Enron Downplayed Risks of Its Ailing Energy Retail Business

Houston, Dec. 20 (Bloomberg) -- In November 1999, Enron Corp. CEO Kenneth Lay and one of his senior executives, Lou Pai, set out to create the first online retailer of electricity and natural gas.

The new company, which they eventually called NewPower Holdings Inc., was aimed at allowing millions of home owners to shop for energy just like they bought books from Amazon.com Inc.

Like Enron's investments in industries as diverse as water treatment and broadband capacity, the NewPower venture was a high-risk gamble. Like those other projects, it hasn't fulfilled its promise.

In the first nine months of 2001, NewPower lost $173 million on $245 million in revenue. Its cash had dwindled to $33 million as of Sept. 30 -- down from $180 million in December 2000. In October, the company fired 44 workers, 22 percent of its workforce.

CEO H. Eugene Lockhart says that, barring an infusion of new cash, NewPower will have run out of money by the end of the second quarter of 2002. NewPower's share price had plunged to 74 cents as of Dec. 19 from $21 at its IPO in October 2000.

``I don't think that NewPower management executed on its business model. We lost faith," says Seth Tobias, a principal at Circle T Partners LP, a New York hedge fund, which dumped its entire stake of 633,800 NewPower shares last August.

Water and Broadband

The poor performance of NewPower and Enron's water treatment and broadband ventures contributed to Enron's downfall by saddling the parent company with $1.01 billion in write-offs in the third quarter, according to company filings with the U.S. Securities and Exchange Commission.

NewPower has been responsible for $197 million in write-offs by Enron over the past two years. Through a subsidiary and partnerships, Enron holds a 44 percent stake in NewPower.

Enron executives had high hopes for NewPower. Lay and Pai, head of the firm's retail energy unit, bet that deregulation of the energy industry was poised to open up a $150 billion retail market, because consumers would be free to shop for energy bargains wherever they could find them.

The venture would own no power plants, no pipelines and no distribution network.

NewPower As Brand Name

Instead, NewPower, based in Purchase, New York, would buy wholesale electricity and natural gas from Enron and resell it online for a profit to home owners and small businesses. In the process, NewPower would become a household brand name like AT&T or MCI.

Some big institutional investors bought into the NewPower vision. GE Capital Equity Investments Inc., a $4.5 billion fund run by General Electric Capital Corp., invested $35 million. So did DLJ Merchant Banking LP, now a unit of Credit Suisse First Boston.

The California Public Employees' Retirement System, the biggest public employee pension fund in the U.S., chipped in $40 million. ``This appeared to have a lot of potential," says Lee Fullerton, a spokeswoman for the Ontario Teachers' Pension Plan Board, which invested $15 million.

Myriad Ventures

Energy industry veterans say Enron's myriad ventures were irresistible to money

managers in those days. ``We were used to seeing them do nothing but hit home runs," says Fred Scott, a trader at Engage Energy in Portland, Oregon. ``They were the company we all loved to hate."

NewPower was Pai's brainchild. He was the company's first chairman and also served as chief executive of Enron Energy Services. EES, a subsidiary of Enron, was formed in 1997 to sell natural gas and electricity to industrial and commercial customers.

NewPower was spun off from EES in November 1999, and Enron provided the fledgling company with existing software, customers in California and Ohio and the use of Enron's formidable lobbying machine for currying favor with state regulators and legislators.

NewPower's board of directors was dominated by Enron officers, who held five of eight seats. In addition to Pai and Lay, Enron General Counsel James Derrick and former Vice Chairman Joseph Sutton were members.

Fastow's Role

In 2000, Enron's then-CFO Andrew Fastow became a director and was eventually replaced by Richard Causey, Enron's chief accounting officer. Peter Grauer, chairman of the board of Bloomberg LP, which owns Bloomberg News, has been a NewPower board member since January 2001.

Pai received generous compensation for his involvement in NewPower. In January 2000, 60 days after the company started, the board granted Pai more than 2 million shares of common stock valued at $8 million ``in consideration of services rendered to [NewPower] in the past," according to the company's prospectus.

Pai left Enron last spring and resigned as NewPower's nonexecutive chairman in September. Pai, who still holds a 5.4 percent stake in NewPower, did not respond to requests for an interview.

In late 1999, NewPower agreed to pay America Online Inc. $49 million over the next six years for pitching its products to the Internet service provider's then 20 million subscribers. NewPower also contracted with International Business Machines Corp. to run a Web site at which customers could pay their electricity and natural gas bills.

