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Congress of the United States
House of Representatives
Washington, DC 20515–0529

HENRY A. WAXMAN
29th District, California

March 1, 2002

Mr. Jeffrey Skilling
c/o Bruce Hiler, Esq.
O'Melveny & Myers
555 13th Street, NW
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Washington, D.C. 20004-1109

Dear Mr. Skilling:

I am writing to follow up on your February 7, 2002, testimony before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce. As you know, the Committee has been conducting a broad investigation of the facts surrounding the collapse of Enron. As Chairman Tauzin noted at the hearing, this effort is "to not only unravel what went wrong here, but try to make sure again that it doesn't happen again to any other American company or to its employees."[1]

Toward that end, at the hearing, the Subcommittee asked you and other former and current Enron executives questions regarding a wide range of areas relating to Enron's collapse. I have a number of follow-up questions for the hearing record concerning several of these issues.

I. <u>Enron Broadband Services</u>

One of the Enron ventures that resulted in huge losses was Enron Broadband Services (EBS). The following are several questions concerning EBS:

(1) Well into March 2001, you reportedly were telling investors that Enron Broadband Services was "doing well."[2] My staff has heard from a former Enron employee, however, that, at the same time, you reportedly told an Enron executive in Europe that EBS was the "biggest mistake we've ever made."

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[1]Statement of Rep. W.J. (Billy) Tauzin, Subcommittee on Investigations and Oversight of the House Committee on Energy and Commerce, *Hearing on the Financial Collapse of Enron Corp.* (Feb. 7, 2002) (Federal News Service Transcripts).

[2]*Enron Corp. CEO: Core Businesses Are In 'Great Shape,'* Dow Jones Newswires (Mar. 23, 2001).

a. Did you tell investors in March 2001 that EBS was doing well?

b. Did you at any time in 2001 believe or tell anyone that EBS was the biggest mistake Enron had made?

(2) In hindsight, do you believe that your portrayal of EBS to investors was always complete and accurate? If not, please describe any instances you recall when your portrayal was not complete and accurate.

(3) According to one former employee at EBS, you encouraged Enron employees with no background in the telecommunications business to work for EBS and, as a result, the vast majority of EBS's employees had no background in broadband. Is this information correct and, if so, why did you believe that people without a broadband background were qualified to run EBS?

(4) To the best of your knowledge, how many parties did EBS complete transactions with for the purchase or sale of bandwidth and what was the total value of these transactions?

(5) On July 19, 2000, EBS announced a 20-year, exclusive agreement with Blockbuster, Inc., to deliver movies on-demand. Then-Enron chairman and CEO Kenneth Lay described the deal as "the 'killer app' for the entertainment industry."[3] Blockbuster Chairman John Antioco reportedly said that the two companies had come up with the "ultimate bricks-clicks-and-flicks strategy."[4] Enron then reportedly set up a partnership named "Braveheart" that would allow the company to record earnings from the Blockbuster deal in 2000 and 2001. Enron claimed $110.9 million in profits from Braveheart in the fourth quarter of 2000 and the first quarter of 2001.[5] According to a former EBS employee, however, the assumptions Enron used to value the Braveheart deal were extremely unrealistic and overly optimistic. Please explain how Enron valued the Blockbuster deal and please explain whether this valuation was, in your opinion, based on realistic and accurate assumptions.

(6) Enron announced the termination of the Blockbuster deal on March 9, 2001. According to a former EBS employee, the Blockbuster deal had essentially fallen apart by the end of

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[3] *Enron and Blockbuster To Launch Entertainment On-Demand Service Via the Enron Intelligent Network*, Enron Corp. Press Release (July 19, 2000).

[4] *Show Business: A Blockbuster Deal Shows How Enron Overplayed Its Hand*, Wall Street Journal (Jan. 17, 2002).

[5] *Id.*

2000 but Enron managed to delay the termination of the deal until 2001 so that Enron could record earnings from Braveheart in 2000. Is this information correct? If it is, please explain whether you believe Enron acted ethically in preventing its shareholders from learning promptly about the deal's collapse. If this information is not correct, please specify why it is incorrect and please indicate when the Blockbuster deal actually fell apart and whether Enron asked or suggested to Blockbuster that the deal's formal termination and/or the announcement of the deal's termination be postponed.

