Blind Faith: How Deregulation and Enron's Influence Over Government Looted Billions from Americans

Sen. Gramm, White House Must Be Investigated for Role in Enron's Fraud of Consumers and Shareholders

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SUMMARY OF FINDINGS

- The combination of unregulated state wholesale electricity markets and federal deregulation of commodity exchanges has removed accountability and transparency from the energy sector, allowing corporations to manipulate price and supply of electricity and natural gas through the exercise of significant market power. California's recent energy crisis and Enron's bankruptcy would have been impossible under a regulated system.

- Enron developed mutually beneficial relationships with federal regulators and lawmakers to support policies that significantly curtailed government oversight of their operations.

- Enron's business model was built entirely on the premise that it could make more money speculating on electricity contracts than it could by actually producing electricity at a power plant. Central to Enron's strategy of turning electricity into a speculative commodity was removing government oversight of its trading practices and exploiting market deficiencies to allow it to manipulate prices and supply.

- Dr. Wendy Gramm, in her capacity as chairwoman of the Commodity Futures Trading Commission (CFTC), exempted Enron's trading of futures contracts in response to a request for such an action by Enron in 1992. At the time, Enron was a significant source of campaign financing for Wendy Gramm's husband, U.S. Senator Phil Gramm.

- Six days after she provided Enron the exemption it wanted, Wendy Gramm resigned her position at the CFTC. Five weeks after her resignation, Enron appointed her to its Board of Directors, where she served on the Board's Audit Committee. Her service on the Audit Committee made her responsible for verifying Enron's accounting procedures and other detailed financial information not available to outside analysts or shareholders.

- Following Wendy Gramm's appointment to Enron's board, the company became a significant source of personal income for the Gramms. Enron paid her between $915,000 and $1.85 million in salary, attendance fees, stock option sales and dividends from 1993 to 2001. The value of Wendy Gramm's Enron stock options swelled from no more than $15,000 in 1995 to as much as $500,000 by 2000.

- Enron became the single largest corporate source of campaign financing for Phil Gramm, contributing nearly $260,000 from 1993 to 2001.

- Days before her attorneys informed Enron in December 1998 that Wendy Gramm's control of Enron stock might pose a conflict of interest with her husband's work, she sold $276,912 worth of Enron stock.

- Enron spent $3.45 million in lobbying expenses in 1999 and 2000 to deregulate the trading of energy futures, among other issues.

! In December 2000, Phil Gramm helped muscle a bill through Congress without a committee hearing that deregulated energy commodity trading. This act allowed Enron to operate an unregulated power auction — EnronOnline — that quickly gained control over a significant share of California's electricity and natural gas market.

! Phil Gramm's legislation was in conflict with the explicit recommendations of the President's Working Group on Financial Markets, which is composed of representatives from the Department of Treasury, the Board of Governors of the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission. The Working group expressly recommended *against* deregulating energy commodity trading because the traders would be in strong positions to manipulate prices and supply.

! From June 2000 through December 2000 — prior to the bill's passage — California experienced significant price spikes but only one Stage 3 emergency (requiring "rolling blackouts"). **After passage of Gramm's energy commodity deregulation bill in December 2000, Stage 3 emergencies increased from one to 38 until federal regulators helped end the crisis by imposing price controls in June 2001. Phil Gramm's legislation, for which Enron was the primary lobbyist, allowed Enron's unregulated energy trading subsidiary to manipulate supply in such a way as to threaten millions of California households and businesses with power outages for the sole purpose of increasing the company's profits.**

! Because of Enron's new, unregulated power auction, the company's "Wholesale Services" revenues quadrupled — from $12 billion in the first quarter of 2000 to $48.4 billion in the first quarter of 2001. This remarkable revenue increase came on top of the record revenue gain that Enron posted from 1999 to 2000, when full-year "Wholesale Services" revenues increased from $35.5 billion to $93.3 billion — a 163 percent increase.

! Investigations by state and federal officials concluded that power generators and power marketers intentionally withheld electricity, creating artificial shortages in order to increase the cost of power.

! Enron took advantage of lax oversight following deregulation and formed a complicated web of more than 2,800 subsidiaries — more than 30 percent (874) of which were located in officially designated offshore tax and bank havens.

! President Bush's presidential campaign received significant financial support from Enron ($1.14 million).

! Upon assuming office in 2001, Bush promptly scrapped plans put into place by former

President Bill Clinton to significantly limit the effectiveness of these countries as tax and bank regulation havens. This action came at the height of high West Coast energy prices, probably allowing Enron to siphon billions to its offshore accounts.

! At the same time, the Bush administration and certain members of Congress waged a legislative and public relations campaign against the imposition of federal price controls in the Western electricity market. Such price controls remove the ability of companies exercising significant market share to price-gouge by effectively re-regulating the market. Bush's opposition to price controls unnecessarily extended the California energy crisis and cost the state billions of dollars.

! When federal regulators finally imposed strict, round-the-clock price controls over the entire Western electricity market on June 19, 2001, companies operating power auctions (like Enron) no longer had the ability to charge excessive prices and no longer had incentive to manipulate supply.

! While price controls clearly saved California, Enron suffered because it could no longer manipulate the market and price-gouge consumers. With no significant asset ownership to offset its losses, Enron's unregulated power auction quickly accumulated massive debts. At the same time, the curtailed revenue flow made it more difficult for executives and members of the Board to conceal the firm's accounting gimmicks. Amid the turmoil, CEO Jeff Skilling resigned in August. But shareholders and federal regulators did not learn of the severity of Enron's financial trouble until November 2001. At this time, Enron's top executives continued to receive significant bonuses.

! Due to Wendy Gramm's position on Enron's Audit Committee, she had intimate knowledge of Enron's financial structure and had access to sensitive financial information not available to Wall Street analysts or average shareholders. It is therefore probable that she knew of Enron's possibly fraudulent practices for some time and that her husband would have known as well. Enron's 874 tax haven subsidiaries allowed Enron to funnel billions of dollars to offshore accounts.

! **The Gramms' close involvement with Enron's corporate and legislative activities, the Gramms' possible knowledge and/or connection to criminal misconduct relating to Enron's collapse, and the effects of Enron's layoffs and other economic impacts on Senator Gramm's constituents may have been the leading factor in Gramm's decision on September 4 not to seek re-election to the Senate in 2002.**

PUBLIC CITIZEN RECOMMENDATIONS

Investigation

- Congress should convene a joint House-Senate committee to thoroughly investigate all aspects of the Enron collapse and the political ties that led to policy changes allowing Enron to operate largely free from government scrutiny. This committee should:

  - Subpoena Wendy Gramm to testify under oath to disclose the extent of her knowledge of Enron's alleged accounting fraud and current status of account balances at offshore tax and bank regulation havens.

  - Subpoena Senator Phil Gramm to testify under to answer questions about his foreknowledge of Enron's alleged fraudulent acts.

  - Require testimony or written answers from key Bush administration officials. These should include Treasury Secretary Paul O'Neill, to answer questions about whether Enron representatives or their agents discussed policies regarding treaties with tax haven nations; political adviser Karl Rove, to answer questions about Enron's influence over Bush energy policy; Republican National Committee chairman Marc Racicot, to answer questions about his lobbying efforts before FERC and Congress as a paid lobbyist on behalf of Enron; Vice President Dick Cheney to answer questions about his secret meeting with Enron chief executive Kenneth Lay; and finally, President Bush, to answer questions about his knowledge of Enron's efforts to influence policy on energy and offshore tax/banking havens.

- Sen. Joe Lieberman, who chairs the Senate Government Affairs Committee, should immediately subpoena records involving the formulation of the Bush administration's energy policy, including those pertaining to a meeting or meetings between Cheney and/or administration officials with Enron chief Kenneth Lay or other Enron officials.

Policy Changes

- Congress must repeal commodity deregulation legislation and regulate the trading of energy futures.

- Congress must pass legislation re-regulating energy futures contracts and "swaps."