AOL and IBM Not Enough

Even with AOL and IBM on board, Lay and Pai had difficulty turning their vision into a reality. The entire business depended on the price of natural gas and the pace of deregulation on a state-by-state basis.

By 2000, only five states had opened their electricity and natural gas markets to competition, and some, like Pennsylvania, imposed severe restrictions on companies like NewPower.

``We cannot assure you that regulatory structures will offer us competitive opportunities to sell energy to consumers on a profitable basis," NewPower said in its July 2000 prospectus.

The California energy crunch, which hit soon after NewPower's launch, also hurt. From June 2000 to June 2001, wholesale electricity prices in California increased sixfold, brownouts swept the state's system and skyrocketing utility bills landed on home owners.

The California Effect

Sonny Popowski, consumer advocate for the state of Pennsylvania, says California's woes motivated other states to slow deregulation. And in those states, like Pennsylvania, that had already opened their markets, regulators sought to strengthen rather than loosen restrictions to protect home owners.

``We want to make sure that if there is a problem, providers like NewPower are still required to serve their customers," says Popowski.

The stricter climate was a blow to NewPower. In southeastern Pennsylvania, for

example, NewPower derives most of its customers through a restricted plan under which it can offer service to only the 20 percent of home owners who neglect to choose among various power providers.

It must offer power at a 2 percent discount to the local utility, Peco Energy Co. State regulators also require that the company buy more energy capacity than it needs --so it can cover unforeseen increases in demand, like air-conditioning in summer heat waves -- or else pay penalties.

$7.5 Million in Penalties

In the third quarter of 2001, NewPower paid $7.5 million in such penalties, prompting it to complain in a 10-Q filing to regulators that such measures ``are flawed and act as a deterrent to creating a competitive marketplace."

The company has also been whipsawed by a decline in the price of natural gas, which fuels power generation in most electricity plants.

The wholesale cost of natural gas on the New York Mercantile Exchange fell 72 percent from December 2000 to December 2001.

That trend has undermined the company's ability to price its electricity competitively, says Tobias of Circle T Partners. ``As long as prices were high, the company made sense," he says, ``but then it got caught in the squeeze."

Falling gas prices had a corrosive effect on NewPower's balance sheet. Under its supply contract with Enron, NewPower has been obligated to post $110 million in cash collateral with Enron to cover the gap between the market price of natural gas and the price set in the contract.

Cash Drain

That, along with similar collateral requirements by other states, drained 80 percent of NewPower's cash reserves in the first three quarters of 2001, which was a critical development in a company that depends on liquidity to buy power on the wholesale energy market.

In September, Lockhart renegotiated the contract so that NewPower could supplant cash in the fourth quarter with inventory and accounts receivable.

The move was late, says J. P. Morgan Securities Inc. analyst Joseph Arsenio. He says Lockhart should have pressed Enron for such an arrangement far earlier in the year, especially given Enron's investment and close ties with NewPower.

``It would have been reasonable for Enron to extend better terms so it didn't bleed out all NewPower's liquidity," says Arsenio, who has a market perform rating on the stock.

Enron's Bankruptcy

On Dec. 5, three days after Enron filed for bankruptcy, NewPower canceled its supply contract with Enron and said it would have to write off the $110 million in collateral.

Making matters worse, Enron's corporate officers used a web of interlocking limited partnerships and other affiliates to keep millions in losses -- from investments in NewPower and scores of other ventures -- off its balance sheet, according to the company's filings with the SEC.

In November, Enron disclosed that it was taking a $710 million write-off to terminate those partnerships. ``In hindsight, we made some very bad investments in noncore businesses," Ken Lay said on a conference call with equity analysts on Nov. 14.

The SEC and the Justice Department are investigating Enron to determine whether the financial arrangements undertaken by the company's partnerships violated disclosure, antifraud and criminal laws.

Kennel of Pups

On Dec. 2, Enron filed for Chapter 11 bankruptcy. ``I've seen companies conduct disastrous diversification plans and do some fancy accounting to cover them up," says

Carole Broderick, a Philadelphia plaintiffs' lawyer who's representing Enron shareholders in a class-action lawsuit against the company, alleging fraud. ``But the remarkable thing here is the scale: It's not just one dog they were hiding; it's a whole kennel."

Enron guaranteed the performance of the partnerships with its own stock. The same was done with NewPower. Fastow ran a limited partnership called LJM2 Co-Investment LP that invested $50 million in NewPower in July 2000 in exchange for 4.6 million warrants.

Fastow set up another limited partnership under LJM2 called Raptor III LP and guaranteed it with a portion of those warrants.

