B. Methodology and Scope of Joint Committee Staff Investigation

In general

This section outlines the methodology and scope of the Joint Committee staff investigation of Enron. This Report attempts to describe the events that occurred over time at Enron both with respect to its Federal tax situation and with respect to its compensation arrangements. To understand the information and analysis that is provided in this Report, it is useful to understand the way in which the investigation was conducted.

The Joint Committee staff did not follow the Federal rules of evidence that would apply in a court proceeding in conducting its investigation. Thus, documents provided to, and reviewed by, the Joint Committee staff would not necessarily be admissible in a court of law. Similarly, with respect to interviews conducted by the Joint Committee staff, the individuals interviewed were not under oath at the time of their interviews. In some instances, the individuals made statements that would constitute hearsay in a court of law.

Enron agreed to cooperate with the Joint Committee staff investigation. Enron complied with requests for information from the Joint Committee staff through the voluntary production of documents.[35] The Joint Committee staff cannot represent that it was able to review all documents relating to a transaction in which Enron engaged or all information relating to other aspects of the Joint Committee investigation. During the course of the Joint Committee staff investigation, Enron was complying with document requests relating to its bankruptcy filing and other Federal investigations; thus, the company was responding to numerous document requests at the same time. In some instances, particularly with respect to executive compensation matters, Enron's recordkeeping was either abysmal or company representatives who compiled the information failed to provide relevant documentation.

Throughout this Report, specific information is provided as it was contained in documents provided by Enron or the IRS.[36] In many instances, the documents provided to the Joint Committee staff contained data and other information as of the time at which a transaction occurred. The Joint Committee staff could not independently verify the accuracy of this information in all cases; for purposes of this Report, the Joint Committee staff has used the information as it was provided. Furthermore, in many cases, information that may have been

---

[35] Throughout this Report, information contained in documents provided by Enron is referred to with a Bates-stamp numbering system (e.g., EC 00001234) used by Enron to identify the documents. Certain of these documents have also been included in the Appendices to this Report, as noted throughout the Report. It should be noted that Enron's counsel Skadden Arps responded to requests for information on behalf of Enron.

[36] Certain documents received by the Joint Committee staff in connection with the investigation are included in Appendices to this Report. Handwritten notes on these documents are not those of Joint Committee staff; in most cases, the author of the handwritten notes is not identified.

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

accurate when included in a document may subsequently have become inaccurate due to subsequent events such as Enron's restatement of its earnings.

Despite these limitations, the Joint Committee staff believes that its investigation provides a useful in-depth examination of some of the transactions into which Enron entered, as well as an in-depth examination of Enron's compensation structures. The information gathered enabled the Joint Committee staff to prepare a detailed discussion of specific transactions and issues to provide an insight into how large corporations might manage their tax liabilities (see Part Three of this Report, below). The discussion outlines the methods and some of the complex transactions that Enron used to manage its Federal income tax liabilities. The transactions that were reviewed by the Joint Committee staff were identified from a variety of sources, including interviews with current and former Enron employees, meetings with the IRS, and published reports relating to Enron. However, the Joint Committee staff cannot represent that this Report identifies and analyzes all transactions in which Enron engaged that might be of interest to policymakers or the IRS. The sheer volume of information relating to Enron made available to the Joint Committee staff, the fact that the issues associated with a company the size of Enron are so broad, and the difficulty faced in attempting to identify specific transactions from the face of a tax return as complex as Enron's necessarily limits the ability to identify all of the transactions in which Enron engaged.[37]

It should be noted that this Report identifies financial accounting benefits that Enron claimed in connection with certain of its tax-motivated transactions. It was beyond the scope of the Joint Committee staff investigation to evaluate the validity of any of the claimed financial accounting benefits. Therefore, the financial benefits are presented as claimed.

The review also led the Joint Committee staff to make certain general observations about Enron that are contained in Part One of this Report, above; while these observations relate specifically to Enron, they highlight some of the systemic issues and problems facing policymakers and the IRS, especially with respect to large corporations.

The following discussion details the work done by the Joint Committee staff in connection with this investigation.

