ONE HUNDRED SEVENTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515–6115

W.J. "BILLY" TAUZIN, LOUISIANA,
CHAIRMAN

January 17, 2002

Mr. Joseph F. Berardino
Managing Partner and Chief Executive Officer
Andersen LLP
33 W. Monroe Street
Chicago, Illinois 60603

Dear Mr. Berardino:

As you know, the Committee on Energy and Commerce is investigating matters relating to the financial collapse of the Enron Corporation ("Enron"). As part of this investigation, the Committee requested and received thousands of pages of documents from Enron, Andersen, and other individuals involved with Enron. During the course of reviewing these documents, Committee investigators uncovered two Andersen documents that raise additional questions. Committee investigators questioned former Andersen partner David Duncan about these documents yesterday, and today we are writing to you to request additional information about the events discussed in these documents.

The first document is a February 6, 2001 e-mail from Michael Jones to David Duncan and Thomas Bauer (attachment). In the email, Mr. Jones forwarded notes he made from a meeting of senior level Andersen officials the previous day in which they discussed whether "to retain Enron as a client." The notes indicate that there were "significant" discussions about potential areas of concern, including (1) "Fastow's conflicts of interest" in his capacity as Enron CFO and LJM fund manager; (2) disclosure of Fastow's earnings stemming from his participation in LJM; (3) Enron Board of Director views regarding the transaction with LJM, and Andersen's and Enron management's communication of such transactions to the Board; (4) whether the Board received competing bids when executing transactions with LJM; (5) "intelligent gambling" related to Enron's mark-to-market earnings; and (6) the possible $100 million-per-year in fees Andersen could receive by continuing its services for Enron.

The second document is an August 21, 2001 memorandum from Andersen audit partner James Hecker to "The Files," copying other senior Andersen partners. Mr. Hecker notes that Enron Vice President Sherron Smith Watkins had contacted him the day before with questions and concerns about "the propriety of accounting for certain related-party transactions" with LJM. The memorandum lists Ms. Watkins' concerns, including questions surrounding the formation, operation, and financial statement disclosure of LJM. Ms. Watkins also informed Mr. Hecker that "she was concerned enough about these issues that she was going to discuss them with Ken Lay, Enron's Chairman on Wednesday, August 22, 2001." After his discussion with Ms. Watkins, Mr. Hecker relayed her concerns that same day to Andersen partner Bill Swanson (head of the Houston office audit practice), and Andersen Enron engagement partners David Duncan and Debra Cash. Michael Odom, Andersen's risk management practice director for the Houston office, also was informed of this discussion on August 21, 2001. According to the memorandum, it was agreed that they would consult with Andersen's legal advisor "about what actions to take."

In order for the Committee to gain a more complete understanding of the events surrounding these particular matters, we are requesting that, pursuant to Rules X and XI of the U.S. House of Representatives, Andersen produce to the Committee the following information by Thursday, January 31, 2002:

1. All records relating to the February 5, 2001 meeting described in the February 6, 2001 attachment, including (1) notes or other records created by the meeting participants (including Samek, Swanson, Jeneaux, Jonas, Kutsenda, Stewart, Bennett, Goddard, Goolsby, Odom, Lowther, Duncan, Bauer, and Jones); and (2) the records prepared and distributed in advance of such meeting, as indicated by Mr. Duncan during his interview yesterday.

2. All records relating to any action taken as a follow-up to what was discussed at the February 5, 2001 meeting, including but not limited to the items referenced in the "To Do's" list.

3. All records relating to communications with, or preparation for communications with, the Enron Board of Directors or its Audit Committee relating to matters raised during the February 5, 2001 meeting, including but not limited to the Audit Committee meeting dated February 12, 2001, at which Mr. Duncan made a presentation.

4. All records relating to the events described in the August 21, 2001 attachment, including notes or other records of the participants in these discussions (including James A. Hecker, Debra A. Cash, David B. Duncan, Michael C. Odom, William E. Swanson, and any Andersen legal advisor consulted).