II. North American Electricity Markets

Another of the issues the Committee has been examining is Enron's effect on energy markets. As you know, questions have been raised regarding whether Enron manipulated power markets to drive up California energy prices in recent years. Please respond to the following questions concerning Enron's role in events relating to energy prices in North America:

(1) Enron recently provided me with videotapes of employee meetings. A videotape of a December 1999 meeting[6] records you stating:

> in North America we saw some of the most troubled wholesale power markets that we've seen. There was a tremendous amount of volatility and instability in the marketplace. . . . [B]ecause of the unstable conditions and high volatility, our earnings performance in the quarter for power marketing was actually higher that it was in the third quarter of 1998. So we continue to see strong earnings growth there.

Please explain how Enron benefitted from volatility in the power market.

(2) During the December 1999 employee meeting, you also said:

> All of the powerful forces that are occurring in the North American market for power are moving in Enron's direction. We're seeing continued disaggregation of the electric utilities. What that means is they're selling off the generation business, separating the transmission business, separating the distribution business, which means that you have more players in the marketplace that need to buy and sell power from the wholesale market which should benefit Enron. A second major trend that's occurring is that we're seeing the development of more merchant power facilities. In the old days, all of the power plants were built by

[6]The tape is labeled 2/1/99, but the discussion in the meeting refers to events that occurred after February 1999. Based on the content of the tape, the meeting appears to have occurred around December 1999.

> electric utilities. Today, virtually all the power plants are built by non-regulated companies. All of those facilities are going to be selling their power into the open wholesale markets. That increases our ability to make money and to transact business.

You identified "powerful forces that are occurring in the North American market for power" that "are moving in Enron's direction." In your view, what impact did those same powerful forces have on consumers of power in California and other states?

III. Chewco, JEDI I, and JEDI II

Another issue the Subcommittee examined during the hearing was accounting activities relating to special purpose entities (SPEs) set up by Enron. One of these SPEs related to two joint ventures known as "JEDI I" and "JEDI II" between Enron and the California Public Employees Retirement System (CalPERS). According to news accounts, Enron and CalPERS entered into JEDI I to make investments in energy projects. When Enron asked CalPERS to invest in JEDI II, CalPERS agreed to on the condition that Enron would buy out CalPERS's interest in JEDI I.[7] The creation of JEDI II led to the creation of an SPE known as "Chewco Investments," which bought CalPERS's stake in JEDI I. Chewco was run by an Enron officer named Michael Kopper, who served as manager of, and an investor in, Chewco's general partner.

I understand that Enron deemed Chewco to be an unconsolidated SPE, enabling Enron to avoid having to include several hundred million dollars of JEDI-related debt on its balance sheet. Enron apparently violated requirements that an unconsolidated SPE have independent ownership with a minimum of 3% of equity capital at risk. Ultimately, in its November 8, 2001, SEC filing, Enron admitted that Chewco and JEDI should have been consolidated onto Enron's balance sheet dating back to November 1997. The result was to add hundreds of millions of dollars to Enron's reported debt and to reduce previously reported earnings by nearly $400 million -- or more than 10% -- for that period.

Please respond to the following questions regarding this matter:

(1) A recent *Dow Jones Newswires* article reported that you were involved in the creation of JEDI II. In November 1997, you and Andrew Fastow reportedly met with CalPERS executives in California and "sold the pension fund on investing in JEDI II."[8] Is this report accurate?

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[7]*Skilling, Fastow Wooed Fund Into Deal Which Led to Partnership's Creation,* Dow Jones Newswires (Feb. 26, 2002).

[8]*Id.*

(2) Please describe in detail any involvement you had in JEDI I, JEDI II, and Chewco, including the time frame of any such involvement, and any role you played in the formation of these entities.

(3) According to the *Dow Jones Newswires* article, two months after CalPERS agreed to participate in JEDI II, the venture invested in Enron Energy Services (EES) with CalPERS's approval. You reportedly owned a 5% "phantom" equity stake in EES, but did not disclose this fact to CalPERS.[9] Did you own a 5% "phantom" equity stake in EES? If your answer is yes:

a. Did you disclose this fact to CalPERS? If you did not, do you think it was appropriate that you did not disclose your ownership of "phantom" equity in EES to CalPERS before CalPERS approved JEDI II's investment in EES?

b. The *Dow Jones Newswires* article quotes a CalPERS spokesperson as saying that had you disclosed your interest in EES, "CalPERS may have thought twice about investing in EES because it could have been seen as a conflict of interest."[10] In light of your ownership of equity in EES, do you believe that there was any conflict of interest involved with JEDI II investing in EES?

