Memories of an Enron Summer

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A few years ago I watched "The Smartest Guys in the Room". It is a documentary on the spectacular demise of Enron in 2001. I did not find it particularly insightful, but I am not a neutral observer on the subject. In 2000, I was close to defending my thesis at Stanford. My department had ties to Enron's research department. I knew the literature on bandwidth pricing and a fair amount of mathematical finance, so I was considered a good fit to be a summer intern there. I accepted, and away I went.

Enron at the time was the place to be. It had been named the "most innovative company" by Fortune four years in a row. It seemed to have invented a new business model: create secondary markets everywhere and then become the market makers in these markets. First, gas. Then, electric power. Then, weather. Then, bandwidth. Wait, there's more: water, pulp paper, TV advertising slots, RAM chips, freight container space. After the bandwidth announcement in 1999, the stock went from $40 to $70. In the process, Enron had dropped "energy" from his slogan "The World's leading energy company". Every other energy company was playing catch-up. Every MBA was applying. Enron was the New Economy rejuvenating the Old Economy. Fortune had also named Enron one of the best 25 companies to work for. All of this, and the money you could make if you performed well. The place was so incredibly cool that even Paul Krugman was consulting for Enron at the time (for a mere $50K)! The headquarters in Houston, at 1400 Smith Ave, looked like a deodorant stick in scale 2000/1, wrapped in aluminum foil. I started my internship in mid May, and Houston already felt like the mother of all saunas, but with people speaking Texan instead of Finnish[1]. On the first day I was sent to the 50th floor, but before meeting with Ken Lay I was escorted out of the building because they had not received my drug test. Auspicious start: suspect coke head on the first day at work. It turned out that they had received it and misplaced it. I was given a seat on the trading floor of the bandwidth division (Enron Broadband Services, or EBS), helping the traders with valuation of bandwidth option contracts, and planning models for optimal purchase of dark fiber.

The traders were all in their twenties or early thirties; the originators were older (as usual, salespeople are less cool than traders). Jim Fallon (not the SNL

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[1] In an earlier version of this document, I had written "Swedish". Since then, I have received a few impeccably polite messages from Finns (that's how Finns express anger) pointing out that saunas are their thing.

comedian) was the head of bandwidth trading. A Columbia MBA in his mid-thirties, he was personable, receptive, fast, and very honest in his opinions. For example, in July 2000 I asked him how much time did we have to become profitable. He said "18 months, or we are done". In December 2001 Enron went bankrupt. In my book, that's a pretty good prediction. Throughout my internship, I spoke quite often to Fallon and to the head of Research. I countered with numbers the projection on bandwidth demand that Nortel presented to us. The size of the bandwidth market that was assessed by McKinsey was also 10 times bigger than what we could come up with internally. Fallon understood everything, and as a result he didn't buy as many dark fiber baskets as before. The impression I received was that at Enron, if you had an idea and could support it with facts, you could even have the ear of the CEO. It's an exhilarating feeling in a company with 17,000 employees.
The mood on the 44th floor was always upbeat. The traders were nice with researchers (the two of us), but clearly viewed us as "glorified admins" (their words). They were all MBAs from good schools, with a slight prevalence of U of Chicago. They cursed a lot, and I, a non-native speaker in hyper-kind Bay Area, learned a few new expressions, like "I'll rip you a new asshole", which at the time felt new and edgy, and now is taught to kindergarteners as a polite way of saying "I don't like you". Once in a while the traders engaged in bad taste. For unknown reasons traders passed to each other a football across the floor. I witnessed a "spit fight" between two traders. A trader had naked women as a background, and sent porn pictures as email attachments. He was merely reprimanded. In a place like IBM Research (my future employer) he would have been fired for merely *thinking* about sex during office hours. IBM's slogan is "Think". They forgot to add "but not about sex".
The research department could not be more different. Located on a lower floor, several of its members were physically far from the action and quiet types. The weekly meetings were not too different from those of a risk group in a hedge fund. The head of the group was Vince Kaminski, and the deputy head was de facto Stinson Gibner. They did not share at all the bluster of the upper floors, and were in fact skeptical. But they knew they could do little to stop the craziness of the firm. Both Vince and Stinson invited me to their homes to have dinner with their families, and for an evening I felt like a part of theirs. This is unusual for finance firm standards, and is admirable.

Another striking feature of the workplace was a certain self-deprecating buffoonery. There were TV screens in the elevators, mostly showing news, but also humorous skits of top executives, like Joe Sutton who was the head of HR, if I remember correctly. Each Monday morning we would find a message by Jeff Skilling waiting for us in our answering machine, pointing out that while we were good, something had to be improved. Skilling was often visiting the trading floor to talk to Fallon. I have no doubt that he had an accurate picture of the status of the division, and of other divisions as well. When I spoke to him, he was very friendly. The parking lot was directly connected to the trading floor (only in Houston!) and Skilling was commuting with Ferraris and Porsches. I remember him saying in the elevator that the Porsche "was something special". I wonder what happened to it.

Two other things were relevant to me. First, almost nobody had a beard. I noticed because I have one, albeit small. There were two other guys with a beard, and they were obvious losers. That caused some consternation, since I am attached to my beard almost as much as to my reproductive organs (you could object that a beard can grow back).