5. All records relating to any action taken as a follow-up to what was discussed as a result of Ms. Watkins' phone call to Mr. Hecker.

6. The memorandum created by Mr. Duncan concerning his recollection of events relating to Ms. Watkins' allegations, including the discussions referenced in the August 21, 2001 attachment as well as the Vinson & Elkins review of Ms. Watkins allegations on behalf of Enron.

Please note that, for the purpose of responding to these requests, the terms "records" and "relating" should be interpreted in accordance with the attachment to this letter. If you have any questions, please contact Mark Paoletta, Chief Counsel for Oversight and Investigations, at (202) 225-2927, or Edith Holleman, Minority Counsel, at (202) 226-3400.

Thank you for your prompt attention to these matters. We appreciate your continuing cooperation with our investigation.

Sincerely,

W.J. "Billy" Tauzin
Chairman

John D. Dingell
Ranking Member

James C. Greenwood
Chairman,
Subcommittee on
Oversight and Investigations

Peter Deutsch
Ranking Member,
Subcommittee on
Oversight and Investigations

Attachments

ATTACHMENT

1. The term "records" is to be construed in the broadest sense and shall mean any written or graphic material, however produced or reproduced, of any kind or description, consisting of the original and any non-identical copy (whether different from the original because of notes made on or attached to such copy or otherwise) and drafts and both sides thereof, whether printed or recorded electronically or magnetically or stored in any type of data bank, including, but not limited to, the following: correspondence, memoranda, records, summaries of personal conversations or interviews, minutes or records of meetings or conferences, opinions or reports of consultants, projections, statistical statements, drafts, contracts, agreements, purchase orders, invoices, confirmations, telegraphs, telexes, agendas, books, notes, pamphlets, periodicals, reports, studies, evaluations, opinions, logs, diaries, desk calendars, appointment books, tape recordings, video recordings, e-mails, voice mails, computer tapes, or other computer stored matter, magnetic tapes, microfilm, microfiche, punch cards, all other records kept by electronic, photographic, or mechanical means, charts, photographs, notebooks, drawings, plans, inter-office communications, intra-office and intra-departmental communications, transcripts, checks and canceled checks, bank statements, ledgers, books, records or statements of accounts, and papers and things similar to any of the foregoing, however denominated.

2. The terms "relating," "relate," or "regarding" as to any given subject means anything that constitutes, contains, embodies, identifies, deals with, or is in any manner whatsoever pertinent to that subject, including but not limited to records concerning the preparation of other records.

Arthur Andersen
E&P and IPP's

To: David B. Duncan@ANDERSEN WO, Thomas H. Bauer@ANDERSEN WO
cc:
Date: 02/06/2001 08:24 AM
From: Michael D. Jones, Houston , 2541
Subject: Enron retention meeting

Dave, I was not sure whether you were planning on documenting the meeting yesterday. My significant notes were as follows (these were not very detailed, but I was not sure how detailed you wanted to get, assuming that you were going to document the meeting). Let me know if you want me to take a stab at it first (if so we should probably get together for a few minutes to discuss your documentation ideas.:

Attendees:
By Phone: Samek, Swanson, Jeneaux, Jonas, Kutsenda, Stewart
In Houston: Bennett, Goddard, Goolsby, Odom, Lowther, Duncan, Bauer, Jones

Significant discussion was held regarding the related party transactions with LJM including the materiality of such amounts to Enron's income statement and the amount retained "off balance sheet". The discussion focused on Fastow's conflicts of interest in his capacity as CFO and the LJM fund manager, the amount of earnings that Fastow receives for his services and participation in LJM, the disclosures of the transactions in the financial footnotes, Enron's BOD's views regarding the transactions and our and management's communication of such transactions to the BOD and our testing of such transactions to ensure that we fully understand the economics and substance of the transactions.