In the third quarter, Enron was forced to bail out Raptor III and take a $48 million charge, according to a 10-Q filing. ``It was a meltdown situation," says Michael Smith, CFO of Mirant Americas, a division of Atlanta-based energy trader Mirant Corp.

More Bad News

There's more bad news: AOL has failed to deliver a significant number of new customers, says Lockhart, and NewPower will take an as-yet-undisclosed charge to write off the deal in the fourth quarter of 2001.

Lockhart says he's trying to securitize a portion of NewPower's 800,000 accounts receivable to rebuild cash reserves and save the company.

NewPower has survived the demise of its parent company. The question now: How long can it last?

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Enron Enriched Wall Street Firms, Analysts Ignored Warnings

Houston, Dec. 18 (Bloomberg) -- On Tuesday, Oct. 16, Enron Corp. Chief Executive Kenneth Lay delivered a shocker. Late in a conference call that followed the release of the company's third-quarter results, Lay said Enron would terminate one of its several limited partnerships -- and thereby wipe out $1.2 billion of shareholder equity.

``I shuddered when I heard that," says Gregory Phelps, who invests $1.1 billion in energy and utility stocks at John Hancock Advisers Inc. and has long avoided Enron. ``But it didn't seem to make much of an impression on part of the investment community."

Over the next few days, reports began piling up on Phelps's desk from the Wall Street analysts who track Enron. Merrill Lynch & Co., UBS Warburg LLC, Credit Suisse First Boston and Goldman Sachs Group Inc. still rated Enron a ``buy."

Prudential Securities Inc. analyst Carol Coale wrote that she was ``dismayed" by management's ``disguise" of the $1.2 billion equity reduction, yet she kept intact her ``buy" rating and $55 price target on Enron stock, which was then trading at $33.17.

`Strong Buy'

Richard Gross of Lehman Brothers Holdings Inc. maintained his ``strong buy" rating. ``The end of the world is not at hand," Gross said. ``We think investors should rustle up a little courage and aggressively buy the stock."

Phelps and other investors say the analysts' reactions were just another sign of Wall Street's gullibility about Enron.

For more than a year, they say, analysts had ignored red flags ranging from inflated business valuations to large insider stock sales, to the abrupt resignation of Jeffrey Skilling in August 2001 -- just six months into his tenure as CEO.

As recently as September, Enron was the second most highly rated stock in the Standard & Poor's 500 Index, behind Tyco International Ltd., according to Thomson Financial/First Call.

``Enron is uniquely positioned to be the GE of the new economy," Donato Eassey, Merrill Lynch's energy stock analyst, told Bloomberg News in February 2001. ``This isn't a management team to bet against." Eassey resigned from Merrill in December.

Support is Obvious

One of the main reasons for all of the support is obvious, say investors: Until the week before its third-quarter earnings report in October, Enron was a deal machine that enriched dozens of Wall Street firms through lucrative underwriting contracts, mergers and acquisitions assignments and derivatives trades.

``You'd be hard-pressed to find a house on the Street that didn't do business with Enron," says Don Coxe, chairman and chief executive of Harris Investment Management Inc., which in early December held 78,000 Enron shares in the Harris Insight Equity Fund. ``They spread a ton of business around the Street, so it's no wonder these analysts were behind the stock."

Enron says it didn't have a quid pro quo relationship with anyone. ``At no time has Enron ever required any financial firm to endorse our stock as a prerequisite for doing business with the firm," says spokesman Vance Meyer.

'Taps on Shoulders'

Some Wall Street veterans say they don't find that denial persuasive. ``Even if there

were no spoken agreements, you can bet analysts often got taps on the shoulders from the investment bankers making sure that they were reminded to keep `buy' ratings intact," says Phelps. ``That's just the way Wall Street works."

Enron spread the wealth across many Wall Street firms. In May 2001, Enron used six banks -- A. G. Edwards & Sons Inc., Banc of America Securities, Dain Rauscher Wessels, First Union Securities Inc., Salomon Smith Barney Inc. and UBS Warburg -- to manage a $151 million unit offering for Northern Border Partners LP, one of scores of Enron-controlled partnerships.

Usually, no more than four underwriters are involved in deals that small, investment bankers say.

CSFB advised Enron on a pending $2.9 billion sale of Portland General Electric Co. in October -- one of 41 separate mergers and acquisitions transactions Enron initiated since January 1999, according to Bloomberg data.

