

**Newsweek**

## Enron: Beyond the Verdicts

Before it became a synonym for scandal, Enron was feted as an innovation machine. Today its ideas are still making billions, for others.

By Kurt Eichenwald

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Issues 2007 - The company's name has become synonymous with corporate fraud. Most of its top managers are either already in prison or on their way. It has been derided as a fake business that owed its success to accounting tricks and lies. But now, five years after Enron's implosion, the marketplace is telegraphing a new story: this was a company that not only had a number of great ideas, but pointed the way for other businesses to make billions.

That is not simply revisionist history—those are the numbers talking, from scores of companies and firms, including some of the biggest names in both energy and finance, that have quietly taken over where Enron left off. Remember, at its peak in the 1990s, Enron was celebrated as the most innovative company in America, and was widely copied in the business world. Call it the dandelion effect, says Arthur Gelber, an energy consultant. Blow a dandelion and the seeds scatter, creating more dandelions. "Enron's strategies, assets and people have all gone to other places," says Gelber, president of Gelber & Associates in Houston. "We saw that Enron was doing some good things and some bad things. So businesses kept the good ones and got rid of the bad things."

The aftermath of catastrophe is often the best time to step into a business. Buy low, sell high, right? The smart money snapped up savings and loans at the height of the late-1980s scandal, and dived into junk bonds in the early 1990s following the scandalous collapse of Drexel Burnham Lambert. After the collapse of Enron, buying opportunities were particularly ripe, because misperceptions about it were so extreme. Enron was not a bogus company, it was a financial powerhouse, albeit one with horrific mismanagement and a poisonous corporate culture.

What killed Enron wasn't simply fraud, it was overvaluation of assets. Power plants, water utilities, electricity-distribution facilities, broadband networks: all were purchased or valued at grossly inflated levels, hardly a surprise given the amount of Enron compensation based on deal price tags. Since trading accounted for more than 90 percent of Enron's earnings—and that the survival of trading depended on the company's credit rating—each new overvalued deal pushed Enron ever closer to demise.

The evidence of value in Enron's businesses was there for anyone who wanted to see it. Even after filing for bankruptcy, the company financed itself through cash flow from operations, an extremely rare occurrence. Shielded by Chapter 11, it no longer had to pay interest on loans used to pay those excessive purchase prices, and could just let its businesses bring in cash.

Little of this escaped the attention of the big players in finance, who saw that Enron's demise created a gaping hole in the energy markets. Through its wholesale gas- and electricity-trading businesses and other ventures, Enron not only provided massive amounts of liquidity to the energy marketplace, but also offered financial vehicles that allowed customers to avoid the risks of price swings in their energy purchases. Enron's implosion was rapidly followed by the stumbling of its traditional competitors, the so-called merchant shops like Dynegy.

Stepping into the void has been an amalgam of hedge funds, banks, traditional energy companies and boutique financial shops, each buying a different piece of businesses once dominated by Enron. In less than a year after Enron's collapse, the Commodity Futures Trading Commission began writing rules exempting commodity hedge funds from traditional oversight. In response, they have snapped up Enron's speculative trading business, infusing billions of needed liquidity into the market. Some have already become industry giants in their own right, such as Houston-based Centaurus Energy, with more than \$1.5 billion under management and headed by John D. Arnold, once one of Enron's top traders.

Banks have stepped into the business of selling long-term energy contracts and now have trading businesses

of their own. Goldman Sachs, Citigroup and UBS have all pushed into some of Enron's old businesses with varying levels of success. As old energy companies work to upgrade the power grid and private equity funds move into energy for the first time, all these invigorated players are involved in price-risk management—a business Enron made prominent, using derivatives to assume the risk of energy price changes. Another Enron innovation involved partnering with utilities that held stored assets, effectively combining the trading market with physical commodities, to the benefit of both. Enron's disappearance didn't eliminate demand for the business, and all the big energy houses, such as Conoco, moved quickly to step into Enron's role.

The spread of Enron's ideas and people has not been limited to the energy business. Often, Enron's weather derivatives have been the butt of jokes—they sold insurance against the weather!—but sophisticated business people knew this was serious business. Lynda Clemmons, who pioneered derivatives that hedge climate-related risks at Enron, moved over to XL Weather & Energy. An industry is growing, and has provided some \$10 billion in international coverage of weather-related risk to date, according to the Weather Risk Management Association. Yes, really.

None of this includes the hard assets of Enron—pipelines, power plants—all long since bought by other businesses, including an arm of Warren Buffett's financial empire. For those tempted to jump on the Enron Act II bandwagon, it's probably too late. The competitors have had a five-year head start, because they were smart enough to remember that, often, even a corporate corpse carries a wallet.

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