The question was raised as whether the BOD gets any competing bids when the company executes transactions with LJM. DBD replied that he did not believe so, but explained thier transaction approval process generally and specifically related to LJM transactions.

A significant discussion was also held regarding Enron's MTM earnings and the fact that it was "intelligent gambling". We discussed Enron's risk management activities including authority limits, valuation and position monitoring.

We discussed Enron's reliance on its current credit rating to maintain itself as a high credit rated transaction party.

We discussed Enron's dependence on transaction execution to meet financial objectives, the fact that Enron often is creating industries and markets and transactions for which there are no specific rules which requires significant judgement and that Enron is aggressive in its tranaction structuring. We discussed consultation among the engagement team, with Houston management, practice management and the PSG to ensure that we are not making decisions in isolation.

Ultimately the conclusion was reached to retain Enron as a client citing that it appeared that we had the appropriate people and processes in place to serve Enron and manage our engagement risks. We discussed whether there would be a perceived independence issue solely considering our level of fees. We discussed that the concerns should not be on the magnitude of fees but on the nature of fees. We arbitrarily discussed that it would not be unforseeable that fees could reach a $100 million per year amount considering the multi-disciplinary services being provided. Such amount did not trouble the participants as long as the nature of the services was not an issue.

In addition to the above discussions were held to varying degrees on each page of the presentation materials.

Take away To Do's:
Inquire as to whether Andy Fastow and / or LJM would be viewed as an "affiliate" from an SEC perspective which would require looking through the transactions and treating them as within the consolidated group.
Suggest that a special committee of the BOD be established to review the fairness of LJM transactions (or alternative comfort that the transactions are fair to Enron, e.g., competitive bidding)
Why did Andy not select AA as auditors, including when PWC was replaced with KPMG. Discussions concluded that we would likely not want to be LJM's financial advisors given potential conflicts of interest with Enron.
Focus on Enron preparing thier own documentation and conclusions to issues and transactions.
AA to focus on timely documentation of final transaction structures to ensure consensus is reached on the final structure.

David B. Duncan

To The Files

From James A. Hecker

Date August 21, 2001

Subject Client Accounting Inquiry

Yesterday I received an ostensibly social call from Sherron Smith Watkins, a Houston office alum who works in the CFO's group at our large audit client, Enron. After some small talk about current events such as the job market and last week's CEO resignation at Enron, she asked me if I knew much about some of Enron's recent structured transactions. I told her I did not, having never worked on the Enron job, but that I had general knowledge about many of the related issues from my work on other marketing and trading clients. Although she seemed initially reluctant to get into the details with me, an Arthur Andersen audit partner, she obviously wanted a "sounding board" with whom she could discuss certain of her concerns related to a set of Enron transactions, and I told her I'd be happy to listen.

Sherron then told me she was concerned about the propriety of accounting for certain related-party transactions. The transactions in question were, based on our discussions, with an entity with a name something like "LJM", which was at the time of the transactions at least partly owned by Andy Fastow, Enron's CFO (and her current boss). She later told me that Fastow's interest in "LJM" has since been sold to Michael Copper, an Enron alum. I also understood by her tone that the potentially sensitive transactions were done within the last couple of years. Sherron seemed even more agitated about the transactions' accounting because she perceived the related footnote disclosures in the company's consolidated financial statements were difficult to understand and did not tell the "whole story".

After some investigative work since her return to Fastow's group, she reportedly had discussed some of her concerns with Enron's general counsel office (she did not name the individual). That individual had assured her that AA and Enron's external counsel (Vinson &Elkins) had reviewed the transactions' accounting and financial statement disclosures and that they were sure there was no impropriety. At that point, I mentioned to Sherron that many people inside and outside the company assume we have seen every small transaction and OK'd the accounting, which for many reasons, potentially including immateriality, is often not true. Sherron understood this, but assured me the dollars involved (approximately $500 million) were material, even to (a company as large as) Enron. Based both on the type and size of the transactions, Sherron told me she was concerned enough about these issues that she was going to discuss them with Ken Lay, Enron's Chairman, on Wednesday, August 22, 2001