- Congress must require the Federal Energy Regulatory Commission (FERC) to revoke market-based rates and order cost-based pricing in all wholesale electricity markets.

FERC continues to have the authority to allow power companies to break from state regulations in America's electricity markets. But deregulation's failure and Enron's collapse demonstrate that these markets are not truly competitive, and therefore should return to cost-based rates.

- Congress must require FERC to cease all federalization of transmission activity, cede regulatory control to the states and, where appropriate, support efforts for multi-state, non-profit, consumer-owned transmission companies.

- Congress must revamp antitrust laws to protect consumers by blocking continued merger activity between electricity and natural gas companies and assets, and seek corrections to antitrust laws to prevent another ruling as occurred with *United States v. American Airlines*, in which a judge dismissed a case charging American Airlines with uncompetitive, monopolistic behavior.

- Congress must require FERC to improve its enforcement of companies like Enron that manipulate prices.

INTRODUCTION

Enron and its chief executive officer, Kenneth Lay, have been remarkably successful in lobbying the executive branch, leaders in Congress and various federal regulatory officials to withdraw government monitoring of many corporate activities within domestic energy markets. As a result of Enron's influence over the last several years, the government has abandoned enforcement powers that prevent corporate abuses of market power. Enron's pursuit of treating electricity as a speculative commodity resulted in millions of consumers paying significantly more for their power and subjected an entire state to forced power outages. Enron's crusade for unaccountable markets and unregulated electricity trading led to their incredible market share which denied consumers access to fair and equitable markets. The three principles of *transparency*, *accountability* and *citizen oversight* — all removed under deregulation — are necessary elements for a market system to function properly.

Enron pursued a business strategy that exploited relationships with elected officials and regulators to pursue policies narrowly tailored to benefit Enron's immediate income needs. Enron purchased these alliances through aggressive financing of election campaigns and spearheaded a national crusade to deregulate energy markets.

Deregulation allowed Enron to become one of the most powerful corporations in the world, but it also directly led to the company's downfall. Deregulation of both energy markets and commodity trading allowed Enron to escape price regulations — a key factor in the company's meteoric, 1,750 percent increase in revenues over the past decade. Enron cannot attribute its success, therefore, to such traditional models as incorporating innovations to improve the delivery of product at competitive prices. Rather, Enron's business model was built entirely on the premise that it could make more money speculating on electricity contracts than it could by actually producing electricity at a power plant. Central to Enron's strategy of turning electricity into a speculative commodity was removing government oversight of its trading practices and exploiting market deficiencies to allow it to manipulate prices and supply. So when federal regulators finally re-regulated the California market in June 2001, Enron's business model was soon invalid and the company bankrupt.

But lawmakers should have seen it coming. Public Citizen has always argued that characteristics unique to the electricity industry inhibit true competition. These central attributes, well-known to engineers and economists for decades, were glossed over by Enron as they paid off politicians at the federal, state and local level.

Clearly, the questionable business practices of Enron and its accounting firm Arthur Anderson must be investigated. But so too, must the role Congress played in Enron's perfidy and demise. Since the 1994 election cycle, Enron has been the single largest campaign contributor to members of Congress from the energy/natural resources industry, shelling out $5.3 million to congressional candidates — three-quarters to Republicans. This report will highlight the largest recipient of that money — Texas Senator Phil Gramm — and the influence he and his wife, Dr. Wendy Gramm, had on protecting Enron and abetting their collapse. The report will also examine the key policy decisions made by the Bush administration, and how those decisions protected Enron at the expense of consumers and shareholders.

The Enron collapse has left thousands of people jobless, many of whom lost virtually their entire retirement accounts. It has cost investors — from individuals saving for retirement to large institutions — tens of billions of dollars in equity as the company's stock dropped from $90 a share to less than $1. It has cost leading banks billions and has rippled through the economy. And California consumers are stuck with dramatically higher electricity bills for the next decade. It demands accountability at the highest levels.

Lame Duck Gramm Does Enron's Bidding

Sen. Phil Gramm, a Texas Republican, has spent almost all of his life connected to government. He taught economics at a public college in Texas, served three terms in the House and was elected to the Senate in 1984. His wife, Dr. Wendy Gramm, held top positions as a government regulator in the Reagan and Bush I administrations. Both Gramms have intimate ties with Enron, and those close ties may implicate the Gramms in Enron's financial dereliction.

Wendy Gramm's tenure as chairwoman of the Commodity Futures Trading Commission (CFTC) was defined by political transition: She was sworn in by a term-limited Ronald Reagan in February 1988 and served until January 20, 1993, former President Bill Clinton's inauguration day. Just one week after Clinton's November 1992 victory ensured that Wendy Gramm's politically appointed chairmanship would end, she initiated a radical rulemaking procedure requested by — and benefitting — Enron. Gramm acted to curtail her own Commission's authority over Enron's business by muscling through a rule change that narrowed the definition of futures contracts, excluding Enron's energy future contracts and "swaps" from regulatory oversight. While her aggressive tactics generated immediate criticism from government officials who feared Gramm's lame-duck rule change would have severe negative consequences, Enron soon rewarded the Gramms with personal and professional financial assistance.

Under the Commodity Exchange Act[1], the CFTC is charged with regulating futures contracts traded in an exchange (such as the New York Mercantile Exchange). At the same time, the Act explicitly excludes ordinary commercial futures forward contracts from the CFTC's jurisdiction. This confusing legal distinction of what constitutes a futures contract was the source of a lawsuit by a disgruntled investor.

Enron petitioned the CFTC on November 16, 1992, to explicitly remove energy

[1]The CEA is set forth at Title 7, Chapter 1 of the U.S. Code, and the regulations thereunder are set forth at Title 17, Chapter 1 of the U.S. Code of Federal Regulations, www.access.gpo.gov/su_docs

derivative contracts and interest rate "swaps"[2] from government oversight as the first step in its business plan to profit on the speculation of energy.[3] Although eight other companies subsequently submitted letters of support, Enron was the only company that signed the original request to Wendy Gramm.[4]

Enron was a flea next to the corporate giants such as Mobil, Exxon, BP, J.P. Morgan and Chase Manhattan, which all followed Enron Chief Kenneth Lay's lead on asking for deregulation. In 1992, Enron had revenues of $6.4 billion, compared to Exxon's 1992 revenues of $117 billion.[5] But even though it was a small fish in the energy market, it had as much or more to gain than Big Oil by deregulating futures contracts: Enron was using billions of dollars in derivative contracts to set future prices of electricity and natural gas. In addition, Enron boasted of its $4.5 billion in "interest-rate swaps" in its 1992 annual report.[6] Enron wanted to continue moving its money through such contracts without having to disclose information to federal regulators.

Not only did Enron have financial incentive for changing the rule, but the company had close ties to Wendy Gramm's husband, Phil Gramm. Of the nine companies writing letters of support for the rule change, Enron had given by far the largest contributions to Phil Gramm's campaign fund at that time, giving $34,100.[7]

Because of her husband's money-and-politics relationship with Enron and since the issue of whether to regulate futures contracts was controversial, one would assume that Chairwoman Gramm would be reluctant to take on the matter. After all, voters had elected a new president, making her a lame-duck chairwoman. But Wendy Gramm surprised her two CFTC colleagues when she immediately initiated the rulemaking process without first consulting them.[8]

Although Congress had passed a law in the fall of 1992 granting the CFTC the authority to decide whether the contracts should be regulated,[9] normally such a rulemaking procedure takes a year or more, because deliberations on a matter with such technical and legal complexity demand a lengthy and open debate. But Wendy Gramm rammed the process through in less than

[2]Both *derivatives* and *swaps* are essentially bets a company makes on the future price of energy (electricity, natural gas, etc.), interest rates, or foreign currencies.

[3]Jerry Knight, "Energy Firm Finds Ally, Director, in CFTC Ex-Chief," *Washington Post*, April 17, 1993.

[4]Charles Lewis, "The Buying of the President 1996," pg. 153. The Center for Public Integrity.

