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Banks, law firms were pivotal in executing Enron securities fraud

- **Nine banks hid loans, set up false investments and facilitated phantom Enron sales**
- **Bank executives profited personally from “Ponzi scheme”**
- **Law firms structure phony deals**
- **Additional insider trading documented**

The Enron fraud perpetrated by the Houston-based energy giant and its auditors succeeded because of the active complicity of several prominent banks and law firms, according to new allegations in federal court today.

The University of California, the lead plaintiff in the Enron shareholders lawsuit, filed a consolidated complaint in the U. S. District Court for the Southern District Court of Texas in Houston, adding nine financial institutions, two law firms and other new individual defendants to a list that already included 29 current and former Enron executives and the accounting firm of Arthur Andersen LLP.

The 485-page amended complaint lays out the scheme in detail, naming J. P. Morgan Chase, Citigroup, Merrill Lynch, Credit Suisse First Boston, Canadian Imperial Bank of Commerce (CIBC), Bank America, Barclays Bank, Deutsche Bank and Lehman Brothers as key players in a series of fraudulent transactions that ultimately cost shareholders more than \$25 billion. At the same time, a number of top bank executives profited personally from the schemes, according to the complaint.

Two law firms were also added to the list of Enron defendants because of their significant and essential involvement in the fraud – Enron’s Houston-based corporate counsel Vinson & Elkins, as well as Chicago-based Kirkland & Ellis, which Enron used to represent a number of so-called “special purpose entities.”

“These prestigious banks and law firms used their skills and their professional reputation to help Enron executives shore up the company’s stock price and create a false appearance of financial strength and profitability which fooled the public into investing billions of dollars,” said James E. Holst, the university’s general counsel. “In return, these firms received multi-million-dollar fees, and some of their top executives exploited the situation to cash in personally.”

The amended complaint also documents a total of almost \$1.2 billion in insider trading by 28 Enron directors and officers, approximately \$171 million more than previously disclosed. Two Enron insiders, Kenneth Lay and Robert Belfer, together sold \$144 million more than has been reported.

Bankers tricked investors with dual deception

Many of the financial institutions named in the complaint helped to set up clandestinely controlled Enron partnerships, used offshore companies to disguise loans, and facilitated the phony sale of overvalued Enron assets. As a result, Enron executives were able to deceive investors by moving billions of dollars of debt off its balance sheet and artificially inflating the value of Enron stock.

For their part, the law firms allegedly issued false legal opinions, helped structure non-arm's-length transactions, and helped prepare false submissions to the U. S. Securities and Exchange Commission.

The banks played a dual role in the elaborate scheme, which the amended complaint describes as “a hall of mirrors inside a house of cards.” While bank executives were helping conceal the true state of Enron's precarious financial condition, securities analysts at the same banks were making false, rosy assessments of Enron to entice investors.

As underwriters in the sales of Enron securities, the banks also misled the public by approving incomplete or incorrect company statements. J.P. Morgan Chase, for instance, helped Enron raise \$2 billion in publicly traded securities that are now almost worthless.

“Instead of protecting the public from the Enron fraud, the bankers knowingly chose to become partners in deceit,” said William Lerach, senior partner at Milberg, Weiss, Bershad, Hynes & Lerach, the university's lead counsel. “They were not only willing participants but profiteers. Their executives followed the example of Enron's insiders, getting rich off thousands of unwitting pensioners and other investors who entrusted – and lost – what for many was their life savings.”

Bankers made inside deal for themselves

Executives at several of the banks took advantage of their positions to invest more than \$150 million in one of the Enron-controlled, off-the-books partnerships called LJM2, which they knew would pay an exorbitantly high return because of “self-dealing” transactions with Enron, according to the complaint.

From the start, the banks provided “extraordinary” assistance to Enron to set up LJM2. In information presented for the first time, the complaint reveals the “prefunding” of LJM2 by J.P. Morgan Chase, CIBC, Deutsche Bank, Credit Suisse First Boston, Lehman Brothers and Merrill Lynch at the end of December 1999 – a critical juncture for Enron. Although under no obligation to do so, the banks advanced nearly 100 percent of the money for LJM2, including a \$65 million credit line.

LJM2 used the money in the final days of 1999 to buy four Enron assets that the company had failed to sell to other parties, enabling Enron to report large gains and prevent a sudden decline in stock prices that would have meant large losses for the company and the banks.

The deals, described as “sham” transactions, involved the Nowa Sarzyna power plant in Poland, the MEGS, LLC natural gas system in the Gulf of Mexico, the Yosemite certificates and a set of collateralized loan obligations. Later, LJM2 sold the assets back to Enron.

