TESTIMONY OF RONALD M. BARONE

MANAGING DIRECTOR, STANDARD & POOR'S

BEFORE THE COMMITTEE ON GOVERNMENTAL AFFAIRS

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Good morning, Mr. Chairman and members of the Committee. I am Ronald M. Barone, a managing director in the Corporate and Government Ratings Group of Standard & Poor's. From 1994 until Enron Corporation's bankruptcy in December 2001, one of my roles at Standard & Poor's was to serve as an analyst with respect to Enron. I was the primary Enron analyst from mid-1996 until early 2000 and then became and have remained the manager of Standard & Poor's ratings work for Enron.

On behalf of Standard & Poor's, I welcome the opportunity to appear at this hearing. Standard & Poor's supports the Committee's urgent sense of the need to investigate the circumstances relating to Enron's collapse and to seek responsible solutions that prevent future harm to employees, shareholders, investors and the financial marketplace itself of the sort that has already occurred here.

There were many victims of Enron's deceit and, it appears, fraud. Regrettably, Standard & Poor's and its ability to provide fully informed ratings analysis, as it has been doing for generations, was also victimized. Not only were we not provided with significant amounts of material information that we had requested but, as I will describe, on a number of occasions Enron made what we later learned were direct and deliberate misrepresentations to us relating to matters of great substance. I will describe some of these deceptions in detail later in my testimony, but as a preliminary matter I want to express our desire to assist the Committee in any way we can with these proceedings.

Along with my testimony I have attached four items, the first two of which are publicly available on our website (standardandpoors.com): a brief overview of credit ratings entitled "Understanding Credit Ratings" and a chronology of our rating actions relating to Enron Corporation since October 15, 2001. The last two are copies of materially false and misleading presentations made by Enron to Standard & Poor's during the ratings process that I just mentioned.

I would like to begin by providing you with some background on Standard & Poor's and credit ratings.

Background on Standard & Poor's and the Nature of Credit Ratings

Standard & Poor's began its credit rating activities 85 years ago with the issuance of credit ratings on corporate and governmental debt issues and today is a global leader in the field of credit ratings and risk analysis. Standard & Poor's is — and has always been — independent of any investment banking firm, bank or similar organization. Since 1916, Standard & Poor's has rated hundreds of thousands of issues of corporate, government and structured financed securities through periods of economic growth and recession. Standard & Poor's also assesses the credit quality of, and assigns credit ratings to, managed funds and the ability of insurance companies to pay claims.

Today, Standard & Poor's has ratings outstanding on approximately 150,000 issues of securities of obligors in more than 50 countries. Standard & Poor's rates and monitors developments pertaining to these securities and obligors from operations in 18 countries around the world. Standard & Poor's is committed to objective ratings by independent rating committees comprised of analysts with credit experience in their areas.

Ratings are a key component of the capital markets, which have functioned effectively for decades in the United States, and which are growing and flourishing in many countries abroad. Investors throughout the world look to our ratings to help in their understanding of credit risks. While not all parties may agree with our ratings at all times —

they are, after all, *opinions* about an issuer's creditworthiness at a particular moment in time — Standard & Poor's credit ratings have gained respect and authority throughout the investment community because they are widely understood to be based on independent, objective and credible analysis. Standard & Poor's rates more than 99.2% of the debt obligations and preferred stock issues publicly traded in the United States, and our ratings are generally regarded as a global benchmark for assessing these issues.

I want to say a few words about what a rating is and what it is not. When Standard & Poor's issues a rating of the sort issued to Enron, it is offering its own opinion about a company's medium- to long-term credit risk. In doing so, we try to take into account whatever relevant future events may be anticipated. Because events always occur which are unforeseeable or simply unknowable, Standard & Poor's regularly reviews its analysis.

Standard & Poor's does not perform an audit of the issuer, does not guaranty an issuer's payment on its debt, or provide insurance in case the issuer does not pay the debt. A Standard & Poor's rating does not constitute a recommendation to purchase, sell, or hold a particular security. Nor does a Standard & Poor's rating speak to the suitability of an investment for particular investors. Rather, a rating reflects our opinion as of a specific date of the creditworthiness of a particular company or security based on our objective and independent analysis. Because ratings concerning creditworthiness are not investment advice or recommendations, they are fundamentally different from recommendations made by equity analysts as to whether investors should "Buy," "Sell," or "Hold" a security. Standard & Poor's also does not rate an issuer's common stock.