[5]Company 10-k reports filed with the Securities and Exchange Commission in 1994.

[6]Jerry Knight, "Energy Firm Finds Ally, Director, in CFTC Ex-Chief," *Washington Post*, April 17, 1993.

[7]Charles Lewis, "The Buying of the President 1996," pg 153. The Center for Public Integrity.

[8]"Derivatives Trading Forward-Contract Fraud Exemption May be Reversed," *Inside FERC's Gas Market Report*, May 7, 1993.

[9]H.R. 707, "Futures Trading Practices Act," 102nd Congress, signed by President Bush October 28, 1992.

two months, bringing the matter for a vote before the Commission on January 14, 1993. At the time of the vote, the commission had two of its five seats vacant. All three commission members present were Bush appointees, and Wendy Gramm voted in the majority of a 2-to-1 decision to prohibit the government from regulating energy commodity contracts and swaps.

Wendy Gramm's decision immediately freed Enron from important disclosure requirements on its own derivatives and swaps contracts. Six days later, Wendy Gramm resigned her position as Clinton took the oath of office on January 20, 1993.

Wendy Gramm said her decision to deregulate futures contracts had nothing to do with Enron's contributions to her husband's campaign, arguing that she was "confident that the new exemptions are based not only on the [Commodity Exchange Act reauthorization] statute, but also on the legislative history," and that the CFTC had "issued a policy statement in 1989 along these lines and no one complained about it until recently."[10]

Wendy Gramm's July 1989 policy memo basically stated her belief that swaps may not necessarily be regulated in the same fashion as futures contracts. The memo did not state that the CFTC was extinguishing its jurisdiction over swaps.[11] As such, she cannot truthfully claim that the 1989 decision gave public notice that swap contracts would be completely free from regulation.

Wendy Gramm's 1989 policy statement was timely: Circuit Judge Easterbrook of the 7th U.S. Circuit Court of Appeals in Chicago decided a case one month later which found that the CFTC, not the Securities and Exchange Commission (SEC), had jurisdiction over futures contracts.[12] But Gramm had stated in her policy memo that she didn't want to regulate the contracts. Wendy Gramm therefore pursued a passive-aggressive strategy: she was happy that the court granted the CFTC the opportunity to be *aggressive* about exerting jurisdiction if it wanted to, but Gramm's policy memo had basically laid out a strategy of being *passive* about actually utilizing that authority. Gramm's hands-off approach, coupled with the court's ruling, ensured that the CFTC had sole authority futures contracts, but that Gramm would do nothing to enforce that authority — which was exactly what Enron wanted.

Just months later, Enron paid Phil Gramm a $2,000 honorarium for a speech he made on

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[10] Aaron Pressman, "Gramm Reflects Upon Her Accomplishments at Futures Commission and Ponders Next Move," *The Bond Buyer*, Vol. 303, No. 29074, January 22, 1993.

[11] Bernard J. Karol and Mary B. Lehman, "Unprecedented Technological and Mathematical Sophistication has Created a Vast Market for Derivatives," *Review of Securities & Commodities Regulation*, Vol 27, No. 12, July 1, 1994.

[12] *Chicago Mercantile Exchange, et al v. Securities and Exchange Commission, et al*, 883 F.2d 537, August 18, 1989.

November 29.[13]

It is notable that Wendy Gramm failed to initiate a rulemaking until more than three years after the policy memo and the court's ruling were issued. If Wendy Gramm and Enron had been confident that the CFTC's lame-duck deregulation order would be viewed as consistent with the CFTC's regulatory history, then why did she publish the proposed rule without consulting her fellow CFTC commissioners, and why did she wait until she was a lame duck to do it? Did she anticipate that criticism of her move would be swift and widespread?

Indeed, both the Federal Reserve Board and U.S. Rep. Glen English (then-chairman of a House Agriculture subcommittee with jurisdiction over the CFTC and current CEO of the National Rural Electric Cooperative Association) protested that Wendy Gramm's action prevented the CFTC from intervening in basic energy futures contracts disputes, even in cases of fraud.[14] Sheila Bair, the commissioner casting the lone dissenting vote, argued that deregulation of energy futures contracts "sets a dangerous precedent." English noted that "in my 18 years in Congress [Gramm's vote to deregulate] is the most irresponsible decision I have come across."[15] A U.S. General Accounting Office report issued a year later[16] urged Congress to increase regulatory oversight over derivative contracts, and a congressional inquiry found that CFTC staff analysts and economists believed Gramm's hasty move prevented adequate policy review.[17]

The implications of Wendy Gramm's unprecedented move were immediate. Revenues in Enron's division that at the time operated futures contracts, Enron Gas Services, increased 30 percent from 1992 to 1993 ($6.1 billion versus $4.7 billion), compared to only a 10 percent increase from 1991 to 1992,[18] due to significant revenue increases in its newly unregulated futures contracts, or "price risk management activities." Enron quickly established itself as a futures trader leader.

Wendy Gramm mentioned that her rationale for removing CFTC jurisdiction over these contracts was that the markets were dominated by "large sophisticated commercial entities," not "real people" investors who could get hurt.[19] But the economy was rocked by a high-profile failure directly related to Wendy Gramm's deregulation of energy futures contracts. In December

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[13]Center for Public Integrity's honorarium database, www.publicintegrity.org/buying_honor.html and "Honoraria Scorecard: The Missing Members," *Washington Post*, August 7, 1989.

[14]Jerry Knight, "Gramm Moves to Keep 'Swaps' Unregulated," *Washington Post*, January 13, 1993.

[15]"Derivatives Trading Forward-Contract Fraud Exemption May be Reversed," *Inside FERC's Gas Market Report*, May 7, 1993.

[16]"Financial Derivatives: Actions Needed to Protect the Financial System," GGD-94-133, May 18, 1994.

[17]Brent Walth and Jim Barnett, "A Web of Influence," *Portland Oregonian*, December 8, 1996.

[18]Enron's 10-k, filed with the U.S. Securities and Exchange Commission on March 30, 1994.

[19]"Energy Traders Raise Ante in Power-hungry California," Dow Jones Energy Service, April 16, 2001.

1993, 11 months after Wendy Gramm forced a vote on the issue, Metallgesellschaft reported energy derivatives-related losses of more than $1 billion throughout its U.S. energy subsidiary, Metallgesellschaft Refining and Marketing. The subsidiary engaged in a significant number of unregulated futures contracts throughout 1993 and got burned when its bets failed late that year. The corporation avoided bankruptcy only after quickly negotiating a $1.9 billion bailout package with the company's 120 creditor banks, but contrary to Wendy Gramm's assertion, many small investors had already lost thousands of dollars.[20] The CFTC eventually fined the company $2.5 million — a move that Wendy Gramm blasted as "micromanagement" on the part of the CFTC: "Too often we have looked to government for answers," was her complaint.[21]

Five weeks after she resigned from the CFTC, Wendy Gramm was asked by Kenneth Lay to serve on Enron's Board of Directors. When asked to comment about Gramm's nearly immediate retention by Enron, Lay called it "convoluted" to question the propriety of naming her to the board, noting the board position was part-time and paid only $22,000 annually.[22]

Enron Finances the Gramms Personally, Professionally

Before Enron's interaction with Wendy Gramm, the company was a relatively minor energy concern with a limited lobbying machine, failing to crack the top 20 Energy/Natural Resources campaign contributors in the 1990 election cycle. By 1992, Enron had broken into the rankings at 18th after giving nearly $300,000 to members of Congress.[23]

Apparently bolstered by its success with Wendy Gramm, Enron assembled a special-interest machine unprecedented for the energy industry — especially considering its relatively small capitalization compared to larger, more mature energy companies. **Since the 1993-94 election cycle, Enron has been the single largest source of campaign contributions from any corporation in the Energy/Natural Resources sector, giving $5.3 million to federal candidates from 1993 through 2001 — 40 percent more then No. 2 on the list over that time period, Southern Company.**[24] Enron shot up in the rankings as one of the largest contributors in the 1994 election cycle, when it ranked 6th highest (up from 18th highest in the previous cycle) after contributing nearly $500,000. These amounts, however, do not include the money Enron spent to influence state-based deregulation efforts, since state disclosure laws are not uniform.