The four transactions allowed Enron to overstate its profits, conveniently meeting forecasts put out by the company and bank analysts. Simultaneously, bank executives who had invested in LJM2 were enriched when the special-purpose entities paid millions to LJM2.

Banks, law firms helped Enron conceal loans and create fake profits

The banks and law firms are accused of playing an instrumental role in creating a mythical picture of Enron profitability. They helped set up transactions that appeared to be independent, but

“which, in fact, Enron controlled through a series of secret understandings and illicit financing arrangements,” said Lerach.

Loans, which should have counted as debt, were made to look like profits from sales. The complaint explains how J.P. Morgan Chase helped Enron hide \$3.9 billion in debt through a company known as Mahonia Ltd., located in the Channel Islands off England. The bank disguised approximately \$5 billion in back-and-forth transactions in which Enron sold gas and oil contracts to Mahonia, but then secretly repurchased the contracts.

The complaint also reveals that Vinson & Elkins gave J.P. Morgan Chase and Enron legal cover for the Mahonia transactions by writing an opinion corroborating them as legitimate.

Citigroup used its Delta subsidiary in the Cayman Islands to carry out \$2.4 billion of financial “swaps” with Enron that the lawsuit says “perfectly replicated loans and were, in fact, loans,” but were not disclosed on Enron’s books. Credit Suisse First Boston gave Enron \$150 million in a transaction that the lawsuit says was “made to appear to be a ‘swap,’” but was actually a loan, as a bank officer later admitted.

Canadian Imperial Bank of Commerce (CIBC) also formed a partnership with Enron, called EBS Content Systems, and pretended to invest \$115 million, enabling the energy company to report \$110 million in profits. However, because Enron secretly agreed to guarantee the \$115 million, the lawsuit calls the transaction a “contrivance” that inflated the company’s profits.

CIBC likewise lent \$125 million to the Enron venture New Power IPO, allowing the company to post fictitious profits, while again receiving a secret guarantee that protected the bank. Later, Enron had to reverse the entire \$370 million in profits it had created by the New Power deal.

In other cases, Enron and the banks made loans look like investments. Barclays gave \$11.4 million to two investors in Chewco, another of Enron’s off-the-books partnerships. While the money gave the appearance of outside investment in Chewco, Enron secretly subsidized the loans through a \$6.6 million cash deposit with Barclays. The complaint describes the two investors as “strawmen.”

Schemes propped up Enron stock but eventually collapsed

The banks' complex maneuvers on Enron’s behalf were intended to bolster the value of Enron stock and its apparent creditworthiness. Bank officers were aware that if the price fell, Enron would be required to issue additional stock that would diminish the company's investment rating and limit access to new capital, likely collapsing the scheme from which the banks were profiting. At one point, executives of Credit Suisse First Boston strongly warned their Enron counterparts that the company would be ruined if the stock dropped to \$20 a share.

For the first time, the amended complaint reveals that some of the financial institutions were themselves at risk for extensive losses because they had written millions of dollars of “credit default puts” on Enron securities, requiring them to make good on Enron’s publicly traded debt if the company defaulted. This gave them strong incentives to keep Enron afloat.

When Enron’s financial manipulations finally became public and the stock collapsed in November 2001, executives from J.P. Morgan Chase and Citigroup pressured Moody’s to keep Enron’s credit rating in place until the banks could arrange a bailout sale of Enron to avoid insolvency and forestall a full-scale investigation into the company’s dealings. A proposed sale to Dynegy fell through, however, and Enron filed for bankruptcy on December 2, 2001.

The losses of the plaintiffs in the shareholders class action, who purchased Enron equity and debt securities between October 19, 1998 and November 29, 2001, are estimated at more than \$25

billion.

The amended complaint also extends the responsibility of Enron's auditing firm, Arthur Andersen, to cover the role of 24 Andersen executives and several of the firm's international entities, including Andersen Worldwide, SC, and affiliates in Brazil, the Cayman Islands, India, Puerto Rico, and the United Kingdom.

"The defendants' sophisticated manipulations allowed them to enrich themselves at the expense of millions of Americans who lost billions of their hard-earned dollars invested in Enron for their retirements," said Holst. "That's not fair. Our lawsuit seeks to return those funds to their rightful owners and to retirees and working families across the country."

A copy of the complaint and background materials will be available online at 9:00 am PDT at www.ucop.edu/news/enron and www.enronfraud.com.

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