Enron Activity Dwarfs Rivals

That dwarfs the number of deals over that span announced by rivals Dynegy Inc., which struck 15 corporate combinations, and Kinder Morgan Inc., which did a dozen deals.

Enron further cemented its relationship with Wall Street by borrowing from banks, obtaining letters of credit and trading in derivatives -- financial instruments such as futures and options whose value is based on other assets.

When Enron filed for bankruptcy in December, its list of creditors was 54 pages long and included Citigroup Inc., CSFB's London branch, J. P. Morgan Chase & Co. and UBS.

Goldman Sachs is a dealer for Enron's $4 billion commercial paper program and has arranged six of the company's 15 preferred share sales.

In June 1999, Merrill Lynch managed the $695 million initial public offering of Azurix Corp., Enron's water business. Run by Enron's former Vice Chairman Rebecca Mark, who resigned in August 2000, Azurix failed in its strategy to buy water companies and win large projects. It lost a bid to acquire a 49 percent stake in Berlin's water utility, for example.

Enron Buys Back Stock

Enron bought back the stock in 2001, after it had fallen more than 55 percent during the company's 18 months as a public entity.

In October, J. P. Morgan and Citigroup's Citibank unit provided Enron with $1 billion in credit lines to help it pay down debt and meet day-to-day costs. Those loans came just in time for the two firms to win the business of advising Enron on its planned acquisition by Dynegy.

J. P. Morgan and Citigroup's Salomon were set to charge $90 million -- $45 million each -- for that advice, according to people familiar with the arrangement.

Dynegy was set to pay $15 million in advisory fees to Lehman Brothers. That would have been Lehman's biggest such transaction in 2001.

Dynegy Deal Falls Through

In December, after the Dynegy deal fell through, Enron obtained as much as $1.5 billion in new financing from J. P. Morgan and Citigroup. On December 11, J. P. Morgan filed a lawsuit in Enron's bankruptcy case, seeking $2.1 billion --funds the bank said aren't part of the energy trader's assets shielded from creditors by the Chapter 11 filing.

Enron traded derivatives in energy, broadband and weather with a host of investment firms, and at the time it filed for bankruptcy, it owed some of them hundreds of millions of dollars.

According to its bankruptcy filing, Enron owed $185 million to two offices of Chase Manhattan Bank, a subsidiary of J. P. Morgan Chase; $74 million to UBS; and $71 million to CSFB. Bear Stearns Cos. said it stood to lose $69 million from the collapse of the energy

trader; Commerzbank AG said it would lose slightly less than $45 million.

Schmoozing Wall Street

Enron's multiple business dealings with Wall Street caused firms to look favorably on the company's new ventures, say investors.

In late January 2001, for example, Enron's senior management hosted a meeting for 170 analysts and investors. Skilling told the crowd that Enron's biggest immediate opportunity was its plan to trade broadband capacity: space on the fiber-optic networks that zip voices, data and images around the planet.

Skilling said that based on his analysis, Enron's broadband business was worth $36 billion, or $40 a share. Enron stock was then trading at $82. The business had lost $60 million on $408 million in revenue in 2000.

``The numbers never added up, but Wall Street didn't challenge them," says Harris Investment's Coxe.

Ronald Barone, an analyst at UBS Warburg, wrote after the January meeting that he was ``brain drained, having digested scores of detailed presentations." He also wrote that he was ``enamored" with Enron's broadband business, even though it wouldn't generate earnings for at least a year because it would take that long to generate enough trades.

$25 a Share

He estimated the business was worth $25 a share, or $22.5 billion. He kept his ``strong buy" rating on the stock and, in a January 25 report, raised his 12-month target on Enron stock to $102 from $100. The stock was trading at $82 at the time. Barone declines to comment on his recommendations.

Lehman's Gross raised his 12-month target price on Enron to $100 from $90 after the company's analysts' conference. He said he viewed Enron's foray into broadband as no different from any of its other endeavors.

``Given the track record that has been displayed over the past 36 months, we have no reason to doubt the success of their efforts," Gross wrote a week after the conference in a report dated Feb. 1. Enron stock was then trading at $78. ``We continue to recommend Enron as a core holding," he wrote. Gross declines to comment.

$180 Million Charge

Enron's fiber-optic business collapsed this past summer. In its third-quarter earnings release, Enron said it had taken a $180 million charge to restructure the business, including severance payments to 500 fired workers and a reduction in the value of its operations.

As Enron's stock was rising on Wall Street, analysts often said they were in the dark about the company: how it made money and booked sales and what was behind dozens of off-balance-sheet partnerships.