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[20] Terrence Roth, "German Firm's Bailout Package Gets Approved," *The Wall Street Journal*, January 17, 1994.

[21] "Former CFTC Chief Scores Agency's Move in Derivatives Case," *The Wall Street Journal*, December 1, 1995.

[22] Jerry Knight, "Energy Firm Finds Ally, Director, in CFTC Ex-Chief," *Washington Post*, April 17, 1993.

[23] All campaign contribution data in the following discussion are fully available through the Center for Responsive Politics campaign contribution web site: www.opensecrets.org.

[24] Center for Responsive Politics, www.opensecrets.org. 2001 contribution data as of October 1, 2001.

Enron Contributions to All Federal Candidates

Total Political Action Committee, Soft Money & Individual Contributions

Election Cycle	Contributions	% to Democrats	% to Republicans	Energy/Natural Resources Industry Contribution Rank
1991-1992	$ 299,509	39%	61%	18
1993-1994	497,990	43%	56%	6
1995-1996	1,136,121	18%	80%	2
1997-1998	1,072,142	21%	79%	1
1999-2000	2,439,198	28%	72%	1
2001-2002	168,834	12%	88%	12
TOTAL 1993-2001	**$ 5,314,285**	**25%**	**75%**	**1**

NOTE: 2001-2002 contribution total as of October 1, 2001.

SOURCE: Center for Responsive Politics, www.opensecrets.org

Not only did Enron establish itself as the energy industry's leader in financing campaigns, but the Houston firm discriminated heavily in favor of Republicans. From 1993 to 2001, Enron gave three-quarters of its $5.3 million in contributions to the GOP.

No one in Congress benefitted from Enron's generosity more than Phil Gramm. Enron has been Gramm's single largest corporate contributor since 1993. In the 1993 election cycle, when Wendy Gramm was selected to serve on Enron's board, the company gave more than $25,000 to Gramm's campaign. By the next election cycle, Enron had become Gramm's top corporate contributor, eventually providing nearly $260,000 from 1993 through 2001. Enron chief Lay served as the regional chair of Gramm's frustrated 1996 presidential campaign.

Not only was Enron ensuring that Phil Gramm's campaign chest was full, but his family's personal bank account as well. Enron paid Wendy Gramm between $915,000 and $1.85 million in salary, attendance fees, stock option sales and dividends from 1993 through 2001. Wendy Gramm's stock options in Enron swelled from no more than $15,000 in 1995 to as much as $500,000 by 2000.

Citing a congressional legislative agenda that included federal electricity deregulation

Enron Campaign Contributions to Phil Gramm

Total Political Action Committee, Soft Money & Individual Contributions

Election Cycle	Contributions	Corporate Contribution Rank
1993-1994	$ 25,100	4
1995-1996	67,000	1
1997-1998	76,750	1
1999-2000	68,000	4
2001-2002	22,000	12
TOTAL 1993-2001	**$ 258,850**	**1**

NOTE: 2001-2002 contribution total as of October 1, 2001.

SOURCE: Center for Responsive Politics, www.opensecrets.org legislation, Wendy Gramm notified Enron in December 1998 — just days after selling thousands of her stock options for $276,912 — that Congress' ethics rules might prevent the Gramms from holding stock in a company that stands to gain from legislation Phil Gramm would be considering. As a result, Enron canceled all of her outstanding shares and provided her with "an additional service fee" for a total of $117,000 paid in quarterly installments over four years. Replacing the annual stock option stocking stuffers that Enron provides Board members, Enron deposited the value of the stock options into her Flexible Deferral Account (FDA), which pays annual dividends. In 1999, the first year of the stock swap, Enron deposited nearly $80,000 in Wendy Gramm's FDA. Enron did not mention in its 2001 Schedule 14a filing with the U.S. Securities and Exchange Commission the amount the company deposited into Gramm's FDA in 2000.[25]

As one of six members of the Board of Directors' Audit Committee, Wendy Gramm helped serve "as the overseer of Enron's financial reporting, internal controls and compliance processes."[26] She reviewed Enron's financial statements for irregularities, verified that the company was in compliance with standard accounting principles, and signed the filing as a witness to these facts. She attended multiple meetings per year where she was privy to financial details unavailable to Wall Street analysts and average shareholders.

Revolving Door: Enron Compensation to Wendy Gramm

	Base Salary	Attendance Fees	**Total Salary**	Value of Enron Stock	Dividends, Stock Sale Min	Dividends, Stock Sale Max	**SALARY+STOCK INCOME Min**	**SALARY+STOCK INCOME Max**
1993	$ 22,000	$ 24,000	**$ 46,000**	n/a	$ -	$ -	**$ 46,000**	**$ 46,000**
1994	22,000	20,250	**42,250**	n/a	-	-	**42,250**	**42,250**
1995	22,000	19,500	**41,500**	$1,001-$15,000	201	1,000	**41,701**	**42,500**
1996	40,000	12,750	**52,750**	$1,001-$15,000	201	1,000	**52,951**	**53,750**
1997	40,000	17,000	**57,000**	$15,001-$50,000	1,001	2,500	**58,001**	**59,500**
1998	50,000	20,000	**70,000**	$15,001-$50,000	276,912	276,912	**346,912**	**346,912**
1999	50,000	30,000	**80,000**	$100,001-$250,000	100,001	1,000,000	**180,001**	**1,080,000**
2000	50,000	21,250	**71,250**	$250,001-$500,000	15,001	50,000	**86,251**	**121,250**
2001	50,000	11,250	**61,250**	n/a	-	-	**61,250**	**61,250**
TOTAL	$ 346,000	$ 176,000	**$ 522,000**	-	$393,317	$ 1,331,412	**$ 915,317**	**$ 1,853,412**

NOTE: Enron's Attendance Fee structure has been slightly modified over Gramm's tenure and is currently $1,250 for each Board and Committee meeting attended (Gramm serves on two Committees). Fees in this table assume 100% attendance of all meetings Gramm was scheduled to attend, and accurately reflect the Fee schedule for each corresponding year. 2001 number of Audit & Nominating meetings is an estimate based on lowest total of each over previous years.

SOURCE: Salary & Fee data from Enron's Schedule 14a filings with the Securities & Exchange Commission. Source for Wendy's $276,912 stock sale in 1998 is Form 4 filings with the SEC. Source for asset values and dividend income is "U.S. Senate Financial Disclosure Report", available from The Center for Responsive Politics, www.opensecrets.org

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25 Enron's Schedule 14a filings from 1998-2001, www.sec.gov/edgar/searchedgar/formpick.htm

26 Enron's Schedule 14a filings, www.sec.gov/edgar/searchedgar/formpick.htm

Senator Gramm Follows Dr. Gramm's Lame Duck Lead

At a recent House Financial Services Committee hearing exploring the demise of Enron, members attacked Enron over allegations of fraud and blasted the company's permissive accounting firm. In response to these criticisms of accountants and financial analysts, committee chairman Michael G. Oxley, R-Ohio, declared, "Modernization of our structure of regulation is clearly called for."[27]

But judging by the impact from the last time Congress "modernized" regulations, Oxley might want to restate his goals. In December 2000, Phil Gramm had pushed the Commodity Futures Modernization Act of 2000 to the president's desk with disastrous results. In the name of modernizing the way electricity and other energy futures could be traded, Sen. Gramm scoffed at the traditional energy trading venues such as the New York Mercantile Exchange.