When we provide a rating of "A," "BBB" or "C," we are encapsulating our opinion into a letter or series of letters, which may be accompanied by a plus or minus. Our credit ratings also generally include more information about the rationale for the rating and our outlook as to the long term credit quality. Long-term credit ratings are divided into several categories ranging from "AAA," reflecting the strongest credit quality, to "D," reflecting default. Ratings from "AA" to "CCC" may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories, although the categories themselves remain the prime component of the rating. Ratings in the "BBB" category or higher are considered by the market to be "investment grade," a term first used by regulators to denote obligations eligible for investment by institutions such as banks, insurance companies, and savings and loan associations. The term has gained widespread use over time in the investment community.

In addition to issuing letter ratings, Standard & Poor's also uses other well-known and understood indicators and signals to alert the marketplace to noteworthy aspects of its ratings. A rating, for example, can appear on "CreditWatch" signaling the strong possibility of a rating change. CreditWatch actions are normally taken in response to specific events or sudden changes in circumstances that have a high potential to affect creditworthiness. However, not all rating changes are necessarily preceded by a "CreditWatch" listing because circumstances may call for an immediate rating change. Additional informational tools useful to investors are so-called Standard & Poor's "Outlooks" which offer long-term (one-to-three-year) perspective on credit quality. Outlooks are assigned to all long-term issues.

Standard & Poor's recognition as a rating agency ultimately depends on the credibility of its opinions with investors, importantly, but also with bankers, financial intermediaries, and securities traders. Standard & Poor's believes it is important that all users of its ratings understand how it arrives at ratings and regularly publishes ratings definitions and detailed reports on its criteria and methodology. The article, "Understanding Credit Ratings," which I have attached to my testimony, provides definitions of the different Standard & Poor's credit ratings, a description of the credit rating process, an overview of Standard & Poor's surveillance and review process, and an explanation of the different parts of our credit opinions.

Standard & Poor's places great importance on communication with the public. Our ratings criteria are available to all interested parties on our website. In order to ensure that issuers and investors understand our rating process and analytics, we regularly publish our complete ratings criteria and provide updates as we introduce new ratings innovations or as the market requires. While we are known for our letter grade ratings, we also regularly publish (as I will refer to in a moment about Enron) reports and rationales that inform the market about an issuer's strengths and weaknesses as well as trends that could affect the issuer's creditworthiness. Around the world, Standard & Poor's annually publishes approximately 10,000 press releases, over 1,100 articles and commentary pieces on sector and industry trends, 51 editions of CreditWeek (our weekly print publication on fixed income securities issues), and 12 sector reports on 19 industry groups. We hold over 200 telephone conferences with investors regarding fixed income topics. We also hold investor forums and conduct hundreds of print and broadcast interviews. All of our published rating actions are available to the public on our free website where we also post approximately 12,000 articles of fixed income-related commentary. In short, thousands of our ratings opinions are subject to market scrutiny every day.

Standard & Poor's Commitment to Objectivity

All Standard & Poor's credit ratings employees are subject to our internal Guidelines and Procedures and Code of Ethics. These policies have been in place for many years and include stringent trading restrictions and reporting requirements. Credit ratings employees are required annually to affirm compliance with these Guidelines and the Code. The Guidelines and the Code stress the overriding importance of objectivity in our ratings process.

In order to ensure maximum objectivity, fairness and in-depth analysis, ratings are assigned by a committee, not by any individual. Moreover, no portion of an analyst's compensation is dependent on or connected with the performance of companies that analyst rates or the amount of fees paid by that company to Standard & Poor's. The record bears out Standard & Poor's emphasis on objectivity and accuracy. There is an exceptionally strong correlation, which has existed for decades, between the ratings initially assigned by Standard & Poor's and the eventual default record. Indeed, independence, credibility and integrity are the foundations of the Standard & Poor's ratings business and they are what ultimately provide value to the marketplace.

