock. That is not the way it is supposed to work. Real earnings are supposed to be compared to real losses.

As a result of these transactions, Enron improperly inflated its reported earnings for a 15-month period—from the third quarter of 2000 through the third quarter of

2001—by more than $1 billion. This means that more than 70 percent of Enron's reported earnings for this period were not real.

How could this have happened? The tragic consequences of the related-party transactions and accounting errors were the result of failures at many levels and by many people: a flawed idea, self-enrichment by employees, inadequately-designed controls, poor implementation, inattentive oversight, simple (and not-so-simple) accounting mistakes, and overreaching in a culture that appears to have encouraged pushing the limits.

Whenever this many things go wrong, it is not just the act of one or two people. There was misconduct by Fastow and other senior employees of Enron. There were failures in the performance of Enron's outside advisors. And there was a fundamental default of leadership and management. Leadership and management begin at the top, with the CEO, Ken Lay. In this company, leadership and management depended as well on the Chief Operating Officer, Jeff Skilling. The Board of Directors failed in its duty to provide leadership and oversight.

In the end, this is a tragedy that could and should have been avoided. I hope that our Report, and the work of this Committee, will help reduce the danger that it will happen to some other company.