As documented earlier, Enron has established very close ties with Phil Gramm. Enron has been the single largest corporate contributor to Gramm's campaigns, giving nearly $260,000 since 1993. And there is a personal relationship and mutual respect, too. Lay, Phil Gramm and Wendy Gramm all hold doctorates in economics, and Phil has described Lay as a "Renaissance man," calling him the type of friend who is "as comfortable talking about the ancient Greeks as he is the competitive selling of electric power."[28] A photo splashed in the *Orange County Register* showed Phil Gramm beaming at the side of Ken Lay and Lay's wife, Linda, at a Houston fund raiser for GOP presidential candidate Bob Dole in 1996.[29]

So it is not surprising that Gramm has a history of doing favors and pushing Enron's agenda in Congress. In 1990, Gramm justified his support of a tax credit for natural gas drilling in tight sands wells by specifically mentioning Enron's desire for the tax break.[30] Gramm embraced Enron's early efforts to force states to deregulate their electricity markets. Defying Senate leadership but falling into line with Enron's agenda, Gramm teamed with U.S. Rep. Thomas Bliley, R-Va., and sponsored a "full-blown deregulation" bill in 1997.[31]

Even when Gramm supported an issue opposed by Enron, he made sure to bend over backward to accommodate his wife's employer. For example, Gramm's early leadership in advocating repeal of the Public Utility Holding Company Act (PUHCA) — a law granting the Securities and Exchange Commission authority to protect consumers from monopolistic

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[27]Michele Heller, "Lawmakers Probing Enron Call for More Analyst Scrutiny," *American Banker*, Vol 167, No. 238, December 13, 2001.

[28]Gary McWilliams, "The Quiet Man Who's Jolting Utilities," *Business Week*, June 9, 1997.

[29]"Politics Briefly," April 13, 1996.

[30]Bill Mintz and Anne Pearson, "Budget Deal Rekindles Gas Plans," *Houston Chronicle*, October 2, 1990.

[31]"Sen. Gramm Working with Rep. Bliley on 'Full-Blown Deregulation' Measure," *Electric Utility Week*, May 5, 1997.

corporate control over electricity markets[32] — was at odds with Enron's agenda, because Enron feared that stand-alone PUHCA repeal would provide too much leverage to utilities, Enron's chief competitors at the time. In a controversial move, Gramm refused to consider PUHCA repeal unless it was directly linked with efforts to force states to deregulate their markets[33] — a position Gramm was able to pursue after he replaced defeated Sen. Alfonse D'Amato as chairman of the Banking, Housing and Urban Affairs Committee.[34]

In 2000, Phil Gramm spearheaded a successful effort to bury major commodity deregulation legislation in an appropriations bill that was introduced during the chaotic days after the Supreme Court issued its ruling sealing George W. Bush's victory in the disputed 2000 presidential election.[35] While Gramm's efforts ensured that the public had no opportunity to scrutinize the legislation before it became law, millions of Americans were immediately affected by the law's implementation. The act allowed Enron to operate an unregulated energy trading subsidiary. Operating a commodities exchange with no transparency and no accountability, Enron was able to command far more market share than before Gramm's legislation. In the days after the law took effect, California was plunged into a month-long nightmare of rolling blackouts. Phil Gramm's drive to remove government oversight of Enron's operations is to blame.

In 1999 and 2000, Enron's in-house lobbying shop spent over $3.4 million pursuing its deregulation agenda in Congress and at federal agencies (this total does not include the nearly $1.6 million Enron paid to lobbyists). Front and center were efforts to build upon the success it had after Wendy Gramm deregulated the *contracts* of energy futures; now Enron sought to deregulate the *trading* of energy futures. The distinction is profound: Whereas deregulated contracts only allowed Enron to hide information of individual energy trades, deregulating the trading of energy futures would allow Enron to create an unregulated subsidiary that could buy and sell electricity, natural gas and other energy commodities in huge volumes without reporting details of its activities to government regulators.

Previously, electricity contracts could only be negotiated through a regulated trading auction, such as the New York Mercantile Exchange. NYMEX must report information on the prices and volumes at which commodities are trading, among other information. But if the trading of electricity were deregulated, Enron would not have to disclose how much was being traded, prices at which commodities were selling, or at what volume Enron itself was conducting its own trades on the floor of its own energy auction.

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[32]For more information on PUHCA, see Public Citizen's web site: www.citizen.org/cmep/energy_enviro_nuclear/electricity/deregulation/puhca/articles.cfm?ID=4245

[33]Evident in Gramm's 2000 deregulation bill that proposed PUHCA repeal, S.2886, 106th Congress.

[34]"Federal Restructuring Bill Introduced Despite Continued Skepticism," *Foster Electric Report*, No. 158, February 17, 1999.

[35]S. 3283, 106th Congress, http://thomas.loc.gov

Enron's in-house lobbying office spent nearly $1.7 million in 1999 (this total does not include the $710,000 the company paid to lobbying firms that year). Enron spent a portion of that money working with Phil Gramm to strategize how to pass deregulation through Congress, and some of it was spent meeting with federal regulators and policy bureaucrats at the CFTC, Treasury and Federal Reserve discussing commodity trading deregulation.[36] But congressional enthusiasm to proceed was dampened while members awaited the November 1999 release of a report by the President's Working Group on Financial Markets — a multi-agency policy group with permanent standing composed at the time of Lawrence Summers, Secretary of the Treasury; Alan Greenspan, Chairman of the Federal Reserve; Arthur Levitt, Chairman of the Securities and Exchange Commission; and William Rainer, Chairman of the CFTC — which was to recommend regulatory policies covering commodity trading. In its 1999 lobbying disclosure form, Enron indicated that the "President's Working Group" was among its lobbying targets.

The Working Group's conclusion in November 1999 was clear: The trading of energy must not be deregulated. The Group reasoned that "due to the characteristics of markets for non-financial commodities with finite supplies … the Working Group is unanimously recommending that the [regulatory] exclusion not be extended to agreements involving such commodities."[37]

The high-profile Working Group's fears that deregulating energy trading would lead to supply and price manipulation killed enthusiasm in Congress to pass such legislation. But Phil Gramm and Enron were undeterred. Enron increased its in-house lobbying expenses to more than $1.7 million in 2000. Among the "Specific lobbying issues" Enron listed on its disclosure form was the "Commodities Futures Modernization Act." Under "Federal agencies contacted" Enron listed the "Commodities Futures Trading Commission," the "Federal Reserve," and the "Department of Treasury."

In addition, Enron paid a lobbying firm, The Commonwealth Group, an additional $40,000 to lobby on "issues related to trading, monetary policy and legislative policies." [38] The Commonwealth Group is headed by Christopher T. Cushing, who used to co-direct C & C Consulting and had been the finance chairman for U.S. Sen. Bob Dole.

And Enron's best friend in Congress, Phil Gramm, also went to work. In early May, he brought his entire Senate banking committee to Chicago to discuss commodity trading deregulation, meeting with CFTC chairman William Rainer, Securities and Exchange Commission chairman Arthur Levitt, all the heads of the Chicago mercantile exchanges and

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[36]Enron Midyear and Year End "Lobbying Report," Secretary of the Senate, Office of Public Records, http://sopr.senate.gov

[37]"Over-the-Counter Derivatives Markets and the Commodity Exchange Act," Report of The President's Working Group on Financial Markets, pg. 16. November 1999. www.ustreas.gov/press/releases/docs/otcact.pdf

[38]Lobbying Report, Secretary of the Senate, Office of Public Records, http://sopr.senate.gov

various executives from electronic trading vendors.[39]

Less than one month later, Gramm rejected the recommendations of the President's Working Group when he helped introduce the Commodity Futures Modernization Act of 2000,[40] which included language deregulating energy trading by excluding companies like Enron from both the Commodity Exchange Act and Commodity Futures Trading Commission jurisdiction. But the bill languished in the Senate, too controversial to get a committee hearing. But the bill's companion in the House did get a hearing, and the House voted to approve the measure in the evening of October 19, 2000. But the more deliberative Senate, where minority members have more authority to alter legislation than their minority colleagues in the House, had no such opportunity to hold the legislation up to the light of public scrutiny. Daniel Rappaport, then-chairman of the New York Mercantile Exchange, noted that "if this bill ever saw the light of day with full floor debate, it wouldn't have a chance to survive."[41]

And Phil Gramm ensured the bill would not be subject to a floor debate. Three days after the Supreme Court issued its ruling sealing Bush's victory in the disputed 2000 presidential election, Phil Gramm helped re-introduce the same bill he had helped introduced in June — but this time with a different bill number. Now-retired Rep. Thomas Ewing did the same in the House, despite the fact that the House had already approved the measure. This coordinated trickery of introducing the same bill under a different name was necessary for Gramm to get the entire bill attached to the appropriations bill that Congress and a lame-duck Clinton had battled over for weeks. With most of the news media still absorbed by the Supreme Court election decision, Congress passed the appropriations bill on December 15, 2000 — the same day Gramm re-introduced the bill in the Senate under a different bill number. The bill, on which Gramm did not hold a hearing in his banking committee, was signed by the president on December 21. When combined with California's electricity deregulation law, this commodity deregulation law enabled Enron to operate an electricity auction closed to the public and free from federal scrutiny.

