Deflationary Death Spiral Engulfs Enron

by John Hoefle

When economic and financial sanity ultimately reasserts itself, the story of the rise and fall of Enron Corp. will be one of the case studies in the examination of how the greatest financial bubble in history came to be, and why it inevitably had to—and did—collapse. Enron is not dead yet, but the Securities and Exchange Commission (SEC) is investigating the company's actions, and the possibility of its demise is now being discussed in the boardrooms of Wall Street and beyond. Enron's blood is in the water, and the sharks are circling.

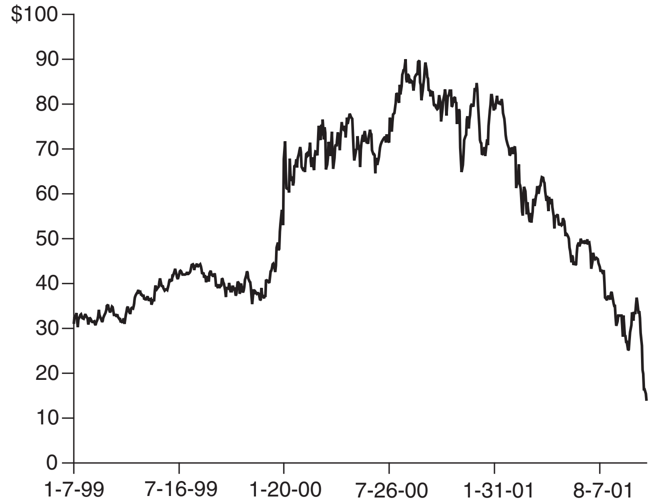
The once-mighty Enron has been in decline since Autumn 2000, but its health took a serious turn for the worse on Oct. 16, 2001, the day it announced a $618 million loss for the third quarter. The loss was not due to a drop in revenue—revenue was up a bubbly 59% from the third quarter of 2000—but due to the write-off of just over $1 billion on its ill-fated water privatization business, its broadband communications business, its investment in the New Power Company, and, in the words of a company press release, "early termination" of "certain structured finance arrangements with a previously disclosed entity."

What Enron chose not to disclose in its earnings release, was something Enron Chairman Kenneth Lay mentioned in passing in a conference call with analysts and investors later that day; namely, that Enron's equity capital had eroded by $1.2 billion—11%—in connection with the repurchase of 55 million of its own shares it had issued as part of a complex series of transactions with that "previously disclosed entity." It was a limited partnership created by Enron and run by the company's chief financial officer, Andrew Fastow.

Enron's equity-loss bombshell, and its failure to disclose it in its earnings statement, triggered a backlash among many Wall Street analysts and institutional investors, who had tolerated Enron's reporting vagaries while the company's stock was soaring, but rebelled as the stock dived. Some among them began to suspect that Enron was a shell game, not actually as lucrative as it was claiming to be. On Wall Street, where money is paramount, false reporting of profits is a capital offense (except, of course, when it is done by the Wall Street firms themselves, which hide their bankruptcies for purely patriotic reasons).

The next day, as word of Enron's presumed duplicity spread, the company's stock began to drop like a rock. Enron's stock, already down 63% from its August 2000, peak, fell 5% on Oct. 17, 10% on Oct. 18, and another 10% on Friday, Oct. 19 (**Figure 1**). The fall escalated on Monday, Oct. 22, when the stock fell another 21%, and by the end of the week, in just nine trading days, the stock had lost 54% of its pre-Oct. 16 value, and was down 83% from its peak.

FIGURE 1
Enron's Stock Meltdown, 1999–2001
(Closing price per share)



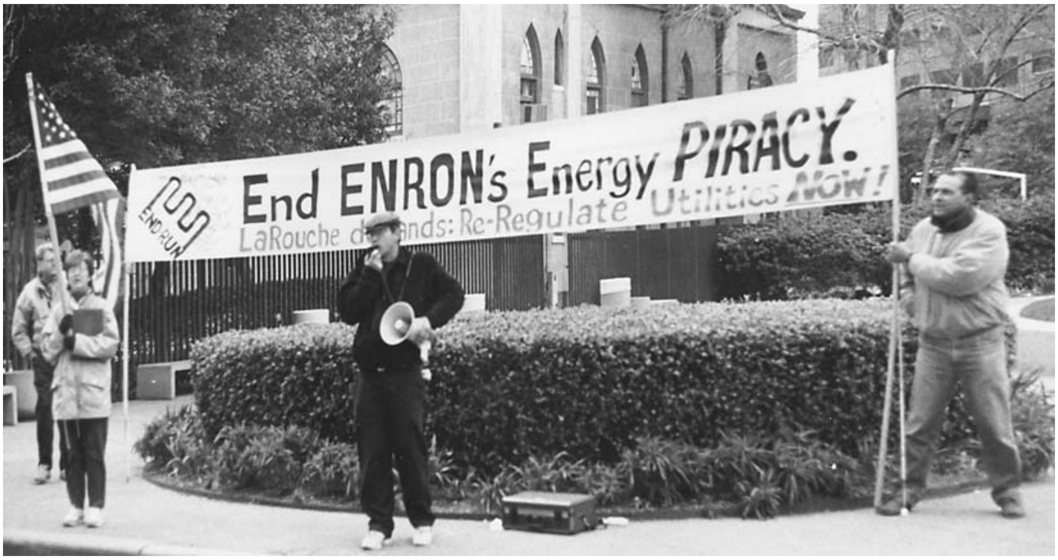
Sources: Yahoo!, Finance, and Bloomberg.