Overview of chronology of Joint Committee staff investigation

The Joint Committee staff began its investigation of Enron in February 2002, prior to execution of the disclosure agreement with Enron. On February 25, 2002, the Joint Committee staff made an initial document request to the IRS. In the letter to the IRS, the Joint Committee staff requested copies of all Federal tax returns (including amended returns) for Enron and other entities in which Enron had an equity interest for tax years from 1985 to the present, including supporting workpapers, and other information in the IRS' possession including, but not limited to, IRS master file information from 1985 to the present, information concerning Enron's

[37] In some cases, documents reviewed by the Joint Committee staff provided inconsistent information relating to certain transactions. In such cases, the Joint Committee staff attempted to develop the most reasonable description of the transaction.

involvement in tax shelter transactions, Federal tax litigation in which Enron has been involved, and information relating to Enron's involvement with specific transactions and entities. In addition, the letter requested information relating to the qualified retirement plans and compensation arrangements of Enron including, but not limited to, copies of all annual returns relating to the qualified retirement plans, copies of any IRS information relating to such plans, and information relating to nonqualified deferred compensation programs.

On February 27, 2002, the Joint Committee staff was briefed in Washington, D.C., on the history of IRS involvement with Enron by IRS personnel from the IRS National Office in Washington, D.C., and IRS personnel from Houston who were involved in the examinations of Enron's tax returns. At the same time, IRS personnel briefed Joint Committee staff on specific information contained in the Joint Committee's first document request and the logistics of transmitting this information to the IRS National Office.

The Joint Committee staff made an initial document request to Enron on March 12, 2002. This document request related to Enron's Federal tax returns and business operations and did not request information relating to the qualified pension plan and other compensation arrangements of Enron. Pursuant to the terms of the disclosure agreement, the letter requested copies of Enron's Federal tax returns for the 1985-1995 period,[38] as well as other information relating to Enron's business operations.

Pursuant to a request made by Enron, the Joint Committee staff met on April 23, 2002, in Washington, DC, with representatives from Skadden Arps and two employees of Enron[39] to discuss the Joint Committee staff's first document request and the parameters of the Joint Committee staff investigation. Enron's employees indicated that full compliance with the first Joint Committee document request would produce 3,500 to 5,000 boxes of information for the period requested. Much of the material requested was located at an off-site storage location in Houston, Texas, with a third-party contractor. The Enron employees argued that it would be too costly to produce the documentation requested by the Joint Committee staff. As a result of this meeting, the Joint Committee staff agreed to narrow the first document request in order to produce a manageable request for documentation relating to business operations of Enron relevant to the Joint Committee investigation.

On April 25, 2002, the Joint Committee staff made a first document request to Enron relating to qualified plans and compensation arrangements.

---

[38] As mentioned above, the disclosure agreement required the Joint Committee staff to attempt to secure Enron's tax returns for years after 1995 from the IRS.

[39] Enron employees in attendance at the meeting were Mr. Jordan H. Mintz and Mr. Edward R. Coats.

On June 7, 2002, at Enron's request, lawyers from Skadden Arps and Enron employees[40] met with Joint Committee staff to make a presentation concerning information requested by the Joint Committee staff and information on certain structured transactions and other significant transactions in which Enron engaged.[41] During this presentation, the Enron employees provided an oral description, with accompanying written material, of the structured transactions that are addressed in depth in Part Three, below, of this Report.

During May, June, and July of 2002, the Joint Committee staff conducted an extensive review of documents provided by Enron and the IRS in response to the Joint Committee staff document requests.

On July 16, 2002, the Joint Committee staff interviewed Mr. Robert J. Hermann, Former Vice President and Director of Taxes, for Enron Corp.[42]

During August through November of 2002, the Joint Committee staff conducted interviews in Houston, Texas, and Washington, D.C., of current and former Enron employees, certain members of Enron's Board of Directors, and certain outside counsel to Enron. Also during this time frame, the Joint Committee staff continued to review documents received from Enron, the IRS, the Department of Labor, the Pension Benefit Guaranty Corporation, and others in connection with the investigation.

In the course of its investigation, the Joint Committee staff received periodic briefings from the IRS with respect to the status of the IRS review of Enron's 1996 to 2001 tax returns for purposes of filing a proof of claim with the bankruptcy court.[43] The Joint Committee staff also received periodic briefings from the Pension Benefit Guaranty Corporation and the Department of Labor with respect to Enron's pension plans.

---

[40] In attendance at the meeting were Enron employees Jordan Mintz, Edward Coats, and James Ginty, lawyers from Enron's counsel (Skadden Arps and Weil Gotschal & Manges LLP), lawyers from Alston & Bird LLP (counsel for the Enron Examiner).

[41] The company presentation and appendix thereto are contained in Appendix A to this Report.

