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United States Senate

COMMITTEE ON
GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

September 25, 2002

The Honorable Harvey L. Pitt
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Sent by mail and by fax to (202) 942-9650

Dear Mr. Chairman:

The purpose of this letter is to urge the Commission to resist any efforts to narrow or weaken the insider loan prohibition established by Section 402 of the Sarbanes-Oxley Act, codified at 15 U.S.C. 78m(k), a key reform designed to stop a common insider abuse found at Enron Corporation, Worldcom, Tyco International, and other publicly traded companies.

Issues related to insider corporate loan abuses were examined by the Permanent Subcommittee on Investigations in connection with its ongoing review of Enron. In its bipartisan report, "The Role of the Board of Directors in Enron's Collapse" (July 2002), copy enclosed, the Subcommittee found that multi-million dollar loans, using company funds, had been approved by the Enron Board for the personal use of Kenneth Lay, then Chairman of the Board and Chief Executive Officer (CEO). The Subcommittee found that the Board's Compensation Committee first gave Mr. Lay access to a $4 million line of credit, increased this credit line in August 2001 to $7.5 million, and authorized repayment with either cash or company stock. The Subcommittee found that, in 2000, Mr. Lay began using what one Board member called an "ATM approach" toward his credit line, repeatedly drawing down the entire amount available and then repaying the loan with Enron stock. Records show that Mr. Lay at first drew down the line of credit once per month, then every two weeks, and then, on some occasions, several days in a row. In the one-year period from October 2000 to October 2001, Mr. Lay used the credit line to obtain over $77 million in cash from the company and repaid the loans exclusively with Enron stock, at a time when the company had significant cash flow issues. After Enron's collapse, it was discovered that Mr. Lay had failed to repay and still owes the company about $7 million. The Subcommittee concluded that the Enron Board had failed to monitor or halt abuse by Mr. Lay of his multi-million-dollar, company-financed credit line.

Enron, of course, is not alone in having experienced corporate loan abuses. Similar abuses by corporate executives given company-financed loans for millions of dollars have taken place at other U.S. publicly traded companies. At the time of Worldcom's collapse, for example, Board Chairman and CEO Bernard Ebbers was found to have outstanding company-financed loans exceeding $400 million. Apparently, most of these loans had been provided to enable him to purchase Worldcom stock. At Tyco International, Board Chairman and CEO Dennis Kozlowski and other executives apparently managed to secure not only multi-million-dollar personal loans using company funds, but to arrange to have these loans deemed "forgiven" in amounts allegedly totaling more than $100 million. Apparently these loans were to pay for

employee relocation expenses, including the purchase of expensive residences. Numerous other publicly traded companies have also provided troubling, multi-million-dollar, company-financed loans to corporate executives, including Adelphia, AMC Entertainment, Dynegy, FedEx, Healthsouth, Home Depot, Kmart, Mattel, Microsoft, Priceline.com, SONICblue, and more.

Given the extent of insider abuse in this area and the lack of effective Board or management oversight, the Subcommittee recommended in its July report that Board members at publicly traded companies bar the issuance of company-financed loans to company directors and senior officers. Later that same month, Senator Charles Schumer offered on the Senate floor the amendment that led to inclusion of the Section 402 prohibition in the final corporate reform law.

Media reports indicate that some companies may be pressing the SEC to narrow the scope of the prohibition or otherwise weaken it through regulation, guidance, or other means. These media reports suggest that opponents want exemptions, for example, for company loans used by executives to purchase company stock, exercise stock options, obtain insurance, relocate for work, or pay taxes. But the legislative history provides no basis for creating these exemptions or otherwise weakening the provision. To the contrary, the statutory prohibition makes it clear that publicly traded companies are not supposed to be using company funds to provide personal financing to company directors or officers for any reason; financing is to be provided instead by lenders, credit card operators, or other third parties engaged in the ordinary course of business.

In light of the abusive record compiled by the Permanent Subcommittee on Investigations among others, the Subcommittee's bipartisan recommendation to bar company-financed loans to corporate directors or officers, and the plain language of the statutory prohibition itself, the Commission should continue to resist efforts to weaken this significant post-Enron reform. Congress enacted and the SEC must enforce this bright-line measure to end corporate loan abuses by top executives.

Thank you for your attention to this important matter. If your staff has any questions or concerns about this letter or would like additional copies of the Subcommittee report, please have them contact Elise Bean, Subcommittee Staff Director, at (202) 224-9505 or Kim Corthell, Minority Staff Director, at (202) 224-3721.

Sincerely,

Susan Collins
Susan M. Collins
Ranking Minority Member

Carl Levin
Carl Levin
Chairman

Permanent Subcommittee on Investigations

CL/SMC:ejb
Enclosure