Their lack of knowledge didn't stop them from promoting
Enron stock. Goldman Sachs analyst David Fleischer said in March that Enron's ``lack of disclosure and transparency is a long-standing hallmark."

Enron had been a fixture on Goldman's ``recommended list`` of a couple hundred favored stocks since 1993, when analyst Fleischer joined the firm.

`Extraordinary Franchises'

``Enron has built unique and, in our view, extraordinary franchises in several business units," Fleischer said in March.

On March 14, Commerzbank Capital Markets analyst Andre Meade raised his long-standing rating on Enron to ``accumulate" from ``hold" because the stock had dropped 30 percent in the previous three months -- even though, he said, he couldn't construct accurate earnings models. ``Enron keeps a lot of facts close to the vest," he said.

``Saying they don't understand it but still recommend it is a slap in the face to remind us how useless analysts are," says Robert Olstein, a 35-year Wall Street veteran who runs the

$890 million Olstein Financial Alert Fund.

After the market closed for trading on Aug. 14, Skilling, 48, abruptly resigned, citing personal reasons and raising concerns among investors that dire financial news might be forthcoming.

Falling Stock

Enron stock dropped as much as $6, or 13 percent, the following day, ending the week at $36.67.

Analysts insisted nothing was awry. ``There is nothing wrong with the company," UBS's Barone said after meeting with Lay, who had once again become Enron's CEO. ``There is no other shoe to fall -- and no charges to be taken." He kept his ``buy`` rating on the stock.

Lehman's Gross also met with Lay and other senior managers on the night of Aug. 16. ``The Enron machine is in top shape and continues to roll along," Gross wrote to investors the next day.

He didn't see a short-term catalyst to boost the stock -- then trading at $36.85 a share -- yet he urged investors to get more shares, maintaining his ``strong buy" recommendation and a 12-month price target of $72.

CSFB analyst Curt Launer wrote a brief note to clients after what he described as ``intensive meetings" with management. He said there was ``no truth to any of the speculations" and kept his 12-month target of $84 and his ``buy" recommendation.

Enron a 'Buy'

Of the 22 analysts who covered Enron, 19 rated the stock a ``buy" as of mid-October 2001. That's when, one after another, disclosures spilled out of the Houston-based company: Enron's partnerships had hidden billions of dollars in debt; years of profits had been exaggerated; and the U.S. Securities and Exchange Commission was investigating Enron's partnerships with affiliates.

The disclosures dashed Enron's credibility with lenders and drove it to bankruptcy.

On Nov. 21, with Enron stock at less than $7 -- down more than 90 percent from its high in August 2000 --Goldman's Fleischer downgraded Enron to ``market perform," Wall Street parlance for ``hold." He didn't respond to several phone calls.

Easier Decision

Investors say Fleischer's decision to downgrade the stock was made easier by his firm's failure to win a role advising Enron on its planned sale to Dynegy. ``I wouldn't doubt at all that being dropped from the `recommended list' had something to do with not winning the advisory business," says Phelps.

Fleischer and Goldman spokespeople didn't return phone calls.

To many investors, there were signals that should have tipped off analysts that something was amiss. In December 2000 and January 2001, 10 top Enron executives sold more than $73 million in stock. Lay and Skilling together sold stock valued at more than $17.6 million, according to the Washington Service, which tracks insider stock sales and purchases.

Insider sales are often a strong sign to investors that something's wrong. Timothy Ghriskey, who at the time was a fund manager at Dreyfus Corp., sold about 1.55 million Enron shares in late 2000. ``It wasn't much of an endorsement that they were bailing out too," he says. ``I didn't see much upside in the stock and figured that with the valuation so high, there was a lot of downside if they failed to deliver."

Wake-Up Call for Analysts

Coxe and other investors say Enron's failure should provide a wake-up call for analysts, who pay too little attention to company balance sheets. ``I pay the Street lots of commission dollars and expect that analysts are reading the footnotes and kicking tires," Coxe says.

Several Wall Street firms took steps last

year to defuse criticism that conflicts of interest taint analysts' research. In July, Merrill Lynch announced that its analysts could no longer own shares in the companies they cover. CSFB soon followed with similar announcements.

As of Dec. 17, with Enron a penny stock, fetching 57 cents a share, 7 of 17 Wall Street analysts rated the stock a ``hold'' and 5 offered a ``sell'' recommendation.

Five other analysts advised their clients that the company at the center of the biggest bankruptcy filing in U.S. history was still a ``buy.''

