Part 1. Context (20 points)

Find out about the Enron scandal, for example by finding documentaries on YouTube or text articles online. (One good one, called "The Smartest Guys in the Room," is reportedly available on Netflix.)

Create PDF document named `context.pdf` that includes:

1. A concise summary of the scandal (maximum half a page)
2. A list of each main player with their organizational affiliation, title (if any), and role in the scandal
3. The year in which the main events unfolded

Most trace the origins of Enron to the merger of InterNorth and Houston Natural Gas in 1985, initially attempted to make money by reaching contracts to sell natural gas on a long-term basis. This approach relied on the price of natural gas continually increasing, as well as continued deregulation of natural gas and energy markets; Ken Lay vision for the future of Enron relied on rapid, global deregulation. Because of the slow pace of deregulation and the volatility in the price of natural gas, the combined company was barely making ends meet.

This fact played an important role in the unfolding of the Valhalla Scandal of 1987. In early 1987, that traders at the companies New York based oil speculating arm, named Enron Oil, had gambled massive amounts of money on oil trading and always seemed to be making profits. These sustained, sizeable profits were usual for the oil speculation, this lead to an investigation by the Enron board. The inquiry revealed that the traders had been gambling beyond the speculation limits and were diverting company profits into their personal bank accounts in addition to breaking generally accepted trading practices.

Despite these revelations, Ken Lay increased the trader's limits and sent a letter to the traders urging them to "keep making us millions." Citing that is was the only part of the company making any money, ignoring the blatantly illegal and dishonest trading practices. Just two month later, the fortunes of the Valhalla traders changed and they "drew over 90 million over just five days;" essentially gambling away Enron's reserves. The company was able to survive at the intervention of the companies CFO, by 'bluffing' the market. This incident is important as it reveals Ken Lays underlying business ethnics, when it came to profits, Mr. Lay also claimed to have no knowledge of the incident. The same claim he made regarding the later fraud at Enron.

This left the company without its main source of profits; this coincided with the arrival of Jeff Skilling as a consultant for Enron, in the June of 1990. At the same time, Enron began a market for buying and selling natural gas as commodity an idea attributed to Skilling. He eventually was asked to join the board of Enron, and would only accept the offer if the company agreed to adopt 'mark-to-market' accounting. By June of 1991, the Securities and Exchange Commission had approved adopt 'mark-to-market' accounting forever changing the business culture at Enron. This type of accounting was extremely subjective and allowed the company to book all future profits from a deal as soon as an agreement was signed.

In 1996, Skilling took over as COO, which accelerated Enron's move into becoming an energy services companies, trading energy via their online marketplace Enron Online. At the same time, Rebecca Mark, the CEO of Enron International began signing deal to build new energy plants and provide natural gas, the most notable of such deals being Dabhol Power Complex in India. Much of Enron's success tied into its stock price and appearance that the company was increasing profits each quarter; additionally large amount of executive compensation included larger quantities of Enron stocks. This motivated executives to maintain the appearance of success and launch projects the pumped up the company's stock price. In the midst of the dot-com bubble, Enron launched Broadband trading market in addition to launching EES (Enron Energy Services).

These ventures, while impressing Wall Street, these ventures lost millions of dollars for Enron. So how did Enron continue showing profits and growth each quarter? The manipulation of California's Deregulated energy market and the work of Enron's West Coast Traders throughout 2000 cushioned some of these losses. Traders lowered capacity, shut down power plants and exported power out of the state to drive up the price of power. Effectively robbing state of needed power and making huge amounts of money. Skilling protégé, Andy Fastow was the answer to Enron's financial predicament. Eventually rising to CFO, Andy created multiple Special Purpose Entities, moving Enron debt off their balance sheets in a system referred to as Structure Finance Structure. These deals moved debt out of sight of Investors, and propped the losses against the company's stock price. Nearly all of the Wall Street's top banks participated in Mr. Fastows questionable transactions, financing the deals and reaping in millions in fees.

As Enron's losses mounted, it became more and more difficult to maintain the illusion of financial success. In early 2001 Fortune Magazine report Bethany McLean, was one of the first to ask questions about how exactly Enron made its money. This began a chain inquiries from short sellers, and investors asking this same question and critical of the company's balance sheet. This caused the stock price to stagger and begin sliding downward, this fall triggered payback provisions in Andy's SPE deals. Enron's financial unwinding, accelerated by provisions that would personally profit Fastow, lead to credit downgrade by rating agencies as well restatement of past financial statements (Showing losses instead). This triggered the repayment of more debt obligations by Enron's creditors. By August of 2001, Enron began to lay off employees in its EES division, shortly after Skilling sold massive quantities of his Enron stock and abruptly resigns. A combination of these factors, and an investigation by the Securities & Exchange commission pushed the stock price to under one-dollar by November of 2001 and into Chapter 11 Bankruptcy by December. Fastow, Skilling and Lay as well as other top Enron Executives were indicted on multiple counts of fraud facing various prison sentences. At the time, Enron was the largest and most expensive corporate bankruptcy in history.

Key People

- **Ken Lay**: Chairmen of the Board, CEO, Founder of Enron
- **Jeffrey Skilling:** CEO, Considered father of the final iteration of Enron
- **Andy Fastow:** CFO of Enron, created Special Purpose Entities storing Enron's debt off their balance sheet
- **Sharron Watkin:** Whistle blower, first to report wide spread accounting profits
- **Lou Pai:** CEO of Enron Energy Service, one of the greatest loss marker at Enron, slow most shares in Enron and left with most about of money.
- **Rich Kinder:** Fmr COO, pasted over for promotion to CEO.
- **Amanda Martin:** Former lawyer at Vinson and Elkins, Executive at Enron
- **Rebecca Mark:** CEO of Enron International, later (Enron's failed attempt to enter Water industry) Azurix Inc.
- **Vince Kaminski:** employee in risk management division, openly opposed and strongly cautioned against Enron's practices.
- **Bethany Mclean:** Reporter for Fortune Magazine who was among the first to raise questions about Enron's financial statements
- **Tim Belden:** Energy trader on Enron's West Coast trading desk, first devised strategies to take advantage of California's Deregulated Energy Market.
- **Ken Rice:** "Companies Chief Deal Maker," committed suicide during the collapse of Enron

Citations

- *Smartest Guys in the Room,* Gibney, Alex, Documentary Film, (2005)
- *Smartest Guys in the Room,* McLean, Bethany, Print, (2004)
- PBS Independent Lens: Enron Timeline, (http://www.pbs.org/independentlens/enron/timeline.html)