[42] The Joint Committee staff contacted Mr. Hermann after his name appeared in a May 22, 2002, Washington Post article that discussed the structured transactions in which Enron engaged. April Witt and Peter Behr, *Enron's Other Strategy: Taxes; Internal Papers Reveal How Complex Deals Boosted Profits by $1 Billion*, The Washington Post (May 22, 2002) at A-1. The article and the interview with Mr. Hermann provided useful information for this Report. A follow-up telephone interview of Mr. Hermann took place on December 4, 2002.

[43] The IRS' deadline for filing a proof of claim regarding Enron's tax liabilities with the bankruptcy court is March 31, 2003. The Joint Committee staff has, in some cases, chosen not to describe or discuss certain aspects of the investigation if the staff determined that doing so could jeopardize the IRS' interests in Enron's pending bankruptcy proceedings.

Review of Enron's tax returns

The Joint Committee staff requested Enron's consolidated Federal tax returns for all years since 1985. Each of these tax returns contains thousands of pages of schedules and attachments. As noted in Table 4, below, since 1997, Enron Corp. prepared more than 1,000 Federal tax returns each year with respect to affiliated and other entities in which Enron held an interest.

Table 4.–Enron's Federal Tax Returns*

	1997	1998	1999	2000
Total number of returns prepared for Enron consolidated tax return	274	333	502	713
Total number of returns prepared for entities filed outside of the Enron consolidated tax return**	58	164	178	190
Total number of entities/branches included in foreign information returns	628	842	1,048	1,485
Total number of entities/branches included in partnership returns	42	66	94	98
Total Number of Federal Tax Returns	**1,002**	**1,405**	**1,822**	**2,486**

Source: Enron presentation to Joint Committee staff, June 7, 2002, included in Appendix B to this Report.
* Includes pro-forma returns for check-the-box, accounting, and legal branches.
** Approximately 15-20 separate company or consolidated returns.

In addition, the Joint Committee staff was provided access by the IRS to returns of partnerships and other entities that were not legally related to Enron, but with which Enron had significant relationships. For example, in some instances, Enron may not have held an interest in a partnership engaged in a transaction with Enron; however, partners in the partnership were high-ranking Enron employees.

The proliferation of Federal tax returns prepared by Enron (note, for example, the 36 percent increase in returns from 1999 to 2000) is consistent with trends the Joint Committee staff observed with respect to the operations of the company. See, for example, the discussion in Part Three,V., below, about the increases in the numbers of off-shore entities utilized by Enron.

As Table 4, above, demonstrates, the scope of Enron's activities, and the number of entities associated with Enron Corp., was quite large in the period before it sought bankruptcy protection. Enron Corp. and members of its consolidated group[44] also held interests in hundreds of other entities that were not themselves included in the consolidated return. For example, in Enron's international operations, approximately 1,300 foreign entities were established, a majority of which were inactive.[45] In addition, Enron and its numerous corporate subsidiaries entered into transactions for which special-purpose entities were formed. The structured tax-motivated transactions and structured financing transactions in which Enron affiliates engaged involved the use of dozens of legal entities.[46] As a result of the broad scope of Enron's group

[44] An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns. An affiliated group means one or more chains of included corporations connected with a common parent, if stock ownership rules requiring 80-percent voting and value are met. Includible corporations do not include foreign corporations; partnerships are not included in a consolidated return. Secs. 1501 and 1504.

[45] "Enron Corp. Presentation to the Joint Committee on Taxation, June 7, 2002," at 42.

[46] These transactions, and the entities involved in them, are described (with diagrams) in Part Three of this Report.

and the numerous consolidated and nonconsolidated entities in which Enron had an interest, the Joint Committee staff took the broad approach of examining transactions and patterns of compensatory arrangements in which Enron engaged, rather than examining Enron's structure or tax posture on an entity-by-entity basis.

In conducting its review, the Joint Committee staff did not conduct the equivalent of an IRS examination of Enron's tax returns. Rather, the staff examined certain tax-driven transactions of Enron that raised issues of tax policy and interpretation of the tax law. The staff focused on these types of transactions rather than attempting generally to examine the activities of Enron. An attempt to duplicate the type of work that the IRS performs when examining a tax return for a corporation as large and complex as Enron would have required staffing, time, and examination expertise well beyond that available to the Joint Committee staff.

The Joint Committee staff used Enron's Federal tax returns as a resource to verify information provided by the IRS and Enron. For example, the Joint Committee staff has provided a book-to-tax reconciliation for certain years, the information for which was obtained from Enron's Federal tax returns. This book-to-tax reconciliation shows how Enron's book income was translated to taxable income on its Federal tax returns.