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Enron Ex-CFO Fastow Set Up Partnerships That Led to Failure

Houston, Dec. 19 (Bloomberg) -- Andrew Fastow, 39, was exactly what Enron Corp. wanted in a chief financial officer: young, self-confident and willing to embrace risk.

He was a friend of former Chief Executive Jeffrey Skilling from their earliest days at the company in 1990. Both men rose from the finance unit, Enron Capital & Trade Resources, to the executive suite in less than a decade.

Skilling, who stunned investors by resigning in August after just six months as CEO, had wanted to morph Enron from a staid pipeline operator into a company that traded financing instruments tied to electricity, fiber-optic bandwidth or financial protection against bad weather. To do that, he needed someone who could design a growth engine that would turn the company into the seventh largest in the U.S.

Skilling was the architect of Enron's transformation. Fastow was the engineer. While Skilling preached to Wall Street about Enron's plans to sell assets in favor of trading risk, Fastow set up an array of interlocking partnerships that kept those assets and their related debt off Enron's books.

A Mystery Man

He rarely granted interviews, had little contact with securities analysts and was a mystery man to many of the company's 21,000 employees, even those who shared the company's mirrored 40-story headquarters tower in downtown Houston.

``Fastow's role was never to be high profile," says John Olson, an analyst at Sanders Morris Harris Inc. in Houston. ``His role was to raise money and run what turned out to be a whole set of off-balance-sheet partnerships that mutated into something different."

It was those partnerships, the fruits of Fastow's obscure labors, that triggered Enron's meteoric rise and fall.

Losses from the partnerships ballooned as Enron's stock price fell last year. In October, Enron revealed that two partnerships Fastow controlled, dubbed LJM Cayman and LJM2 Co-Investment, had cost the company $35 million and lopped more than $1.2 billion from its shareholder equity.

Financial Commitments

Investors and analysts began to question the extent of Enron's financial commitments to the investment vehicles, some of which were capitalized with Enron stock.

On Nov. 1, credit ratings agencies began lowering Enron's debt ratings, thereby sparking worries of defaults and impairing the company's ability to raise cash.

Enron's board ousted Fastow in October and set up a special committee to review the partnerships. The U.S. Securities and Exchange Commission and Congress are investigating Enron's financial arrangements.

Enron's stock, which had zoomed to a high of $90 on Aug. 17, 2000, was selling for 50 cents by Dec. 18.

After a $23 billion buyout by rival Dynegy Inc. fell through on Nov. 28, Enron filed the biggest bankruptcy reorganization in history.

World energy markets reeled, employees were left holding worthless shares in retirement accounts and financial institutions and public pension funds filed lawsuits to recover losses. Fastow's anonymity evaporated faster than Enron's market value.

'A Lot of Fingers'

``There's a lot of fingers from Enron pointing at him," says Sean Jez, a Houston

attorney who represents investors who are suing the company.

Fastow, through Houston attorney David Gerger, declined requests for an interview, and a spokesman for Skilling declined to comment. Both men are defendants in more than 40 lawsuits filed by shareholders and employees since Oct. 22.

At a press conference in New York on Dec. 12, attorney David Boies, who is also representing Fastow, said his client would cooperate with authorities investigating Enron's collapse.

``I wouldn't want to call him a scapegoat, but he is sort of an obvious, easy target," Boies said.

Fastow was born in Washington and earned a bachelor's degree in Chinese and economics from Tufts University in 1983. There, he met his future wife, Lea Weingarten of Houston, whose family owned an 87-store grocery chain and a local real estate firm.

Fastow's Early Career

In 1986, Fastow received an MBA from Northwestern University and took a job with Continental Bank Corp. in Chicago as a senior director in the asset securitization division, where he helped the bank bundle loans and sell them to investors.

Fastow joined Enron Capital in 1990, forming a friendship with Skilling, who'd recently signed on with the company from consulting firm McKinsey & Co.

In 1996, Fastow was named head of Enron's retail energy group and spearheaded the company's push into the newly deregulated electricity markets.

Promoted to CFO in March 1998, Fastow was a member of the team of young executives that Skilling and Chairman Kenneth Lay had tapped to change the company.

Enron employees farther down the management ladder say the top group instilled a sense that Enron was smarter than other companies. ``There was always the feeling that you were the best and the brightest -- one of the chosen few," says David June, a computer software contractor in Enron's human resources division.

Fund-Raising Galas

The Fastows made frequent appearances at local social events, including fund-raising galas for the Contemporary Arts Museum and the Interfaith Ministries of Greater Houston and benefits for the city's Holocaust Museum.