Our ratings opinions are based on public information provided by the issuer, audited financial information, and qualitative analysis of a company and its industry sector. We also may have access to certain confidential information of the issuer but only to the extent that the company's management lives up to its obligation to give us complete, timely and reliable information and is willing to provide such information. We use that information and rely upon it. We tell the companies we rate that we rely upon them to provide complete, timely and reliable information — information that includes, but is by no means limited to, the company's financial statements. As we told Enron (and, indeed, every other company we rate): "Standard & Poor's relies on the issuer and its counsel, accountants, and other experts for the accuracy and completeness of the information submitted in connection with the rating process."

As mentioned earlier, we are not auditors, we do not audit the auditors of the companies that we rate or repeat the auditors' accounting work, and we have no subpoena power to obtain information that a company is unwilling to provide. We expressly rely on the companies we rate not only for current and timely information at the time of the initial rating but on an ongoing basis for the proper conduct of surveillance of the company's creditworthiness. This ongoing obligation includes providing on a timely basis all material changes to information the company has previously provided to Standard & Poor's. Indeed, our entire business and the United States financial system is based on the principle of full and fair disclosure, and this United States model is widely envied and in some cases replicated throughout the world.

As mentioned earlier, studies on ratings trends repeatedly demonstrate that our track record is excellent. There is a clear correlation between initial ratings and the likelihood of default: the higher the initial rating, the lower the probability of default and vice versa. The information below shows cumulative default history over the past fifteen years of issuers rated by Standard & Poor's based upon the rating category they were initially assigned. This clearly demonstrates the very low probability of default of an issue initially rated in the "AAA" category (only 0.52% have defaulted in the past fifteen years) contrasted with the much greater possibility of default for an issuer initially receiving our lowest rating level of "CCC" (54.38% have defaulted in the past fifteen years):

Rating Category	Percentage of Defaults Initially Rated in the Category
AAA	0.52
AA	1.31
A	2.32
BBB	6.64
BB	19.52
B	35.76
CCC	54.38

These statistics reflect a strong correlation between the initial rating and the likelihood of default. The correlation would be even greater if the dollar volumes of the issues were similarly analyzed.

As might be expected, Standard & Poor's quickly and closely examines cases where defaults occur and reviews its rating criteria on an ongoing basis. While such situations are highly unusual, we examine these defaults very carefully since they may identify new risks or extraordinary circumstances. Clearly, Enron was one of these highly unusual situations.

Enron Corporation

I now turn directly to Standard & Poor's ratings of Enron. From December 1995 until November 1, 2001, Standard & Poor's rating of Enron was BBB+, which we define as adequate ability to repay debt, but subject to worsening economic conditions. This was by no means the greatest vote of confidence a Standard & Poor's rating can bestow. It placed Enron at the lower levels of investment grade ratings and was well below what Enron repeatedly — and unsuccessfully — sought from Standard & Poor's. High-ranking Enron executives made repeated visits to New York over the years at meetings I attended to urge Standard & Poor's to raise the company's rating to an "A" level. They made detailed presentations to us that were designed specifically to lead us to raise Enron's rating. We repeatedly declined to do so, notwithstanding that the "BBB" level rating we had assigned was not only well below how Enron was often treated when it borrowed money from the market, but consistently lower than the ratings of other companies its size.[1] In fact, according to the Fortune 500, Enron was the seventh largest corporation in the world yet it received a lower rating as of November 27, 2001 than all but two of the current largest fifteen corporations.[2]

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1 Enron often borrowed from banks, investors, pension funds, etc. at lower interest rates than those usually charged to companies rated BBB+.

2 The fifteen largest corporations on the latest Fortune 500 list (including Enron) and their ratings as of November 27, 2001 are: Exxon Mobil (AAA); Wal-Mart Stores (AA); General Motors (BBB+); Ford Motor (BBB+); General Electric (AAA); Citigroup (AA-); Enron (BBB-); International Business Machines (A+); AT&T (A-); Verizon Communications (A+); Philip Morris (A); J.P. Morgan Chase (AA-); Bank of America corp. (A+); SBC Communications (AA-); Boeing (AA-).