Gramm's Last Minute Move Spells Disaster for California

This law had immediate and enormous consequences. It allowed Enron to bypass regulated trading auctions, such as the New York Mercantile Exchange, and operate its own unregulated energy trading auction. The combination of California's 1996 law removing regulations over the buying and selling of electricity in the state's wholesale market and the federal law in 2000 removing disclosure requirements for Enron's trading of electricity allowed the company to command significant market share in the Western market, enabling Enron to manipulate wholesale electricity prices to a far higher degree than when the company had to trade

[39]"Political Recharge," *Futures* (Cedar Falls, Iowa), Vol. 29, Issue 6, June 1, 2000.

[40]S. 2697, 106th Congress, http://thomas.loc.gov

[41]Roberta C. Yafie, "Bending the Rules," *AMM*, Volume 108, Issue 208, October 27, 2000.

electricity in a regulated commodities exchange.

Because of Enron's new unregulated power auction, the company's "Wholesale Services" revenues quadrupled — with revenues rocketing from $12 billion in the first quarter of 2000 to $48.4 billion in the first quarter of 2001. This incredible increase in revenues was on top of the record revenue gain when total "Wholesale Services" revenues grew from $35.5 billion in 1999 to $93.3 billion in 2000 — a 163 percent increase[42] — in the midst of California's crisis.

Enron was able to increase revenues by tens of billions of dollars because its unregulated power auction subsidiary — EnronOnline — established firm control over a significant share of the California energy market. ***Despite the fact that Enron did not own a single power plant in the state, its control of the venue in which electricity was bought and sold placed Enron in almost total control of California's energy supply.*** In its greed to ratchet prices higher and higher, Enron had tremendous incentive to withhold supply in order to create artificial shortages, which increase prices.

Prior to December 21, 2000 — the date Enron was allowed to operate an unregulated trading auction — prices had been very high in the California market. But there had been only one "rolling blackout" — called a Stage 3 emergency—from the time the crisis began in May 2000 to December 21, 2000 (the single rolling blackout occurred for a two-hour period on December 7, 2000). But from the time after Gramm's legislation took effect until California was re-regulated in June 2001, there were 38 Stage 3 emergencies declared in California — in all of 2000, there had been only one Stage 3 emergency. In addition, Stage 2 emergencies increased 81 percent from 2000 to 2001, and there were 27 percent more Stage 1 emergencies over that time period.[43] The correlation is clear: Phil Gramm's commodities deregulation law allowed Enron to control electricity in California, pocket billions in extra revenues and force millions of California residents to go hundreds of hours without electricity and pay outrageous prices. Enron's rapacious rampage ended June 19, when FERC re-regulated California's market by imposing strict, round-the-clock price controls.[44]

The fact that Stage 3 emergencies were declared during winter — when electricity demand is at its lowest point of the year — rather than during the peak-demand summer months indicates that manipulation, not consumer demand, caused the outages.

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[42] Enron 10-k and 10-Q reports filed with the Securities and Exchange Commission in 2001.

[43] California Independent System Operator (ISO), "System Status Log" as of October 16, 2001. www.caiso.com. A Stage 1 emergency is declared by the ISO when the Operating Reserve—the difference between demand and supply—falls below the recommended minimum. A Stage 2 emergency is declared when the Operating Reserve falls below five percent. A Stage 3 emergency is declared when the Operating Reserve falls below 1.5 percent, necessitating the ISO to intentionally shut power off to large sections of consumers (a "rolling blackout").

[44] "Order Addressing Price Mitigation in California and the Western United States," the Federal Energy Regulatory Commission, June 18, 2001. www.ferc.gov

Before it was over, Enron posted Wholesale Services revenues of nearly $97 billion in the first six months of 200 — an increase of 350 percent over the same period in 2000.

Amazingly, Gramm offered the following explanation for California's crisis during an interview with the *Los Angeles Times* in January 2001: "As they [Californians] suffer the consequences of their own feckless policies, political leaders in California blame power companies, deregulation and everyone but themselves, and the inevitable call is now being heard for a federal bail-out. I intend to do everything in my power to require those who valued environmental extremism and interstate protectionism more than common sense and market freedom to solve their electricity crisis without short-circuiting taxpayers in other states."[45] A day after Gramm gave this interview, millions of Californians were plunged into darkness due to rolling blackouts.

Phil Gramm's rant about "environmental extremism" suggests that he blames environmentalists for blocking or slowing the construction of power plants. Deregulation defenders, like Gramm, have argued that not a single power plant was constructed in California in the 1990s. This claim, however, is false. California Energy Commission data clearly show that new power plants with the capability to generate 1,200 megawatts of electricity, or enough power for more than 1 million homes, came on line during the 1990s.[46]

At the height of California's electricity crisis, as much as 13,000 megawatts in-state was offline for undisclosed reasons. According to the *Wall Street Journal*, 461 percent more capacity was offline for undisclosed reasons in August 2000 compared to a year earlier.[47] In deregulated markets, undisclosed power plant shutdowns are a new phenomenon; under state-regulated markets, power plant owners must continually disclose any problems that force a plant shutdown.

Williams Co., an Oklahoma power marketing firm with a presence in California, was fined tens of millions of dollars by FERC for intentionally shutting down some of its power plants. The federal investigation found that Williams intentionally withheld output at one of its plants so it could charge rates 12 times higher at its neighboring power plant.[48] And although Enron did not own any power plants, it withheld power through its energy auction. The lack of accountability in deregulated wholesale markets allows corporations to manipulate critical commodities like electricity.

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[45]Robert A. Rosenblatt and Richard Simon, "Federal Pact Would Give Utilities More Time to Pay Power," January 10, 2001.

[46]California Energy Commission, "Power Plant Projects before the California Energy Commission since 1979," January 16, 2001.

[47]Chip Commins and Rebecca Smith, "For Power Suppliers, The California Market Loses Its Golden Glow," *The Wall Street Journal*, Jan. 25, 2001.

[48]Rebecca Smith, "California Seeks Curbs on 2 Power Firms," *The Wall Street Journal*, June 1, 2001.

These facts — that the state indeed had adequate capacity that was, at best, poorly managed by unaccountable corporations — forced the nation's leading libertarian think tank, the Cato Institute, to draw the same conclusion in a July 2001 report: "We find little evidence to support the argument that environmentalists are primarily to blame for the [California deregulation] crisis."[49]

George Bush Protects Enron at the Expense of Consumers, Shareholders

The Bush administration's aggressive intervention to scrap an international treaty cracking down on offshore tax havens may have greatly aided Enron's ability to defraud its shareholders. Deregulation allowed Enron to conduct more of its operations in secret through the use of 874 subsidiaries registered in countries officially designated as tax havens and having weak bank disclosure regulations. Enron was so successful at its strategy to conceal information from regulators that billion-dollar Wall Street investment firms were caught flat-footed when the Enron empire collapsed.