Second, everyone was almost comically republican. The tone was a mix of Kudlow and O'Reilly. Even Tucker Carlson would have sounded like an incorrigible intellectual. There were a few closeted democrats, but they did not speak out, and I could extract confessions only in private. It is an uncontroversial fact that energy deregulation in the UK and parts of the US has failed: prices are both higher and more volatile than before the change. Making this offhand remark at Enron would have been cause for excommunication and Monday Morning Skilling phone messages. Although I am in favor of decentralized decision making and well-thought-out deregulation, four months of unconditional, self-righteous pro-market jingoism almost made a marxist-leninist out of me.

Sometime in August, Ken Rice, the CEO of the bandwidth division, announced a deal with Blockbuster to deliver video on demand, "worth up to one billion". Employees were ecstatic. Wall Street was ecstatic. The stock went up 56 dollars, up to $86, and then, at the closing auction, it reached $90 at the end of the day. Traders on the 44th floor asked half-seriously "should we short the stock?".

Despite all the optimism, all was not good on the floor. For example, a trader covering the South West was buying and selling the same lit bandwidth in Florida with the same counterpart on a daily basis. Clearly, both had an incentive to show that their volumes were increasing. Another example was the much-touted deal with SUN Microsystems. In January 2000, Enron announced a "partnership" with Sun: they would buy $100M worth of servers, and would provide SUN with bandwidth on demand. This made the news as another strike of genius that would make Enron the ultimate New Economy company. In August 2000, we had $100M of workstations languishing in a storage facility in Shepherd St., because Enron was a Windows shop, and SUN didn't have any use for our bandwidth, since it was essentially useless. They ended up buying one or two millions worth of infrastructure. When John Echols (a former Arthur Andersen accountant) was named Chief Risk Officer for the Bandwidth division in the summer of 2000, he tried to locate that contract and find out who signed it, in order to enforce it. For all his efforts, he couldn't. Nobody knew who had signed the contract. For $100M. In a financial company whose job is to trade contracts, this is not good.

I couldn't understand how Enron made money. Enron was organized around wholly owned subsidiaries: Gas Trading, Power Trading, Enron Energy Services (EES), Water (Azurix), Enron Broadband Services (EBS), etc. so that the profitability of the unit was relatively easy to determine. Surely, bandwidth was not profitable. Our circle of friends had people from every division. The emerging markets (e.g., pulp paper) were losing money. Enron Energy Services, headed by Lou Pai, had just announced they were profitable, but nobody believed it. Everybody knew that revenues could be manipulated with mark-to-market accounting. Electric power trading was so-so. All that was left was gas trading, for a company with a $60B market cap. What was so striking is that nobody was hiding this. Everybody worked hard, was enthusiastic, and admitted that their side of the business wasn't profitable. Once I asked Stinson a question: Enron wants to create new classes of commodities and trade them all, but have we thought about the features that make something commodifiable? For example, products with many attributes (think of a car) can't be commodities. Products in which the production function changes rapidly (think RAM) too, because the product becomes obsolete too quickly. This seemed a worthwhile research question, and a basic one. Stinson told me had not thought of it, but it was indeed a good question.

In April 2001 I received an offer. My then-girlfriend-now-wife was going to New York for a post-doc. My Enron manager had rejoined his previous employer, IBM Research, and proposed that I interview there. That was reason enough to decline the offer.

Some Twenty Years Later

What Enron showed me was to prove that very good people can make very bad decisions, not because they are instructed to do so, but because of short-range interactions. In this respect, I disagree with "The Smartest Guys in the Room". They explain the failure using the Milgram experiment, which shows how a person can overcome his reservations when he is being instructed by a superior (Skilling, according to the movie). Instead, to me Enron's failure is better explained by the Lucifer Effect[2]. It was self-organizing bad behavior. What was the mechanism, though? My explanation is that Enron became very successful at

[2] I should note in passing that the Lucifer Effect is highly debatable. The Stanford Prison Experiment has been essentially debunked. But then, Psychology is one of the fields most affected by the replicability crisis. We should interpret all these experiments and effects as stories we tell ourselves to make sense of things.

something (gas trading) and *as an organization* it extrapolated that success could be achieved in anything it set its mind to. This enabled two classes of behaviors, each feeding on the other. First, an entrepreneurial hypertrophy, and associated excess risk taking: every new idea should be pursued, *because* it was new. Second, controls and processes were seen as obstacles. Hence the loosely drafted and kept contracts, and the approvals for businesses (like water trading) that made no sense. Most egregiously, the creation of entities taking on debt guaranteed by the parent company eventually caused its downfall.

My belief is that Enron was not the first organization suffering from these illnesses, and won't be the last one. One recent example is FTX. Like Enron, they innovated in their field. Alameda was an early crypto maker (if not as succesful as initially believed), and FTX was better than its direct competitors. FTX had brilliant, entrepreneurial employees. Like Enron, they expanded their scope far beyond their area of competence. Like Enron, they ignored internal controls and cut corners, to the point of commingling client funds with the firm's.
John J. Ray III was appointed the Chairman of Enron Creditors Recovery Corporation in 2004, where he liquidated assets and settled claims by Enron's creditors. In 2022, he was named CEO of bankrupt FTX.

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