The SEC, the agency responsible for making companies report their results according to the generally accepted dishonesties, also noticed Enron's sleight-of-hand, and requested that the company provide information about its "related party" transactions. The inquiry reportedly comes from the enforcement arm of the agency, suggesting that the SEC is looking at possible violations of U.S. securities laws.

Sacrifice To The Street

Enron attempted to mollify Wall Street with a conference call on Oct. 23, but failed miserably. Rather than calming the waters, Lay roiled them, accusing one analyst of attempting to talk down the company's stock and testily cutting off his questions. The call was a failure, with analysts demanding answers and Enron dancing around them. When it was making money hand over fist, everyone put up with Enron's arrogance and cryptic financial statements, but with its financial power crumbling, the Wall Street gang decided it was time to put Enron in its place, and demanded a sacrifice.

The next day, Enron announced that Andy Fastow—whom Lay had steadfastly defended in the conference call—



"When Enron was up," and ripping up the economies of California and other states with a hyperflationary energy-price bubble, it was attacked and exposed by the LaRouche campaign and EIR. *Now down, the Wall Street bubble-maker is going "pop," and suddenly has many detractors.*

had been replaced as chief financial officer, and Lay publicly ate crow.

"In my continued discussions with the financial community, it became clear to me that restoring investor confidence would require us to replace Andy as CFO," Lay admitted in a press release announcing the change. Lay added that Fastow's replacement, Jeff McMahon, "has the trust and confidence of our investors and financial institutions."

That trust and confidence was essential, as Enron was actively seeking cash to fund its operations and pay down its debt. Faced with a rash of downgrades by the major credit-rating firms, and the probability of further downgrades, Enron tapped an existing $3 billion line of credit arranged through J.P. Morgan Chase and Citicorp, and used about $2 billion of that cash to redeem its outstanding commercial paper. Enron characterized the action as a move to restore investor confidence, but many observers saw it as an act of desperation, a sign of weakness. Sharks do not react with *agapē* to signs of weakness.

Enron is now reportedly seeking another $1 billion to $2 billion line of credit for future contingencies, fuelling yet another round of selling, as some investors dump their Enron holdings and others go short on the stock, betting on further drops.

The company is also running the risk of becoming a pariah in the global energy market. Through its EnronOnline Internet energy-trading site, Enron buys and sells electricity, natural gas, and other commodities worldwide, and is involved as a buyer or a seller in nearly one-quarter of all U.S. energy trades. Companies which sell to Enron through this on-line marketplace, do so with the expectation that they will be paid; if the confidence of payment is not there, companies will cease doing business in that venue. This has already occurred, with reports that at least a half-dozen European electricity firms have frozen their trades with Enron, until new payment guarantees can be worked out.

The Predator Becomes The Prey

Given Enron's role as part of the infrastructure of energy trading—which is to say the brave new world of unregulated energy speculation and looting—the company's problems directly mirror the larger energy and financial markets, which at the top are inseparable. Energy deregulation was essentially conceived of as a way to convert the pricing structure of the energy cartel away from long-term stable prices, to volatile spot-market prices, in the process smashing the remnants of national sovereignty and putting the power to set prices in the hands of the cartel-controlled "free market." Deregulation, as we have said before, is a geopolitical strategy, the main goal of which is to shape the post-crash world, allowing the oligarchs who run the financial/energy cartel to remain on top of whatever pile of rubble is left after the system has disintegrated.

It is this in-progress disintegration which defines the geometry in which the rise of Enron occurred, and in which its fall is now well under way. One must place the Enron disaster within that context in order to understand the forces at work; it is but an element of a global deflation of the speculative bubble, which continues to erode even faster than Federal Reserve Board Chairman Alan Greenspan and his fellow central bankers can hyperinflate money into the system.

In such an environment, the predatory nature of the financial system rises visibly to the surface, as open warfare breaks out among institutions determined to preserve their shares of the shrinking pie. Enron, yesterday a feared predator, has become today's prey, as Wall Street rips it to shreds.