Many of Enron's connections with various Bush administration officials have been well-documented. For example, a February 2001 report by Public Citizen suggested Bush's opposition to price controls in California's dysfunctional market was influenced by Enron's significant campaign contributions.[50] Enron gave more than $1.1 million to Bush's presidential campaign: $127,525 directly to his campaign, and $713,200 to the Republican National Committee, which served as an arm of the Bush presidential campaign. Enron and Lay also gave $300,000 to the Bush-Cheney 2001 Presidential Inaugural Committee.

While energy prices skyrocketed and California endured rolling blackouts for an entire month as soon as Bush came into office, the President and high-ranking members of his administration went on a public relations campaign to ridicule price controls as an option that would make matters worse. In a tense meeting with California Governor Gray Davis in Los Angeles on May 29, Bush failed to grasp the irony of his proclamation that electricity price controls would lead to "more serious shortages and even higher prices": Bush made the statement while in a building wired to one of the only regions in the state immune from the power crisis — the city-owned power of Los Angeles.[51] In the nearly six months Bush refused to re-regulate California's wholesale market, Enron posted increased revenues of nearly $70 billion from the previous year.[52]

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[49]Jerry Taylor and Peter VanDoren, "California's Electricity Crisis: What's Going On, Who's to Blame, and What to Do," July 3, 2001. www.cato.org

[50]"Got Juice? Bush's Refusal to End California Electricity Price Gouging Enriches Texas Friends and Big Contributors," www.citizen.org/documents/ReportGotJuiceFeb12.PDF

[51]George Skelton, "Bush Blunders Into Equal Footing with Davis," *Los Angeles Times*, May 31, 2001.

[52]Enron 10-q filing with the Securities Exchange Commission on August 14, 2001.

As Bush and FERC played their "free market" ideological fiddle while California burned, the state's utilities mounted huge losses as prices for the electricity they had to purchase on the wholesale market vastly exceeded the amount the state permitted them to charge consumers. As a result, the taxpayers of California were forced to use the state's impeccable credit to assume responsibility for purchasing electricity on behalf of the beleaguered utilities. The failure of the federal government to control wholesale prices forced California to spend $60 million per day to purchase overpriced electricity from a handful of greedy companies, including Enron.

In light of the state spending tens of billions of dollars on electricity, even fellow Republicans hopped on board the price control train. Eight western state governors — half of whom are Republicans — called on Bush to enact price controls, and two GOP members[53] of the House of Representatives with ratings at mid-90 percent from the American Conservative Union sponsored federal legislation to force Bush to enact price controls.[54] Despite the bipartisan support for the Republicans' measure, the price control bill failed to even get a committee hearing from Republican leadership, and the president refused to consider it.

After the Federal Energy Regulatory Commission, under heavy political pressure, imposed round-the-clock wholesale price controls for the entire Western electricity market in June 2001, prices dropped significantly, and California has experienced not one single rolling blackout. Spot prices fell more than 80 percent immediately after the price controls took effect.[55] Unquestionably, price controls have been a success.

Recently, Enron became even more tightly bound to the Bush administration. Bush in December appointed former Montana Governor Marc Racicot to head the Republican National Committee. Racicot is a registered lobbyist for the Houston law firm Bracewell & Patterson. Since Racicot joined the firm at the beginning of 2001, the firm has made more than half of its $710,000 in income for the first six months of 2001 from Enron ($360,000). Racicot personally lobbied Congress and FERC on behalf of Enron this year.[56]

Bush Blocks Efforts to Clamp Down On Enron's Offshore Tax Havens

While President Bush's opposition to price controls fueled Enron with billions of dollars in extra revenues, the administration actively blocked attempts to crack down on Enron's use of offshore subsidiaries in nations with weak bank disclosure laws. Enron's more than 2,830

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[53] U.S. Reps. Duncan Hunter and Randy "Duke" Cunningham.

[54] Rebecca Smith, "Governors Seek Caps on Prices for Electricity," *The Wall Street Journal*, Feb. 5, 2001.

[55] Mark Golden, "Electricity Prices in West Fall on FERC controls," *The Wall Street Journal*, June 25, 2001.

[56] Bracewell & Patterson 2001 Midyear "Lobbying Report," Secretary of the Senate, Office of Public Records, http://sopr.senate.gov

subsidiaries[57] played a crucial role in the company's spectacular collapse into bankruptcy, and Bush administration moves during this period may have allowed Enron to funnel billions of dollars to unregulated banks in the Cayman Islands.

First it is necessary to examine the reasons behind Enron's fall. On June 19, 2001, the Federal Energy Regulatory Commission, under enormous political pressure from Congress and California state officials, finally imposed strict, round-the-clock price controls for the entire Western electricity market. The action was long overdue, since federal and state investigators concluded that California endured billions of dollars in price-gouging by power suppliers like Enron and weathered nearly 40 days of forced power outages from the time the crisis began in May 2000. Not a single Stage 3 emergency has been declared since FERC's June 19 price controls were implemented.

FERC's regulation order had an immediate impact on Enron's ability to continue exercising market control through its unregulated power auction, EnronOnline. Enron no longer could charge whatever price it wanted for electricity traded in its auction. Because Enron's business strategy focused on an "asset-light" approach, the company had zero power plants in California. Although other companies like Dynegy operated power auctions similar to Enron, they had significant generation assets in California. So when FERC imposed price controls, Dynegy and other companies were able to control a portion of their power auction losses through sales of electricity from their own power plants. But Enron had no such option, and was therefore stuck with billions of dollars worth of contracts purchased at a time when Enron assumed it would be able to sell them at any price. Unable to sell its high-priced contracts for anywhere near what the company paid for them, and lacking an alternative source of revenue in the state, Enron's losses quickly mounted.

Indeed, Jeff Skilling — who had replaced Lay as Enron's CEO in February 2001 — abruptly stepped down in August 2001, just weeks after FERC's price controls began to wreak havoc with Enron's cash flow. One month later, on September 4, Phil Gramm announced he would not seek re-election to the Senate.

A significant portion of Enron's business strategy involved the use of subsidiaries registered in countries officially designated by the United States as tax havens with little to no bank disclosure laws. Of Enron's 2,832 subsidiaries registered in a U.S. state or foreign country, 874 — or 31 percent — are located in the Cayman Islands and other officially designated tax havens. The sheer number of offshore subsidiaries, and the dispersal of these subsidiaries throughout Enron's business operations, provides the company with tremendous incentive to funnel large sums of cash into the bank accounts of the 874 subsidiaries located in nations with

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[57]Exhibit 21 to Enron's 10-k filed with the SEC on April 2, 2001. www.sec.gov. Nations described as "tax havens" and "noncooperative" jurisdictions by the multilateral organizations the OECD and the Financial Action Task Force name 7 countries Enron lists as hosting registered subsidiaries: Aruba, Barbados, Bermuda, the British Virgin Islands, the Cayman Islands, the Turks & Caicos Isles and Mauritius. The vast majority are registered in the Caymans.

few or no bank disclosure regulations. Having access to this number of unregulated bank accounts provides Enron with potentially thousands of phantom accounts to hide money from U.S. tax officials, California energy crisis investigators or creditors during Enron's bankruptcy filing.

Enron's use of both a large number of subsidiaries and the use of such a large proportion of offshore tax haven subsidiaries is highly unusual. Dynegy, which backed out of a recent bid to acquire Enron, has 12 subsidiaries, all registered in the United States. Duke Energy has six subsidiaries, all registered in the United States. Only 6 percent of ExxonMobil's 147 subsidiaries are located in tax havens.

Appearing before the Senate Permanent Subcommittee on Investigations on July 18, 2001 (not surprisingly, Phil Gramm's banking committee declined to host the hearings), Manhattan District Attorney Robert M. Morgenthau testified that $800 billion U.S. dollars is on deposit at banks licensed the Cayman Islands — more than twice the amount on deposit at every bank in New York City, and equal to 20 percent of deposits at all U.S. banks.[58] The Cayman Islands are attractive for companies like Enron because of their lack of basic bank disclosure regulations, making it an easy safe haven to hide money from the IRS, shareholders and creditors.

