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WEEK OF MAY 29, 2006—ENRON'S LESSONS

Ken Lay and Jeff Skillings' convictions on fraud and related charges were as much an indictment of poorly crafted deregulation that allowed such fraud, as of corporate malfeasance. For it was Ken Lay's messianic belief in deregulation—and his millions spent on lobbying to tailor it to Enron's specifications—that enabled the culture of deceit that brought down Enron.

And the Office of Federal Housing Enterprise Oversight (OFHEO) announced a $400 million fine would be levied against Fannie Mae for its accounting tricks. OFHEO also announced that national first quarter housing prices rose 12.54 percent in one year, but just 2.03 percent for the quarter. Arizona had the fastest appreciation rate of 32.81 percent, while California was ninth, with average prices rising 19.2 percent in a year. "Price growth is moderating," said the report, "particularly in areas where prices have been rising the most."

Why has deregulation failed, when it was supposed to bring cheaper energy and a greater energy supply, in Enron's case, (and more transparent accounting to Fannie Mae)? Because rather than design a system that benefited consumers and business users, Enron and other members of Vice-President Cheney's energy task force, chose to remove all regulations and oversight to more easily manipulate energy markets for their benefit. That is to say, there were neither state nor federal checks and balances to speak of. And it has now given deregulation a bad name.

California's 2000-2001 energy crisis that cost Californians $9 billion and bankrupted PG & E, Northern California's utility, is such an example. Enron, who had cornered 80 percent of California's energy market, largely caused the crisis. Much has been made of the recorded conversations of Enron traders bragging that they were taking Grandma's savings. Testimony by state Senator Joseph Dunn (D-Orange County) before the U.S. Senate Committee on Commerce, Science and Transportation also revealed how Enron, with the help of other power generators, "gamed" the system.

"…the evidence suggests that Enron and other market participants used the mail and wires to defraud the State of California and its consumers," said Senator Dunn in his testimony. "Given this, I believe they may have violated the Racketeering Influence Corrupt Organizations Act, commonly referred to as RICO."

It was a variation of CFO Andy Fastow's paper entities like "Chewco", and his LJM partnerships that hid Enron's trading losses. Enron's energy traders created trading strategies with code names like "Ricochet", "Fat Boy", and "Get Shorty" for the sole purpose of moving energy supplies in and out of California to create artificial shortages and thereby avoid both regulators' scrutiny, and the price caps that had been set up to protect California's utility users during such emergencies.

This was easy for Enron to do. It owned or controlled the natural gas pipelines via its El Paso Corporation that transported the fuel to run California's utilities, as well as the transmission lines that carried its electricity. The El Paso pipeline group's 55,500-mile interstate pipeline system, for example, connects the nation's "most prolific" natural gas supply regions with the "largest consuming" regions in the United States, transporting about one-third of daily natural gas consumption in the country, according to the companies own web site.

Meanwhile, inflation fears this week continued to upset markets, with some Fed officials saying that prices were at the "upper" end of the Federal Reserves proclaimed 2 percent inflation limit. Best example was April's jump in personal income and spending. The 0.5 percent income rise was cancelled out by a 0.5 percent increase in retail prices for the month. Therefore, so-called real disposable income (inflation-adjusted, after taxes) actually fell 0.1 percent, putting a further dent in consumers' pocketbooks. And the U. of Michigan's sentiment survey said consumers now expect an inflation rate of 4 percent over the next year, which means they see it getting out of control. This is bad news for those who want to see a halt in the Fed's rate hikes.

NEW AND EXISTING-HOME SALES—Real estate continues to confound, as April new-home sales rose to an 8-year high of 1.2 million annualized units while interest rates continued their climb. Inventories fell slightly to 5.8-months supply from 6 months in March. The median price rose 2.8 percent to $238,500, but median prices are up just 0.9 percent in a year.

Existing-home sales fell 2 percent and are down 5.7 percent over last year. Markets are cooling in the hottest markets of California, Arizona and Florida, but heating up in Texas, New Mexico, the Carolinas, Utah and Ohio, said NAR chief economist David Lereah.

GROSS DOMESTIC PRODUCT—The first quarter's second estimate of economic growth jumped to 5.3 percent from the "preliminary" 4.8 percent. The main growth factors were higher personal consumption, up 5.2 percent (inflationary), and higher exports up 14.7 percent (deflationary). Domestic sales are still booming, in other words. Until the dollar gets cheaper and so imports more expensive, consumers will not spend less (and save enough) to bring down the inflation rate.

The OFHEO is Fannie Mae and Freddie Mac's government regulator. Its main complaint was that Fannie Mae also lacked adequate oversight. "The image of Fannie Mae as one of the "lowest risk" and "best in class" institutions was a façade. In fact it was just the opposite," said the just released report. "They promoted unrestrained growth while undermining proper internal controls, under investing in systems, risk management, and staff. Unprincipled corporate behavior and inadequate controls will simply not be tolerated."

State Senator Dunn's Senate Select Committee to Investigate the Wholesale Energy Market uncovered some of Enron's shenanigans that "gamed the system to reap excess profits on the backs of Californians," according Dunn's testimony. "Ricochet" was the name given to its strategy of megawatt laundering, for example. "Enron buys energy from the PX in the Day Of market, and schedules it for export. The energy is sent out of California to another party, which charges a small fee per Megawatt, and then Enron bought it back to sell the energy to the ISO real-time market…This behavior implicates other companies and provides evidence that Enron's behavior rises to the level of fraudulent and anti-competitive behavior," said Senator Dunn.

BBC reporter Greg Palast on PBS's Democracy Now put it more bluntly. "It used to be that these guys had to keep the lights on and keep track of the money that they took from you to keep your lights on. Well, that game is over now. We had a blackout, if you remember, a couple years ago, and that was because these companies had literally sucked the cash out of these firms and fired all their workers to keep the money that you pay to keep your lights on.

So deregulation will not work, until the foxes are kept out of the henhouse.