Fastow's charity also extended to the workplace: He was a supporter of the Enron Economic Development Corp., a $20 million venture capital fund the company set up to back urban and minority- and female-owned businesses.

At the time of Enron's collapse, the Fastows were building a home in Houston's River Oaks neighborhood, where Lay, Skilling and many of the city's corporate and civic leaders live.

While Skilling traveled the world meeting with employee groups and touting the company's prospects, Fastow rarely made such appearances.

`Never Heard That Name'

``We'd never heard that name until it was in the paper," says Steve Lacey, an emergency dispatcher at Portland General Electric Co., an Oregon utility Enron owns.

As CFO, Fastow became a master of off-balance-sheet financing, a tactic that companies in capital-intensive industries use to avoid carrying debt on their books.

For years, the energy industry had used partnerships to finance drilling and build pipelines. For example, an oil company that wanted to drill a group of wells would form a partnership.

Investors would put money into the partnership in exchange for a share of the profits from the wells. The company, as general partner, would contribute the leases and oversee the drilling and completion of the wells.

The arrangement enabled oil companies to drill wells without taking debt onto their books for the financing.

A Similar Tactic

Airlines still use a similar tactic: Rather than buy jetliners outright, they sell them to investment partnerships that lease them back to the airline. The arrangement prevents the airline's credit rating from being lowered because of too much debt from buying airplanes. And the higher credit rating makes it cheaper for the airline to borrow money in the future.

Fastow set up far more complicated transactions. Enron needed capital as it expanded internationally and tried to exploit deregulated energy markets. In 1990, it had been primarily a regulated pipeline company with about $3.5 billion in assets. By 1999, its assets were worth $35 billion, a number that had risen to $61.8 billion by the time of the bankruptcy filing.

Taking on debt would have jeopardized the company's credit rating and impaired its ability to grow, Fastow told CFO magazine in October 1999 in one of the few interviews he's ever granted.

`Soup to Nuts'

``We needed someone to rethink the entire financing structure at Enron -- soup to nuts," Skilling told the magazine. ``Andy has the intelligence and the youthful exuberance to think in new ways."

Fastow's solution was to establish partnerships that would hold and sell such assets as power plants and pipelines. In some cases, Enron capitalized the partnerships with notes that were convertible into shares of Enron stock. Enron would get the cash up front and would continue managing the assets.

Shortly after Fastow became CFO, Enron acquired Cogen Technologies Inc. for $1.1 billion. Cogen operated three natural gas-fired power plants in New Jersey that sold electricity to commercial customers.

To finance the transaction, Fastow drew on his experience in asset securitization. Enron created and owned 50 percent of a ``special-purpose entity" which it used to buy the plants.

Legal But Complex

The entity, in turn, sold debt to finance the purchase. The collateral was the return promised by plants' electricity supply contracts. The arrangement, which is legal, meant the debt sale didn't affect Enron's credit rating.

Dozens of similar transactions followed. In some cases, notes convertible into Enron shares were pledged as collateral for debt issued by partnerships and other financing entities. In Texas alone, Fastow was associated with 30 partnerships, companies and other entities all tied to Enron, according to records filed with the Texas secretary of state's office.

They had names like Enron Cash Co. No. 2 and ES Power 3 LLC. Some, like Obi-1 Holdings LLC and Kenobe Inc., were named after characters in the Star Wars film series.

The partnerships often took stakes in each other, creating an interlocking network of ownership. For example, in 1998, Enron made a $12.5 million loan to Kafus Industries Ltd., a company in Vancouver, British Columbia, Canada, that makes fiberboard and newsprint from recycled materials.

More Wrinkles

In 1999, it increased the loan to $20 million and received a note and warrants convertible into Kafus shares. It then sold the Kafus stake to an affiliated partnership, SE Thunderbird LP, according to SEC filings.

SE Thunderbird was controlled by Blue Heron I LLC, which in turn was controlled by Whitewing Associates LP, a partnership whose sole member was Whitewing Management LLC, which was controlled by Egret I LLC, the filings show.

All are listed as affiliates in the annual 10-K report Enron filed with the SEC in May 2001.

The problem was that some of the partnerships, such as the LJMs and another called Chewco, were controlled directly by Enron. Under accounting rules, results from those partnerships should have been carried on Enron's financial statements, something the company decided to do in November.

It restated earnings for more than four years, reducing profit by $586 million because of losses from the partnerships.

Intricate Relationships

While the intricate relationships among the partnerships confounded investors, they earned Fastow praise from his peers. In 1999, he received a CFO Excellence Award, sponsored by CFO magazine and Arthur Andersen LLP, Enron's auditor.