In April 1998, the Organization for Economic Co-Operation and Development (OECD) released a report[59] that discussed strategies for how OECD member-nations (of which the United States is one) could deal with "harmful preferential regimes" such as the Cayman Islands. In response to this report, Clinton directed the United States to co-chair an OECD body called the Forum on Harmful Tax Practices, which the U.S. headed for two years beginning in October 1998.

Led by Clinton Treasury Secretary Lawrence Summers, the administration focused on first "naming and shaming" countries with little or no banking regulations, then working on multilateral agreements to bring nations into compliance with acceptable standards of disclosure.

The Clinton administration also was motivated to crack down on tax havens after Osama bin Laden's August 7, 1998, terrorist attack on U.S. embassies in Kenya and Tanzania. The Clinton administration knew that bin Laden used al Qaeda to funnel money, possibly through nations with lax banking regulations. Clinton's initiative culminated with the December 2000 publication of the *International Crime Threat Assessment,* which blamed nations with "weak financial regulatory systems [and] lax enforcement measures" for facilitating international crime networks like al Qaeda[60].

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[58]www.senate.gov/~gov_affairs/071801_psimorgenthau.htm

[59]"Harmful Tax Competition: An Emerging Global Issue,"www.sourceoecd.org

[60]http://clinton4.nara.gov/WH/EOP/NSC/html/documents/pub45270/pub45270index.html

Prior to the July 2000 G-7 summit, the Clinton administration negotiated a deal with six nations — including the Cayman Islands — extracting nonbinding commitments from them that they would work with the United States to improve transparency of their banking laws. In exchange for this commitment, the OECD did not include them in its June 2000 list of "pariah" nations with banking systems that encouraged criminal behavior. At the G-7 summit in July 2000, and based on a strategy coordinated with the multi-lateral Financial Action Task Force (FATF), the Clinton administration took the lead on a plan threatening strict economic sanctions on all nations identified by FATF and the OECD, including the Cayman islands, unless they cleaned up their lax banking laws by July 2001.[61]

Immediately upon taking office, the Bush administration attacked Clinton's multilateral efforts to crack down on nations operating as tax and banking havens. After less than a month on the job, Treasury Secretary Paul O'Neill told G-7 representatives on February 17, 2001, that Bush was placing Clinton's efforts at cracking down on offshore tax havens "under review." O'Neill signed an opinion article in May 2001 arguing that Clinton's efforts were "not in line with this administration's tax and economic priorities."[62] In testimony before the Senate, O'Neill stated his belief that the Bush administration would not "interfere with the internal tax policy decisions of sovereign nations," even if sovereign nations like the Caymans permit sham subsidiaries that suck shareholder value out of the United States.[63]

The Bush administration informed the OECD in the spring of 2001 that it would not support the agreement Clinton negotiated that would have imposed sanctions on nations not complying with acceptable banking disclosure laws. As a result, the OECD's effort to apply pressure has fallen apart.

In its place, the administration has pursued a strategy highly deferential to the needs of nations suspected of being tax havens. On November 27, Paul O'Neill announced that the Cayman Islands had agreed to begin cooperating with American investigators beginning in 2004, providing companies like Enron 25 months to move their assets to another tax haven and seal the records of their cheating from scrutiny. Manhattan District Attorney Robert M. Morgenthau joined a chorus of tax experts blasting the Bush administration's deal, calling it a "sham." Morgenthau noted that the Cayman Islands is free to back out on the agreement on only three months' notice, with no repercussions.[64]

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[61]William F. Wechsler, "Follow the Money," Foreign Affairs, Vol. 80, Issue 4, July 1, 2001.

[62]*The Washington Times*, May 11, 2001.

[63]www.senate.gov/~gov_affairs/071801_psioneil.htm

[64]David Cay Johnston, "Manhattan Prosecutor Criticizes Caymans Tax Pact," *The New York Times*, December 8, 2001.

Deregulation is the Reason for the Crisis

In previous reports Public Citizen has discussed in great detail what exactly caused the California crisis in the first place, along with many of the myths surrounding electricity deregulation.[65] Shareholders and consumers never would have been exposed to the price volatility and Enron's sudden corporate collapse had electricity and commodity markets continued to be well-regulated by state and federal officials. Electric utility deregulation freed Enron to charge consumers inflated prices for electricity, and commodity trading deregulation allowed Enron to conceal its financial shenanigans from shareholders.

Enron's collapse followed its strategy of largely eschewing owning power plants domestically and instead concentrating on power marketing through its operation of power auctions, where Enron could command significant market share by trading electricity and other energy commodities.

America has painfully learned what happens when deregulation is applied to an industry that provides an essential commodity with inelastic supply and demand, high capital costs and prohibitively expensive transaction costs. With some state government regulators no longer officiating wholesale electricity markets, the inherent characteristics of electricity generation lead to excessive market power concentrated in a handful of energy companies. Federal legislation deregulating the trading of electricity has escalated the problem.

California state investigators, sifting through confidential wholesale price information, have calculated that these top energy corporations overcharged California's utilities and ratepayers more than $9 billion. FERC has acknowledged (prior to Enron's collapse) that billions in refunds are to be collected from Enron and other energy corporations.[66] Now Enron will probably never pay. Immediate repeal of commodity deregulation is the only way to reintroduce transparent energy auctions that will protect consumers and shareholders.

SOLUTIONS

Since it is clear that the "energy crisis" was caused by corporate misconduct and aided by high-ranking government officials, an important step in restoring faith to the marketplace is to conduct an immediate investigation to find out what key participants in the energy crisis knew and when they knew it .

[65]"Electric Utility Deregulation and the Myths of the Energy Crisis," published in the December 2001 "Energy Controversy" issue of *Bulletin of Science, Technology & Society*, Vol. 21, No. 6. www.citizen.org/documents/MYTHS_Dec01_BofST&S.PDF

[66]Ricardo Alonso-Zaldivar, "Regulators Plan Energy Rebate Settlement," *Los Angeles Times*, July 26, 2001.

Public Citizen therefore calls upon Congress to immediately hold hearings to question Wendy Gramm and ask her to disclose the extent of her foreknowledge of Enron's alleged accounting fraud and current status of account balances at offshore tax and bank regulation havens.

Congress must ask Sen. Phil Gramm to testify under oath to answer questions about his foreknowledge of Enron's alleged fraudulent acts.

Congress must ask President Bush, Vice President Dick Cheney, Treasury Secretary Paul O'Neill, Republican National Committee chairman Marc Racicot and Bush political adviser Karl Rove to answer questions on whether Enron representatives or their agents discussed policies regarding energy and treaties with tax haven nations.

Furthermore, Congress must take action to re-establish transparent, accountable markets that will protect consumers. To achieve these objectives, Public Citizen recommends that Congress:

1. Repeal Sections 103 and 106 of the Commodity Futures Modernization Act in order to re-regulate the trading of energy futures.

2. Regulate energy futures contracts and "swaps."

3. Order FERC to revoke market-based rates and order cost-based pricing in all wholesale electricity markets.

4. Order FERC to cease all activity that threatens the ability of states to have adequate jurisdiction over their electricity markets. In order to achieve this, Congress must cease attempts at federalization of transmission, cede regulatory control to the states and, where appropriate, support efforts for multi-state, non-profit, consumer-owned transmission companies.[67]

5. Revamp antitrust laws to protect consumers by blocking continued merger activity between electricity and natural gas companies, and strengthen antitrust laws to prevent another ruling as occurred with *United States v. American Airlines*, in which the airline was charged with uncompetitive, monopolistic behavior.

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[67]Please see Public Citizen's discussion of these issues in our June 2000 publication, "The Transmission Solution: Non-profit, Consumer-owned Transmission Companies." www.citizen.org/documents/transmissionsolution.PDF