Standard & Poor's rating of Enron in the BBB category was calculated and monitored on an ongoing basis through a thorough analysis of, among other materials, Enron's reported and audited financial statements including, in particular, its cash flow, debt burden, and other key financial metrics relevant to our opinion concerning Enron's creditworthiness. Standard & Poor's also employed a capital adequacy and liquidity review as Enron's businesses focused more on energy trading and marketing. Standard & Poor's also took into account Enron's emphatic and repeated representations, both publicly and to Standard & Poor's, about its strong corporate commitment to maintain its creditworthiness. In fact, Enron had, in the past, backed up its statements with action by issuing sizable amounts of equity to shore up its balance sheet, as necessary, to maintain its credit rating. Moreover, over the years, Enron had proven itself to be swift and effective in managing risk. Enron repeatedly articulated its strong commitment to maintain creditworthiness during personal visits to our offices by the company's CFO's (including Mr. Andrew Fastow) and, in at least one instance, a personal telephone call to me from its Chairman, Mr. Kenneth Lay, who explicitly stated that maintaining Enron's creditworthiness was a top corporate priority.

On their face, Enron's financial statements and credit commitment representations might be thought to have justified a higher rating than what it received. Nonetheless, because of the volatility involved in Enron's businesses and its many high-risk transactions, Standard & Poor's factored additional debt-like burdens into its rating. Although the additional debt was not legally binding on Enron, it was significant enough to our analysts to justify a lower rating for Enron than the reported and audited financial statements might have otherwise suggested. Indeed, over the years Standard & Poor's "put back" onto Enron's balance sheet off-balance sheet amounts of between $2 billion and $4 billion in debt-like obligations for purposes of our ratings analysis.

Standard & Poor's made continuous efforts to monitor Enron's credit quality closely over the years. As Enron's troubles began to surface in the second half of 2001, this included close focus not only on Enron's publicly filed documents but through frequent contact with Enron personnel for the purpose of continually assessing the company's financial position and future prospects. We also frequently conducted telephone conversations with Enron counterparties to determine the effect Enron's troubles might have on its core trading businesses. We repeatedly re-evaluated Enron's financial position as new revelations came to light. Throughout all our communications, we asked many probing questions of Enron executives in order to get as clear a picture as possible of Enron's finances. After Standard & Poor's changed Enron's "Outlook" to negative on October 25, 2001, for example, Enron personnel (including its then-President Gregory Whalley and CFO Jeffrey McMahon) came to our offices on October 31, 2001 to present a plan to resuscitate Enron's financial fortunes and stabilize its credit rating. Because our analysis indicated that the proposed plan was not sufficient to allow the company to maintain its credit rating, we were unconvinced and the next day downgraded Enron from "BBB+" to "BBB" and placed the rating on “CreditWatch Negative” — a clear and public warning by Standard & Poor’s about Enron’s ratings future. Standard & Poor's specifically noted the uncertainty surrounding Enron in the capital markets, the crisis of investor confidence and Enron's inability to calm investor fears about the strength of its core energy trading business.

During November 2001, Standard & Poor’s again downgraded Enron two more times. On November 9th, Enron’s rating was lowered to "BBB-" because of concerns about Enron’s credit following its restatement of earnings on November 8th. The rating remained on CreditWatch Negative — continuing to signal publicly a possible further downgrade. During this same time period, the financially stronger Dynegy confirmed that it was in merger discussions with Enron. Standard & Poor's expressly stated publicly that without the Dynegy merger, Enron's credit rating would likely fall below investment grade. As Standard & Poor's press release announcing the November 9th downgrade revealed, Enron's "investment-grade rating is predicated on the prospect for improvement of credit quality with the acquisition by the financially stronger Dynegy and the near-term liquidity enhancement, through the injection of $1.5 billion of equity capital, which came with the signing of the merger agreement." On November 28th, the day we determined that the merger was unlikely to occur, yet still before Dynegy publicly called off the merger, Standard & Poor's lowered Enron's rating to "B-", a non-investment grade rating. Our press release regarding this downgrade stated, “[a] collapse of the Dynegy deal would create enormous pressure on Enron's credit profile . . . Furthermore, Enron faces rising liquidity needs in connection with its trading activities as counterparties demand greater assurances to transact business with Enron. A move by Enron to seek protection from its creditors through a voluntary filing under Chapter 11 of the U.S. Bankruptcy Code is a distinct possibility if the merger falls through."

