Testimony of

The Honorable Christine O. Gregoire

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Good morning. Thank you Senator Leahy and members of the committee for the opportunity to testify here today and your work on this important and troubling issue.
As Washington's Attorney General I am working on several fronts to sort out the impacts on millions of state residents from the secretive, questionable, and potentially illegal business practices of Enron. Clearly it is a corporation with a troubled culture that cared little for its customers, employees and investors, and now we all are left to try and pick up the pieces and see what can be done to make sure this never happens again.

In Washington we feel like Enron has been the gathering of the perfect storm. First they gouged our consumers and ratepayers with highly questionable power prices last summer, and now, sadly, they have defrauded our investors and others across the nation.

Enron first came on our radar screen in June 2000, when the Western States began to experience a serious energy crisis. About one year ago I joined the attorneys general of California and Oregon in an investigation of whether the energy market was being manipulated.

The price spikes, unplanned maintenance outages and transmission capacity restraints certainly were peculiar and warranted a closer look.

Wholesale market rates for a megawatt-hour of electricity skyrocketed from $30 to $300 and even as high as $3,000. Was that the result of natural market forces, or was there manipulation?

Over a year later, I wish I could tell you the answer. But while the companies, including Enron, keep insisting to you that they have nothing to hide, in fact they have refused to turn over documents necessary for us to determine once and for all what role they played in energy pricing.

I can tell you that the price of some unregulated long-term energy contracts in the West dropped by as much as 30 percent when Enron declared bankruptcy in December. It may be just a coincidence, but until Enron begins cooperating with investigators, we won't know.

So I applaud the efforts of Senators Cantwell and Wyden to push for a federal investigation.

Currently I am also involved in a lawsuit against Enron on behalf of our state pension fund. At least 31 public pension funds across the nation have lost an estimated $1.5 billion on Enron investments. These are losses to our funds for the retirement obligations made to millions of police officers, firefighters, teachers and other public servants around this nation.

I have joined attorneys general from Ohio and Georgia in seeking lead plaintiff status in the class action lawsuits filed on behalf of investors against Enron, its executives and Arthur Andersen. There are 1.3 million employees and retirees covered by our three systems.

Our suit contends Enron and others violated the Securities and Exchange Act by improper accounting, disclosure of false and misleading information, and some outrageous examples of insider trading.

We have alleged that Enron used off-shore tax havens to hide its debt burden from investors and that it misstated its financial position and investors' equity in the company repeatedly.

As a state Attorney General, I warn consumers about avoiding shady get-rich-quick schemes and I urge them to check a company out carefully before handing over money.
In Enron's case, investors followed the rules. They listened to Wall Street. They relied on audits and published financial reports. They assumed there was adequate government regulatory oversight. And they assumed the seventh largest company in America was playing by the rules. In the end they found themselves ripped off just like the naïve person who lost money in a pyramid scheme.
Now investors find themselves having to sue with questionable financial restitution, little or no accountability by the accountants, and an insurance policy likely to be denied because of fraud by the directors.
Enron's ability to operate in secrecy, with soft or limited regulatory review, and with apparently no independent audit oversight are the common factors behind our lawsuit and the energy price manipulation probe.
I know Congress is discussing a number of lessons learned from the implosion of Enron and what we can do to avoid future problems. I have a few thoughts.

First, the SEC must have quality staff and necessary resources to investigate and take enforcement action.
But before we try to rely on government and government regulation for the solution, it seems we first should focus on the terribly flawed audit function.

It appears the accountants for Enron, and I fear many other companies, have put their allegiance to money over their ultimate allegiance owed to creditors, stockholders and the investing public. The auditing role is not a business partner but an independent force in the market place that lets investors make decisions based on accurate financial information.

The United States Supreme Court recognized this in a 1984 opinion in which it referred to the role of the accountant. "This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust."

Something obviously went dreadfully wrong with this independent role with a duty to the public and I think we need to hold the accounting industry accountable.
Approximately 67 percent of the class action litigation against publicly-traded companies today allege accounting fraud as a basis of liability.

As Attorney General in case after case of Medicaid Fraud, we file against providers who claim they have simply followed accounting schemes approved by their accountants.
The problem is, when the providers are found guilty of fraud, the accountants walk away. I don't think it is too strong to suggest that in many cases, the accounting firms are facilitating the commission of a white collar crime, but they aren't held accountable.

For that reason I support the discussions I have heard to provide more accountability by accounting firms, and to end the peer review process which has resulted in negligible censure or discipline.

And as an elected Attorney General, who is not beholden to my state agency clients and can give them independent legal advice, I strongly support proposals to prohibit accounting firms from collecting consulting fees from clients they are auditing.

It is time to look at other ways to hold accounting firms more accountable. I don't have specific answers today, but I think there are some fertile areas to look at - particularly those areas where the industry has built up a shield from accountability.

As we have learned in the Enron case, document retention rules obviously need more scrutiny.

I would also suggest recent amendments to the Securities laws be reviewed to ensure responsible parties, such as auditors and others, are not improperly shielded from liability. In particular, I think a review of the statute of limitations and proportionate liability are in order.
Finally, Senator Leahy and members of the committee, I would suggest the real problem here has to do with corporate culture. It is a problem, I am afraid, that is far more pervasive than Enron and is not something you legislate.

As Attorney General, whenever we take Consumer Protection or Antitrust actions we find the company has discarded its business ethics and values and replaced them with a goal of making money whatever the cost.

The new economy may demand new ways to do business. But values from the old economy still are vital. Directors have a fiduciary responsibility to investors. Auditors have a responsibility for independent audits that the public can trust. And corporate executives should put investors before their hunger for profits and stock options.

Thank you for the opportunity to testify today.