ENRON

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What was Enron?

- An energy company based in Houston, Texas that originally involved in transmitting and distributing electricity and gas throughout the United States
- Company developed, built, and operated power plants and pipelines
- Company expanded and dealt with energy trade on an international and domestic basis

History

- Northern Natural Gas Company formed in 1932 in Omaha, Nebraska
- 1979 reorganized as the leading subsidiary of a holding company, InterNorth
- Interstate pipeline company formed by the merging of Houston Natural Gas and Omaha-based InterNorth in 1985, which later changed it's name to Enron
- Founders:

  Jeff Skilling (chief executive)

  Ken Lay (chairman)

History Cont.

- Grew wealthy through marketing and promoting power
- Daniel Scotto and Enron's financial flaws
- Northern Natural Gas purchased back by Omaha investors.

Products and Services

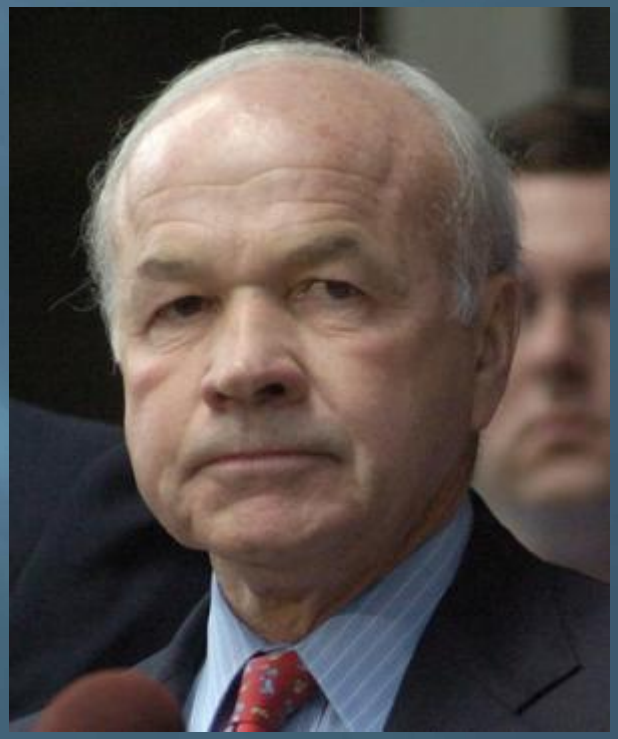
- Traded in more than 30 different Products
  - Petrochemicals, plastics, power, steel, principal investments, shipping/freight, etc.
  - Future trader: sugar, coffee, grains, meat, etc.
  - Online Marketplace services
    - Enron Online
  - Broadband services

Products and Services Cont.

- Energy and commodities services
- Commercial and industrial outsourcing services
- Project development and management services
- Energy transportation and upstream services

Enron's History & Success

- 1984: Kenneth L Lay became the Chief Executive Officer (CEO) of Houston Natural Gas Corporation, a pipeline operator.
- Soon after his firm merged with Internorth, another pipeline company, and he became the CEO of the new merged firm which they named Enron.



Kenneth L. Lay

Enron's History & Success

- Soon after Lay hired the consulting firm, McKinsey & Co. to help develop a business strategy for Enron.
- One of the consultants assigned to the Enron study was Jeffrey Skilling who was later hired to develop new business activities for Enron. Skilling successfully launched Enron's highly profitable business of trading energy derivatives.

Jeffrey Skilling

Enron's History & Success

- 1988: Enron opens offices in the UK after the country's privatizes its power industry.
- 1989: Enron opens its Gas Bank, where consumers can buy long-term supplies of natural gas at a fixed price, even as the real price fluctuates.

Enron's History & Success

- 1990: Andrew Fastow was hired by Enron from Continental Illinois Ban in Chicago
- 1990 – 1998: Expands holdings in the UK, Europe, South America and Indian
  - Moves again from natural gas and pipeline operations to marketing in other energy-related commodities
- 1998: Andrew Fastow was appointed Chief Financial Officer (CFO) of Enron.

Andrew Fastow

Enron's History & Success

- 1999: Enron had expanded to Enron Online which was used for trading commodities.
  - Soon after, about 90% of Enron's income eventually came from trades over Enron Online.
- August 2000: Enron's shares hit an all-time high more than $90 US. Annual revenues reach $100 billion US.
  - Become the seventh-largest company on the Fortune 500 and the sixth-largest energy company in the world. The company's stock price peaked at $90 US.

Beginning of the Downfall

- **October 2001:** Enron reports its first quarterly loss in four years, $618 million US, and a reduction in shareholder equity of over $1 billion.
  - CFO Andrew Fastow is replaced. The Securities and Exchange Commission begins an investigation related to investment partnerships led by Fastow.
- Investigation would later show that a complex web of partnerships was designed to hide Enron's debt.