As I have said, at the heart of the process which leads to a rating being issued by Standard & Poor's is an unambiguous understanding between the company seeking the rating and Standard & Poor's itself: The company is obliged to furnish complete, timely and reliable information to Standard & Poor's on an ongoing basis and we, in turn, use that and other information we gather to assess the creditworthiness of the company and then offer our opinion as to creditworthiness in the form of a rating. But Enron did not keep — it did not begin to keep — its part of this well understood bargain.

1. Enron's Material Misrepresentations to Standard & Poor's

Day-by-day, it becomes ever clearer that Enron, far from providing anything like complete, timely and reliable information to Standard & Poor's, committed multiple acts of deceit and fraud on Standard & Poor's, just as it did to many others with whom Enron dealt. Despite our repeated requests for all information material to our analysis of its creditworthiness, Enron appears, for example, to have intentionally concealed from Standard

& Poor's and others the true nature of its debt obligations by treating in-substance loans it received from various banks as financial hedges. According to the New York Times, from 1992 through 2001 Enron booked $3.9 billion worth of in-substance debt transactions as hedge instruments. $2.5 billion of this total came in the years 1998 through 2001 alone. (See "Enron's Many Strands: Finances; Enron Had More Than One Way to Disguise Rapid Rise in Debt," New York Times, February 17, 2002).

Enron appears to have engaged in a series of "swaps" — derivative — transactions with certain Wall Street firms that allowed Enron to receive large cash infusions and obligated it to pay these same sums along with premiums back to the banks over a period of years. These transactions, all of which were hidden from Standard & Poor's, "perfectly replicated loans." (Id.) Indeed, according to the Times, at least one of the banks actually booked its transactions with Enron as loans. (Id.) It is no surprise the Times article suggested that one of the prime motivations for Enron's practices was to hide its true debt obligations from the rating agencies for the purpose of inflating its credit rating.

These were not the only material and systematic misrepresentations publicly revealed within the last months. On February 1, 2002, The Special Investigative Committee of the Board of Directors of Enron Corp., chaired by William C. Powers, Jr., issued its report regarding Enron's deceptive practices and concealment related to certain off-balance sheet partnerships and special purpose entities ("SPEs"). The Powers Report is necessarily preliminary in nature, and it may well be that the full scope of Enron's misrepresentations will take many months to be uncovered. But based upon the Powers Report and newspaper articles that have already appeared, there is every reason to believe that the scope of Enron's misconduct was massive — and necessarily had a substantial impact on the rating provided by Standard & Poor's.

The Powers Report focused on four entities: Chewco, LJM1, LJM2, and the Raptor entities. None of these was adequately described in any of the company's publicly reported financial statements, if at all.[3] Nor did Enron provide information — complete or otherwise — about their nature to Standard & Poor's separately. In fact, in a series of presentations, Enron failed to bring these entities to our attention despite explicitly assuring Standard & Poor's that it was providing a "kitchen sink" analysis of its affiliated off-balance sheet entities. The first of these presentations occurred in October 1999 after Standard & Poor's, seeking a better understanding of the financial impact of Enron's relationship to its off-balance sheet partnerships, expressly requested from Enron a full account of the debt obligations of any such partnerships even if Enron was not legally obligated to honor such

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3 As the Powers Report observes, Enron's financial statements did mention the existence of some of these partnerships. "However, these disclosures were obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships." (Powers Report at 17). <u>See</u> <u>also</u> Powers Report at 200-03.

debts. In response, Enron provided Standard & Poor's with one of the presentations I mentioned at the beginning of my testimony and which I have provided at the conclusion of this statement. This October 1999 presentation explicitly purported to provide an analysis "including the kitchen sink" of "100%" of Enron's "off-balance sheet affiliates." That is what Enron said. But in the chart provided to Standard & Poor's by Enron that lists these affiliates and their debt obligations:

- There is no mention of the Chewco partnership;
- There is no mention of the LJM1 partnership; and
- There is no mention of the LJM2 partnership.