Based on our following discussions, her perceptions and concerns were:

- In summary, Sherron couldn't understand how Enron could, with its own capital stock, repeatedly add to the collateral underlying an obligation owed to Enron from a related party without recognizing in its financial statements either a) the related Enron stock distributions or contributions to that related party or b) the high-tech investment losses such related-party obligation was supposedly protecting against.
- LJM, an investment company formerly owned at least partially by Andy Fastow (CFO of Enron), was formed to enter into various structured transactions with Enron. I understood from Sherron that one such transaction involved the hedging of certain of Enron's investments in high-tech companies. Since these high-tech investment values have declined, Enron's hedge from LJM has increased in value, thus putting LJM on the hook for a potentially large liability to Enron. Supporting this hedging arrangement, Sherron described to me that LJM was initially capitalized in large part with Enron stock, which has also significantly declined in value since yearend 2000. Well after LJM's formation, and in response to this resulting reduction in total LJM asset value, her investigative inquiries had pieced together a very troublesome scenario. She perceived that Enron was putting additional Enron stock into LJM (the exact mechanism -- sales, contributions, exchanges or otherwise --wasn't clear from our conversation), primarily to bolster LJM's perceived ability to repay obligations that will be owed to Enron at some future date. However, according to Sherron, these additional Enron stock contributions/issuances to LJM did not appear to be recorded on Enron's books. I informed Sherron I could not comment because I was obviously unfamiliar with the facts behind both the formation and ongoing operations of LJM.
- She asserted that the Enron financial-statement disclosures related to the Fastow investment-company relationships and transactions were (putting it kindly) hard to understand and incomplete. A $500 million gain from the LJM contract(s) was purportedly identified in interim financial disclosures. However, according to Sherron, it was not clear in the disclosures that the $500 million gain on Enron's books from the Fastow agreement (through LJM) actually offset other losses on Enron's investments in various high-tech investments. The potential collateralization/collectibility issues behind the LJM obligation that Sherron perceived are a problem were also not spelled out. I did not attempt to confirm these disclosure assertions by pulling Enron's Form 10-K or 10-Q's (but see documentation of engagement team discussions below).
- She also asserted that, at the time of the recent sale to Mr. Copper, she had mentioned to others that LJM must have had "very limited" stockholders' equity and must have been an unsuccessful investment for its owner(s). I inferred that she thought Mr. Copper's purchase price must have been relatively small, for one or more of the following reasons: a) LJM owed so much to Enron, or b) the company had so few other assets or c) it only had assets such as Enron stock that had declined so much in value since LJM's inception. However, she also asserted that she had been told that most, if not all, of LJM's equity had been distributed to its shareholder(s) [including Fastow and CIBC, an independent banking organization unrelated to Enron] concurrently, or shortly after, its original formation.

Based on our discussion, I told her she appeared to have some good questions. I emphasized that I was uninvolved in the issues or client and therefore unable to give her any definitive advice or conclusions on these matters, especially without knowing all the facts, which she understood. However, I encouraged her to discuss these issues with anyone in the company who could satisfy her about the accounting and disclosures related to these transactions. I told her that I admired her "stand-up" attitude and that corporate introspection about these sorts of accounting and reporting issues often was very healthy and should not be surpressed. She neither committed to update me about her discussions with Ken Lay nor requested anything further from me.

Immediately after my discussion with Sherron on August 20, I relayed the essence of her asserted concerns to Bill Swanson (ABA practice director), Dave Duncan (Enron engagement partner) and Deb Cash (a partner on several of the trading segments at Enron). On August 21, we all added Mike Odom, practice director, to the discussions, and agreed to consult with our firm's legal advisor about what actions to take in response to Sherron's discussion of potential accounting and disclosure issues with me.

Copies To:

Debra A. Cash
David B. Duncan
Michael M. Lowther
Michael C. Odom
William E. Swanson