Document requests

The Joint Committee staff made seven written document requests (including requests for information contained on other forms of media (e.g., videotapes and CD-ROMs)) to Enron during the course of its investigation. Enron responded in 16 separate letters prepared by its counsel, Skadden Arps. The document production from Enron totaled more than 100 boxes of information.

The Joint Committee staff requested documents and information from the IRS on at least six occasions. The IRS responses to these requests totaled more than 40 boxes of information.

On March 6, 2002, the Joint Committee staff requested documents and other information from the Department of Labor relating to Enron's qualified plans and other compensation arrangements within the Department of Labor's jurisdiction. Certain materials were provided to the Joint Committee staff by the Department of Labor during the summer of 2002. On October 1, 2002, a follow-up letter was sent to the Department of Labor. On October 11, 2002, the Department of Labor provided additional documents in response to the Joint Committee staff's requests.

On June 6, 2002, the Joint Committee staff met with staff of the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs with respect to the Subcommittee's investigation relating to Enron. The Joint Committee staff was afforded the opportunity to review documents the Subcommittee had collected that might be relevant to the Joint Committee staff investigation.

Interviews of individuals relevant to the Enron investigation

The Joint Committee staff considered interviews with current and former Enron employees and other individuals with connections to Enron to be an important element of its

investigation. Between July 16, 2002, and January 23, 2003, the Joint Committee staff conducted 46 interviews of individuals with information relevant to the Joint Committee staff investigation.[47] Generally, each interviewee was asked a standard set of questions based upon the individual's particular knowledge of Enron. Some of the interviews were conducted by telephone, but many were conducted in person in Houston, Texas, and Washington, D.C.

In some cases, individuals who the Joint Committee staff requested to interview were not available. Some individuals refused to cooperate with the Joint Committee staff investigation. Some individuals did not respond to repeated requests for an interview.

The Joint Committee staff who conducted the interviews took notes, but generally did not record the interviews. After each interview, the Joint Committee staff compiled their notes into a single interview record. These interview records have been used extensively in this Report to detail the activities of Enron and, in some cases, the motivation or purpose for Enron's activities.

It is important to note that the individuals interviewed by the Joint Committee staff were not under oath. To the extent individuals made statements that were inconsistent with statements made by others or with documents provided by Enron or other sources, the Joint Committee staff attempted to resolve the inconsistency through follow-up interviews or further document review. In some unresolved cases, the Joint Committee ultimately had to use its best judgment to resolve inconsistencies.

Appendix A to this Report contains a list of individuals the Joint Committee staff interviewed and their relationship to Enron. The document in Appendix A also contains a listing of certain individuals who did not agree to the Joint Committee staff's request for an interview.

Joint Committee staff travel

Joint Committee staff made four trips to Houston, Texas in connection with its investigation (during March, August, and September of 2002). During these trips, the Joint Committee staff met with IRS personnel from Houston and Dallas and interviewed current and former Enron employees.

Other investigations and sources of information

The Joint Committee staff reviewed publicly available information relating to Enron, including information made available by the Securities and Exchange Commission; the Department of Labor; the Pension Benefit Guaranty Corporation; the Senate Committee on Health, Education, Labor, and Pensions; the Senate Committee on Governmental Affairs; the Senate Committee on Energy and Commerce; the Senate Committee on Commerce, Science and Transportation; the Senate Committee on Banking, Housing, and Urban Affairs; the House Committee on Financial Services; the House Committee on Energy and Commerce; the House Committee on Education and the Workforce; and the U.S. Bankruptcy Court for the Southern District of New York.

---

[47] The Joint Committee staff sent more than 48 letters to potential interviewees and their counsel and made numerous telephone calls in its attempts to schedule interviews.

The Joint Committee staff reviewed media reports relating to Enron's activities for information relevant to the Joint Committee staff investigation.

Outside advisors

The Joint Committee staff reviewed tax opinions and other documentation regarding the tax advice provided by Enron's outside advisors with respect to many of the transactions within the scope of the investigation.[48] Although the Joint Committee staff reviewed such opinions and advice for purposes of analyzing the transactions, the Joint Committee staff did not examine the propriety of this advice under present standards of professional conduct or similar rules relating to Federal tax practice, or for purposes of determining whether there may have been violations of tax statutes relating to tax return preparers or tax advisors.

[48] Many of the tax opinion letters reviewed by the Joint Committee staff are included in Appendix C to this Report.