The magazine article, which accompanied the award, extolled Enron's growth during the 1990s, which it said had been ``fueled by unique financing techniques pioneered by Fastow."

Enron offered few details on those techniques to investors. And the company's SEC filings made only passing references to them and to Fastow's involvement.

The profit that Fastow made from running them amounted to hidden compensation that should have been disclosed, says John Coffee, a professor at Columbia University Law School and an expert on securities laws.

``These entities came to have a life of their own," Coffee says.

Fastow Made $30 Million

Fastow made about $30 million in two years from managing and investing in LJM Cayman and LJM2 Co-Investment, according to a report Enron filed with the SEC on Nov. 8.

Those same partnerships cost Enron at least $35 million in cash and more than $1 billion in shareholder equity as the partnership investments soured.

The losses were among the $1.01 billion in failed investments that led to Enron's $618 million third-quarter loss.

Like other Enron executives, Fastow also reaped the benefit of the company's soaring stock price. Since 1998, Fastow has sold almost 474,000 Enron shares at prices as high as $83 apiece for a total of more than $34 million, according to SEC records.

Accounting experts say Fastow's network of partnerships misled investors into believing Enron had more debt capacity than it actually did.

Bigger Problems

The losses the partnerships generated, which ultimately triggered the company's bankruptcy filing, are a sign of bigger problems with Enron's corporate governance, says Wayne Shaw, an accounting professor at Southern Methodist University's Cox School of Business in Dallas.

``If it was the CFO, why was he put in a position where no one knew what he was doing?" asks Shaw. ``If the blame's being placed on one party, you have to wonder about the internal controls of the company. There's got to be checks and balances, and they weren't there."

Chairman Lay, talking to reporters on Nov. 9, said he didn't hold any individual responsible for Enron's collapse. ``I certainly don't blame Mr. Skilling, but I don't blame Mr. Fastow either," Lay said.

Fastow was removed as CFO because his role in the partnerships hurt the company's credibility with investors, Lay added.

British Lord

Lay also said Enron's board -- which includes Lord John Wakeham, former leader of the British House of Commons; John Mendelsohn, president of Houston's M. D. Anderson Cancer Center; and Wendy Gramm, former chairman of the U.S. Commodities Futures Trading Commission -- had full knowledge of the partnerships and Fastow's

role in running them.

In addition to the CFO, Enron's corporate structure included such other executives as a chief accounting officer, a chief risk officer and an executive vice president of finance, all of whom may have had some oversight of Enron's finances.

An Enron spokeswoman declined to comment on the exact duties of each executive.

Fastow was not the only officer involved in the partnerships. Records at the Texas secretary of state's office list more than two dozen officers, directors and other employees -- including Skilling, former Vice Chairman Clifford Baxter and Jeffrey McMahon, Fastow's replacement as CFO.

On Nov. 8, Enron fired Treasurer Ben Glisan and Kristina Mordaunt, the general counsel of an unnamed Enron division, saying they had invested in an affiliate created to buy and sell Enron assets.

Transaction Principals

Those transactions also involved Fastow and two other former Enron employees: Kathy Lynn, a division vice president, and Anne Yaeger, described in SEC filings as a nonofficer employee.

Fastow has become a popular target for angry investors and former employees. The shareholder lawsuits and the investigations by the SEC and Congress all involve the partnerships he created.

Securities law experts say it's unlikely Fastow or any other Enron executive will be held personally liable unless regulators find evidence of criminal wrongdoing.

``It's a pretty low probability that he'll have personal liability," says Alan Bromberg, a law professor at Southern Methodist University who specializes in securities issues. Because Enron's board approved the partnerships and Fastow's role in running them, it's the company that faces the blame, he says.

Suing the Company

Lacey, the Portland General dispatcher, is among the employees suing the company over its 401(k) investment plan. Because Enron was changing the plan's managers, the company said, employees were prohibited from selling shares they held in their investment accounts as Enron stock fell in October.

Some, such as Roy Rinard, a Portland General lineman, watched a $400,000 retirement account dwindle to $35,000 by the time he filed suit on Nov. 20.

``They caused us to lose money, and they made money," Lacey says.

Lacey isn't alone in feeling betrayed. More than 20,000 creditors are lining up in federal bankruptcy court in Manhattan, waiting to collect what they're owed by Enron and its 3,500 subsidiaries and affiliates.

To them, Andrew Fastow is no longer a mystery man. He's an object of scorn.

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