A hard act to follow: the future for energy without Enron

Corporation's fall creates leadership void

Failure will affect deregulation debate

Return to business fundamentals seen

By David Wagman
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The energy industry is beginning to imagine its future without the swashbuckling Enron, the future of which could now rest with bankruptcy courts on both sides of the Atlantic.

Not so long ago, the idea that the great energy trader Enron could be driven to its knees was laughable. The Houston-based company hired the best and the brightest. Now thousands of those people have been laid off. And while its corporate swagger may have grated on a few nerves, the company had admirers everywhere, and not just inside the energy industry.

"I'm not sure the significance of what happened to Enron has sunk in," said the president of one Texas-based natural gas pipeline, who didn't want his name used. "Who'd ever have imagined it? This is a huge, huge change in our industry."

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Enron's fall also opens up leadership voids in at least three areas within the industry: as a champion for state and federal retail deregulation; as a force in building wholesale energy markets; and as a pacesetter in attracting investors to what had been a staid and conservative industry.

Enron helped shape public policy

Within the U.S. retail deregulation debate, Enron proved to be one of many voices. Large industrial energy users and some utilities played larger roles, especially in recent years, said Kenneth Rose, an economist with the U.S. National Regulatory Research Institute in Columbus, Ohio, and an expert on state regulatory policy. Enron did, however, pour lots of money into efforts to shape public policy.

"Enron was the poster child for the new world," said Carl Wood, a regulator with the California Public Utilities Commission. "The fact that they were so spectacularly discredited is profound."

Ironically, to many observers, "California" and "Enron" are one and the same failure. In reality, however, "California" stemmed not so much from deregulation's flaws as from the failure of an ill-conceived re-regulation scheme. And "Enron" was not so much the failure of one company's energy investments, or too innovative trading, but the cumulative effect of creative accounting. Even so, its failure will profoundly affect the deregulation debate.

"I don't think a dead Enron killed deregulation. I think the memory of a live Enron killed it," said Peter Navarro, a business professor at the University of California at Irvine. Navarro has been an outspoken proponent of the idea that a seven-member cartel—which included Enron—was responsible for manipulating energy prices in California.

The memory of that alleged manipulation might be enough to cause policy makers to tighten market rules in the future.

Regulation would have saved Enron—from itself

Indeed, some observers see Enron's business failure as providing a good argument for more regulation. "Some might argue that had there been adequate regulation it might have saved them," said Ashley Brown, with the Kennedy School of Government at Harvard.

For those looking for historical parallels, Wood points to the circumstances that led to enactment of the Federal Power Act and the Public Utility Holding Company Act in the 1930s. Heavily leveraged investments by some big corporations failed, not only disrupting the U.S. electricity delivery system, but also helping cause the Great Depression. The response was the creation of the regulatory structure that Enron sought to dismantle.

Energy companies are now quick to argue that wholesale markets were not to blame for Enron's failure. Nor was the broadly general notion of deregulation to blame. And, for now, anyway, federal policy makers are focusing on flaws within the rules that monitor business practices.

As part of that scrutiny, questions are being asked about securities regulation and rules related to accounting practices. Shareholder rights could be strengthened, as could rules related to employee retirement accounts, in particular the popular 401(k) plan. The version at Enron took a beating when the company collapsed.

Retail deregulation now out of favor

Retail deregulation was stalled well before Enron fell. Michigan was the last state to begin the process in June 2000, Rose said. Since then no other state has moved to adopt retail deregulation, and several have acted to slow their deregulation processes. And this autumn, California suspended its restructuring altogether.

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By contrast, wholesale energy markets may be on a more certain footing. Enron accounted for 15%-20% of wholesale trades in the U.S. But in the weeks since

Enron's troubles began, the wholesale markets have "behaved well," said Harvey Padewar, a group president for Duke Energy who is responsible for wholesale markets.

In the days following Enron's collapse, trading volumes on the Intercontinental Exchange—a system in which Duke Energy holds a stake—rose 30%. The biggest winners from this have been companies with good credit ratings and strong counterparty relationships.

"Customers want physical assets to back up energy trading positions," Padewar said—a contrast to Enron's general disdain for physical assets and preference for financial instruments. While such instruments remain a part of the mix and are an acknowledged important risk management tool, Padewar said, more balance between trades and assets may be seen than in the recent past.

Though Enron played hardball in the wholesale energy markets, in some ways it was not in the same business as Duke, Reliant, Dynegy, El Paso Corp. and others that made ongoing investments in physical assets, Padewar said. Those investments now offer a source of comfort to energy buyers nervous about their market exposure.

"The spin right now is it's a wonderful thing" to have a portfolio rich in assets, said the Texas pipeline company president.

Nevertheless, wholesale electricity markets could see volatile prices into 2002 if overall trading volumes fall, said Gary Ackerman, director of the Western Power Trading Forum in San Jose, Calif., which represents wholesale power buyers and sellers. To ease investor worries, the normally circumspect New York Mercantile Exchange rushed to market a number of new energy contracts that had been in development. The products are expected to offer some protection to market players with exposure to Enron.

Then comes the issue of who will be the energy industry's style leader. For the near term, the industry may look more like its old, conservative self. Companies such as Duke, Reliant, Dynegy, American Electric Power and others are sure to absorb Enron's business. But few of them measure up in terms of sheer panache and joie de vivre.

Return to business fundamentals welcomed

Many industry insiders believe the renewed focus on business fundamentals rather than inventiveness is a good thing.

"There was too much focus on markets and day-to-day trading," said TJ.Glauthier, a former U.S. deputy secretary of energy who now leads the Electric Innovation Institute, an independent affiliated organization of EPRI, based in Palo Alto, Calif. "The industry is right to resume making investments on transmission lines and other assets related to the grid," he said.

With Enron in bankruptcy protection, it now seems that much of its success was based on big claims and on the very idea of "Enron." When confidence in that idea eroded, Enron's credibility burst and the company fell quickly, said Wood.

"It's sort of like the old Texas joke about all hat and no cattle," he said. Enron's "hat" may now be the stuff of legend and litigation.

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