Downfall Cont.

- **November 2001:** Enron announces it had overstated its earnings back to 1997 by about $600 million. Its shares plunge to "junk" status by the end of the month.
- December 2001: Enron files for bankruptcy protection, the largest bankruptcy in U.S. history at the time.
  - Over 4,000 workers would be laid off

Concealing its Debt

- After several years of international and domestic expansion involving complicated deals and contracts, Enron was billions of dollars in debt. All of this debt was concealed from shareholders through partnerships with other companies, fraudulent accounting, and illegal loans.
  - Fastow was allegedly responsible for creating a web of off-balance sheet partnerships with external companies that allowed him to hide Enron's very large losses

RADR

- 1997: A group of entities secretly funded by Enron purchased electricity-generating windmills from Enron, then later sold them back with some of the profits going to key Enron officials and their families.

Chewco

- 1997: A company formed by executives of Enron in order to buy out the shares of California Public Employees' Retirement System (CalPERS) in a joint venture investment partnership known as JEDI. Chewco bought out CalPERS interest in order to retain JEDI's off-balance-sheet status. However, Chewco did not meet the requirements for accounting rules and claimed profits that it was not entitled to. In addition, when Enron bought out Chewco's interest, Chewco's price was driven up, reaping huge benefits for the original investors (Enron execs).

Southampton

- February 2000: Enron bought the shares of National Westminster Bank (NatWest) in a limited partnership with Credit Suisse First Boston. Enron paid $20 million, but only $1 million went to NatWest. The remainder of the money went to several executives and their families, as well as to three NatWest employees who were in on the deal. Although top level executives at Enron were likely aware of the debt and the illegal practices, the fraud was not revealed to the public until October 2001 when Enron announced that the company was actually worth $1.2 billion less than previously reported.

Nigerian Barges

- December 1999: Enron and a financial institution entered into a sham "sale" transaction that enabled Enron to book approximately $12 million in earnings. In the transaction, the financial institution agreed to "buy" from Enron an interest in certain power-producing barges in Nigeria based on an express oral promise from Fastow that Enron would arrange to take the financial institution out of the investment within six months. Six months later, Fastow fulfilled his promise to take the financial institution out of the deal. He arranged for a partnership he controlled, LJM2 Co-Investment, L.P. ("LJM2") to purchase the financial institution's interest on the previously-agreed terms.

Raptor I/ Avici

- Enron and LJM2 engaged in complex transactions with an entity called Raptor I. Raptor I was used to manipulate Enron's balance sheet and income statement and to generate profits for LJM2 and Fastow at Enron's expense. In September 2000, Fastow and others used Raptor I to bring about a fraudulent hedging transaction and thus avoid a decrease in the value of Enron's investment in the stock of a public company called Avici Systems Inc. Fastow and others back-dated documents to make it appear that Enron locked in the value of its investment in Avici in August of 2000, when Avici's stock was trading at its all time high price.

The Cuiaba Project

- To avoid consolidation of debt related to a power-plant project in Cuiaba, Brazil, and to recognize earnings, Enron entered into a sham sale with LJM1. Fastow arranged for LJM1 to buy an interest in the plant despite significant cost overruns, completion delays, and operational problems, after Enron failed to secure an independent buyer. However, in connection with this transaction, Fastow had entered into an unwritten side agreement with Enron (which Enron later honored) requiring Enron to buy back the interest it sold to LJM1 at a guaranteed profit regardless of the risks associated with the project.

After the Downfall

- the Enron case has caused many problems on the accounting profession than any other case in U.S. history.
- Companies that deal in special purpose entities and complex financial instruments similar to Enron have suffered significant declines in their stock prices.
- Enron's collapse also contributed to the creation of the U.S. Sarbanes-Oxley Act (SOX), signed into law on July 30, 2002. It is considered the most significant change to federal securities laws since FDR's New Deal in the 1930s.
  - Among other things this law provides:
    - stronger penalties for fraud
    - requires public companies to avoid making loans to management
    - to maintain stronger independence from their auditors
    - and most controversially, to report on and have audited, their financial internal control procedures

After the Downfall

- Enron sold its last business, Prisma Energy, in 2006, leaving it as an asset-less shell. In early 2007, it changed its name to Enron Creditors Recovery Corporation. Its goal is to pay off the old Enron's remaining creditors and wind up Enron's affairs.
- As of 2008, Enron has settled with all of the institutions, ending with Citigroup. Enron was able to obtain nearly $20 million dollars to distribute to its creditors as a result of the megaclaims litigation.

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