Later, in January 2000, Enron made another presentation to Standard & Poor's, this time as part of one of its many aggressive (and unsuccessful) attempts to persuade us to raise its rating to the "A" or even "AA" (per the presentation) level. I have included this presentation with my testimony as well. This presentation also contained explicit "Kitchen Sink" representations about the extent and nature of the debt obligations of Enron's "Off Balance Sheet Ventures." Under the chart titled "Non-recourse Debt," Enron listed the same entities and debt totals that were contained in the October 1999 presentation referenced above.

Again this chart fails to mention the Chewco, LJM1, or LJM2 partnerships.[4] This presentation contains several other misrepresentations by Enron including, under the heading "Top Ten Reasons Enron is Under-Rated," an assertion that Enron's "[c]ommunication with analysts[,] investors and credit officers is direct and candid - No Secrets Policy."

In these presentations and our other interactions with Enron, Enron also failed to tell Standard & Poor's that Michael Kopper of Enron's Global Finance department managed and had a financial interest in Chewco or of the nature of compensation LJM1 and LJM2 were providing to Mr. Fastow, Enron's CFO. The subsequent creation of the Raptor partnerships was similarly never brought to our attention. Following the 1999 and 2000 presentations, Standard & Poor's requested updates to this information (all issuers are required to update information previously provided) as part of the clear understanding between

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4 It should be noted that the only difference between this chart and the one presented in 1999 is that under the column heading for the long-term debt totals of these off-balance sheet entities, the 1999 chart reads "1998 LT Debt" while the 2000 chart reads only "LT Debt." One can only assume that this single difference was deliberate. The effect, in any event, was significant. For example, in presenting the 1999 document, Enron might have been able to justify showing only 1998 totals (i.e., pre- LJM1 & LJM2) by claiming these were the only year-end totals available. However, no such justification existed at the time of the later presentation. By omitting the 1998 notation Enron represented that the totals listed were current when, in fact, they were woefully out of date and misleading.

Standard & Poor’s and Enron about Enron’s obligations to furnish updates. As we now know, however, this "understanding” was based on deception.

The visage of Enron as an entity that engaged in fraudulent misconduct has recently been bolstered by judicial rulings. In one ruling on February 26, 2002, federal district court judge Thomas P. Griese in New York concluded that “sufficiently particularized allegations of fraud” had been made to permit one case to go forward alleging fraud against Enron. In another, on March 5, 2002, federal district court judge Jed S. Rakoff in New York concluded that Enron transactions that took the form of natural gas trades actually “appear to be nothing but a disguised loan.”

2. The Impact of Enron’s Misstatements and Omissions on Standard & Poor’s Rating

A. Financially

As recounted above, Standard & Poor’s relied heavily on receiving complete, timely and reliable information from Enron in assigning its ratings. That is what we always do. But complete, timely and reliable information is precisely what we did *not* receive. Had Enron told Standard & Poor’s the truth about its financial condition during the ratings process — as it was required to do — the impact on Enron’s rating would necessarily have been significant. Though it is difficult to accurately assess precisely what would have occurred in hindsight — our rating decisions, as I have said, are made collectively by committees — the extremely harmful and material impact on Enron's creditworthiness is obvious.

I referred earlier to the New York Times report that revealed that Enron concealed nearly $4 billion in in-substance loan obligations between 1992 and 2001 by treating them as financial hedges. Enron incurred $2.5 billion of this total in its last three years alone. For a company that actually showed between $8 billion and $10 billion in debt during this period, the effect on Enron's book debt-to-total capital ratio of showing several billion more in debt would have been enormous. Thus, even without considering the obviously material impact of Enron's dealings with SPEs, it is clear beyond dispute that Enron's concealment of its true financial obligations from the rating agencies had a significant and misleading effect on our ongoing review of its creditworthiness.

The qualitative effects of full disclosure on Enron's credit rating would also have been substantial. The very foundation of Standard & Poor's opinion on Enron's credit quality rested on the previously high regard the Standard & Poor's analysts had for the company's risk management oversight and controls. The revelation that Enron was significantly more leveraged than previously thought and was far more lax about its risk management controls than it led Standard & Poor's to believe would have directly undermined this fundamental predicate of Standard & Poor's rating.