(4) The *Dow Jones Newswires* article also stated that you convinced the Ontario Teacher's Pension Plan to invest in EES in January 1998. The pension fund investments resulted in a $1.9 billion enterprise value for EES, and Enron booked profits even though EES had not secured any new business. As a result, your "phantom" equity was reportedly worth approximately $100 million. You then reportedly took 1/3 of this value -- $33 million -- in Enron common shares.[11] Is this accurate? If it is not accurate, please explain specifically which assertions are inaccurate and why.

(5) Please describe in detail any actions you took in recommending investments by JEDI I, JEDI II, or Chewco. Please include in this description when you took any such actions and any individuals involved with such actions.

(6) Were you aware – other than from news accounts – that Mr. Kopper served as manager of, and an investor in, Chewco's general partner? If the answer is yes, please state when and how you became aware of this fact.

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[9] *Id.*

[10] *Id.*

[11] *Id.*

(7) At any time during your employment with Enron, did you become aware that Enron was not consolidating Chewco and/or JEDI on its balance sheet? If your answer is yes:

a. Please state when you became aware of this fact.

b. During your employment with Enron, did you believe that it was appropriate for Enron to treat Chewco as an unconsolidated SPE despite the fact that (i) Chewco did not have the required independent 3% equity capital at risk, and (ii) Chewco was run by Enron officer Michael Kopper, who served as manager of, and an investor in, Chewco's general partner?

c. If the answer to (b) is no, did you ever raise concern about Enron's treatment of Chewco with anyone at Enron? If so, please state when you raised this concern, to whom you raised it, and what actions you or anyone else took as a result of your concern.

(8) Do you now believe that it was appropriate for Enron not to consolidate Chewco and/or JEDI on its balance sheet? If your answer is no, please state the basis for this conclusion.

IV. <u>Role of Political Activity in Enron Collapse</u>

In the House Energy and Commerce Committee's February 6, 2002, hearing on Enron, Chairman Tauzin summarized "some of the most important policy issues that related to . . . Enron's collapse." As the Chairman noted, these issues include "proper governance, accounting and governance of the auditing profession, and, very importantly, the health of our energy interests in markets."[12] The Energy and Commerce Committee and others in Congress currently are working to make sure that appropriate oversight policies are in place to help prevent the types of problems that arose relating to Enron.

A critical component of this effort is gaining understanding of the extent to which Enron was able to influence federal oversight and regulation concerning the problems relating to Enron's fall. Over the past several years, Enron became one of the most influential voices in Washington with both the Republican and Democratic parties, and benefitted from actions by the Bush and Clinton Administrations, as well as Congress. Accordingly, I request the following information:

(1) Please provide a list of all contacts of which you are aware by Enron's employees or

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[12]Statement of Rep. W.J. (Billy) Tauzin, House Committee on Energy and Commerce, *Hearing on the Financial Collapse of Enron Corp.* (Feb. 6, 2002) (Federal Document Clearinghouse Political Transcripts).

outside representatives with the Executive Office of the President and all federal departments and agencies from 1993 to the present regarding the following: regulation of accounting practices; regulation of energy derivatives and any other form of derivatives, including swaps; regulation of Enron's off-balance-sheet partnerships; Enron's financial position and prospects, including any potential federal action to assist Enron in improving its financial position and averting bankruptcy; regulation of Enron or any of its subsidiaries under the Public Utilities Holding Company Act; federal energy policy, including but not limited to regulation of energy facilities and energy markets, North American power markets, oil and gas pipeline issues, and policies related to siting, construction, and operation of transmission lines, generation plants, hydro-electric projects, and other electricity-related facilities; and environmental issues related to electricity generation, including air emissions, pipeline safety issues, and gasoline formulations and additives.

For each contact, describe the date it occurred, the Enron employee(s) or outside representative(s) involved, the government official(s) involved, and the substance of the contact, and provide a copy of any written materials or electronic communications you have that were provided by any Enron employee or outside representative to any government official.

Thank you for your attention to these questions. I request that you respond in writing by March 7, 2002.

Sincerely,

Henry A. Waxman
Member of Congress

cc: The Honorable James C. Greenwood
The Honorable Peter Deutsch