

PART TWO: GENERAL BACKGROUND INFORMATION

I. BACKGROUND AND METHODOLOGY

A. Background Information Relating to Joint Committee on Taxation Staff Investigation of Enron

Letter to Joint Committee on Taxation staff directing investigation of Enron

On February 15, 2002, Senators Max Baucus and Charles E. Grassley, then Chairman and Ranking Member of the Senate Committee on Finance (“Senate Finance Committee”), directed the staff of the Joint Committee on Taxation (“Joint Committee staff”) to undertake a review of Enron’s Federal tax returns, tax information, and any other information deemed relevant by the Joint Committee staff to assist the Senate Finance Committee in evaluating whether the Federal tax laws facilitated any of the events or transactions that preceded Enron’s bankruptcy. The letter indicated that press reports had raised troubling questions about Enron, including the use of entities in tax haven countries, other special purpose entities, and questionable tax shelter arrangements. The letter stated that the Joint Committee staff should, as part of the review, examine the adequacy of present tax law, particularly in the areas of tax shelters and offshore entities.

The letter also directed the Joint Committee staff to include a review of the compensation arrangements of Enron employees, including tax-qualified retirement plans, nonqualified deferred compensation arrangements, and other arrangements, and to analyze the factors that may have contributed to any loss of benefits and the extent to which losses were experienced by different categories of employees. A copy of the letter from Senators Baucus and Grassley to Ms. Lindy L. Paull, Chief of Staff of the Joint Committee, is included in Appendix A to this Report.

Senators Baucus and Grassley directed that the Joint Committee staff conduct the Enron investigation pursuant to the authority provided to the Joint Committee under section 8022 of the Internal Revenue Code.²⁹ They asked that the Joint Committee staff transmit its findings and recommendations as soon as practicable.

²⁹ Section 8022(1)(C) of the Internal Revenue Code of 1986 (the “Code”) provides that the Joint Committee will conduct such investigations with respect to the Federal tax system as the Joint Committee may deem necessary. Code section 8021 authorizes the Joint Committee to obtain and inspect tax returns and return information (as specified in sec. 6103(f)). In addition, section 8023 authorizes the Joint Committee (or the Chief of Staff of the Joint Committee), upon approval of the Chairman or Vice-Chairman, to secure tax returns, tax return information, or data directly from the Internal Revenue Service or any other executive agency for the purpose of making investigations, reports, and studies relating to internal revenue tax matters, including investigations of the Internal Revenue Service’s administration of the tax laws.

Disclosure agreement

On January 30, 2002, staff of the Senate Finance Committee, Joint Committee staff, and lawyers from Skadden, Arps, Slate, Meagher & Flom LLP (“Skadden Arps”)³⁰ met to discuss whether Enron would consent to the public disclosure of its tax returns and return information in connection with a Congressional review of the role that Federal taxes may have played in the Enron bankruptcy. This meeting set in motion a series of interactions, during February of 2002, among the staff of the Senate Finance Committee, the Chief of Staff of the Joint Committee, and Skadden Arps to negotiate a disclosure agreement relating to the Joint Committee staff investigation. A representative from the Office of the Senate Legal Counsel also participated in the negotiations. The disclosure agreement was executed on March 6, 2002, by Mr. Raymond M. Bowen, Jr., Executive Vice President and Chief Financial Officer of Enron Corp., Senator Baucus, Senator Grassley, and Ms. Paull.³¹

Under the terms of the disclosure agreement, Enron agreed to provide upon request to the Senate Finance Committee and the Joint Committee copies of all Federal tax returns and related information of Enron and of affiliated and related entities not included in Enron’s consolidated returns. Enron retained the right under the disclosure agreement to elect to assert any applicable privilege or legal objection provided that such assertion would be accompanied by a document-by-document index sufficiently detailed to enable the Senate Finance Committee and the Joint Committee to evaluate the assertion.³²

³⁰ Skadden, Arps, Slate, Meagher & Flom LLP (“Skadden Arps”) represents Enron in connection with Congressional investigations and other matters.

³¹ A copy of the disclosure agreement is included in Appendix A to this Report.

³² During the course of the Joint Committee staff investigation, Enron (through its counsel Skadden Arps) did not generally raise an issue of privilege or legal objection with respect to any document requested by the Joint Committee staff. Enron made the following statement in each of the letters addressed to the Joint Committee staff: “The enclosed documents are being provided to you in accordance with the terms of the Disclosure Agreement entered into by and among the Senate Committee on Finance, the Joint Committee on Taxation and the Company as of March 7, 2002. With this production, the Company does not intend to provide a general waiver of the attorney-client, attorney work product or other applicable privileges, and does not waive those privileges as to other documents not produced here.” Enron did assert privilege in a letter to Senate Finance Committee staff dated May 8, 2002, with respect to certain matters contained in minutes of the Board of Directors from August 2001 through January 2002. Enron asserted its privilege by redacting certain portions of the minutes that Enron asserted related to (1) communications with counsel or among counsel, or involving work product of counsel, relating to discussions or handling of government and congressional investigations; and (2) communications with counsel or among counsel, or involving work product of counsel, relating to discussions or handling of litigation. In the letter, Enron stated “Other privileged material, outside these two narrow exceptions, has not been redacted in keeping with the Company’s past practice in this matter.”

The disclosure agreement required the Senate Finance Committee and the Joint Committee to seek tax returns and return information for years after 1995 from the Internal Revenue Service (“IRS”) and to request such information from Enron only to the extent either Committee was unable to obtain the information expeditiously from the IRS.

The disclosure agreement set forth the terms and conditions under which Enron agreed to the public disclosure of information collected by the Senate Finance Committee and the Joint Committee. The first part of the disclosure agreement related to Enron’s tax returns and return information.³³ In the case of Enron’s tax returns and return information, obtained by the Finance Committee or Joint Committee pursuant to section 6103,³⁴ Enron consented to disclosure only through official reports, meetings, or hearings of either the Senate Finance Committee or the Joint Committee. Any other disclosure of such information is prohibited and would violate section 6103 because it would constitute a disclosure outside the agreement. In the case of tax returns and return information of Enron for years after 1995, the Senate Finance Committee and Joint Committee further agreed to make no public disclosure before June 10, 2002.

The second part of the disclosure agreement related to all other documents and information (other than tax returns and return information obtained from the IRS). Under the disclosure agreement, the Senate Finance Committee and Joint Committee agreed that they would not disclose other nonpublic documents or information obtained from Enron, except through official reports, meetings, or hearings. In addition, the Senate Finance Committee and Joint Committee agreed that neither Committee would disclose before June 10, 2002, any such nonpublic information for years after 1995, which would be return information if it were in the possession of the IRS.

³³ Under sec. 6103 of the Internal Revenue Code of 1986 (the “Code”), the returns and return information of a taxpayer are confidential. However, a taxpayer can consent to the disclosure of information that otherwise would be subject to sec. 6103.

³⁴ Sec. 6103 only applies to returns and return information obtained from the IRS. Information provided directly by Enron, including tax returns, is not subject to sec. 6103. As noted above, the Senate Finance Committee and the Joint Committee agreed that they would first attempt to obtain tax returns and return information for years after 1995 from the IRS.