B. Loss of Confidence in Enron's Credibility and Honesty

The failure of Enron to provide full, timely and candid disclosure to Standard & Poor's not only has financial ramifications bearing on Enron's creditworthiness. It relates directly to Enron's honesty and thus to the validity of *all* its numbers. A company that fraudulently veils $4 billion of debt simply cannot — to put the point mildly — be trusted.

The Powers Report similarly determined that the off-balance sheet partnerships had been created and designed precisely to conceal from others (including Standard & Poor's) the true picture of Enron's financial status. "These partnerships — Chewco, LJM1, and LJM2 — were used by Enron Management to enter into transactions that it could not, or would not, do with unrelated commercial entities. Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve *bona fide* economic objectives or to transfer risk." (Powers Report at 4) In discussing a transaction with the Raptor entities that Enron executives did not disclose to Enron's Board of Directors (or to Standard & Poor's), the Report concludes, "[i]t continued the concealment of the substantial losses in Enron's merchant investments." (Powers Report at 15)

These entities, therefore, not only hid many of Enron's debt obligations from the view of, among others, Standard & Poor's, but were in fact expressly designed and implemented in such a way as to create precisely the opposite impression; namely, that

Enron’s debt obligations were in fact not problematic. To that end, and through “creative efforts to circumvent accounting principles” (Powers Report at 5) countenanced by an accounting firm that “did not fulfill its professional responsibilities” (id. at 24), Enron hid its true financial picture — and, more specifically, its true creditworthiness — from Standard & Poor’s. (Id. at 15)

The concealed loan-like transactions, the nature and very existence of significant related party off-balance sheet entities and Enron’s policy of deliberate non-disclosure regarding them appear to have been designed to keep the true nature of these entities and their transactions with Enron from the view of Standard & Poor’s and others. This concealment persisted, notwithstanding repeated requests from Standard & Poor's for any further information to more clearly depict Enron's true financial situation.

Had they been revealed, the clandestine dealings and obfuscatory disclosure practices conducted by Enron’s management would necessarily have cast long shadows on the validity of Enron’s credibility in general and its financial reporting in particular. While it is difficult to say with certainty all the steps Standard & Poor’s would have taken had it known these material facts, Standard & Poor’s does have a policy of not issuing ratings at all when it concludes that it does not have enough information to form a clear and accurate opinion of the issuer's creditworthiness. The recent revelations about Enron — with more to come, if the past days offer any clue to the future — certainly tell us that Enron materially failed to provide Standard & Poor's with the information necessary to form a true and accurate rating opinion.

Conclusion

At Standard & Poor’s, we are constantly engaged in a process of reviewing our performance, and the Enron situation has made these efforts all the more timely. We consistently survey investors in order to assess ways in which credit ratings can be more useful and forward-looking to the fixed income investment community. Working with the investment community, we are assessing our policies and procedures in order to implement any appropriate and warranted changes.

Clearly the collapse of Enron has been a terrible tragedy for its employees, shareholders, investors, business partners — in fact, the marketplace and economy as a whole. It has caused many to question the effectiveness of several long-standing and effective components of our capital markets, most of which have functioned effectively for decades. It is vital, however, that we all look to the Enron collapse as an opportunity to consider improvements that can be made to our system, weighing such improvements against the enormous benefits that we have witnessed as the capital markets have grown in size and scope. We at Standard & Poor’s are continuously exploring ways in which our ratings can become still more timely, effective and relevant.

Just as we have looked for ways in which we can make the ratings process as effective as possible, Standard & Poor's has long been an advocate for the highest standards of corporate transparency. Because ratings ultimately depend upon information provided by the issuer, we have been a long-time champion of complete, timely and reliable disclosure of financial information and the best means of corporate governance. We have supported, and will continue to support, any regulatory efforts aimed at enhancing these goals.

As I noted at the outset of my testimony, Standard & Poor's publishes thousands of ratings that are subject to market scrutiny every day. We welcome that scrutiny. Our rating opinions are based on an objective and independent process that we consistently disclose and describe to the marketplace.

My job and the job of my colleagues at Standard & Poor's is to make judgments based on information that is full, fair, timely and accurate. Sadly, these baseline standards of integrity were shattered by Enron.

The efforts of this Committee and others to get to the bottom of these matters is most welcome and will help rebuild the confidence and trust required for our capital markets to function and flourish.

Thank you.