Enron

Enron had its beginnings in Nebraska State; it all started in 1930 when three small utilities formed the Northern Natural Gas Company to pipe gas north from Kansas. By 1980 the company had established a parent corporation, InterNorth, to oversee its various operations and expansions. In 1985 InterNorth merged with Houston Natural Gas and created the nation’s largest natural gas pipeline system. Within a year the head of the Houston Company, Kenneth Lay, had moved the headquarters to Houston and renamed the company Enron.

Over the years the company invested millions of dollars in lobbying federal officials and financing their political campaigns to get them to privatize and deregulate the energy industry. At first Enron sold natural gas through its own pipelines, but after the energy markets were deregulated it sold some of its hard assets and increasingly made money linking buyers and sellers of commodities. In 1989 Enron began trading natural gas commodities to help utility customers shield themselves from risk by locking up the long-term prices that they wanted ahead of time. Enron bought the gas supplies from producers, arranged for delivery and took a cut of every deal. In time, the company became the largest natural gas merchant in North America and the United Kingdom. This success in the natural gas industry soon made Enron believe it could apply these tactics of deregulation and political influence to a dizzying array of businesses from internet broadband to water, coal and steel. Jeffrey Skilling, a former energy consultant at McKinsey & Company, who joined Enron in 1990, transformed the company into the biggest and most aggressive of the new breed of unregulated energy traders that bought and sold billions of dollars of electricity and other commodities daily. But instead
of bringing prices down for buyers, these transactions had the effect of driving up prices to hundreds of times of production costs.

The Securities Act of 1933 and The Securities Exchange Act of 1934 applies to trading companies. The term “security” means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warranty or right to subscribe to or purchase, any of the foregoing. The Securities Act of 1933 was designed to prohibit various forms of fraud and to stabilize the securities industry by requiring that all relevant information concerning the issuance of securities be made available to the investing public. Essentially, the purpose of this act is to require disclosure.

The Securities Act of 1934 provides for the regulation of securities exchanges. The SEC regulates the markets in which securities are traded by maintaining a continuous disclosure system for all corporations with securities on the securities exchanges and for those companies that have assets in excess of $10 million and five hundred or more shareholders. These corporations are referred to as Section 12 companies, because they are required to register their securities under Section 12 of the 1934 act. The act regulates proxy solicitation for voting and allows the SEC to engage in market surveillance to regulate undesirable market practices such as fraud, market manipulation, and misrepresentation.
There is also an act named, Public Utility Holding Company Act of 1935, which I believe also applies to Enron. The Public Utility Holding Company Act of 1935 applies to interstate holding companies engaged, through subsidiaries; in the electric utility business or in the retail distribution of natural or manufactured gases are subject to regulation under this Act. These companies, unless specifically exempted, are required to submit reports providing detailed information concerning the organization, financial structure, and operations of the holding company and its subsidiaries. Holding companies are subject to SEC regulations on matters such as structure of their utility systems, transactions among companies that are part of the holding company utility system, acquisitions, business combinations, the issue and sale of securities, and financing transactions.

State securities laws are commonly known as Blue Sky Laws, which also apply to trading companies. Typical provisions include prohibition against fraud in the sale of securities, registration requirements for brokers and dealers, registration requirements for securities to be sold within the state, and sanctions and civil liability. A majority of states, with the exception of New York and California, have adopted the Uniform Securities Act, at least in part.

Enron publicly traded equity and debt securities between October 19, 1998 and November 27, 2001. This is why I believe Trust Indenture Act of 1939 also applies to Enron. This Act applies to debt securities such as bonds, debentures, and notes that are offered for public sale. Even though such securities may be registered under the Securities Act, they may not be offered for sale to the public unless a formal agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act.

Enron established partnerships called LJM, which were used to hide bad investments and losses. Enron was able to avoid losses even after certain assets declining in value after the sale. In keeping assets and liabilities off their balance sheet, it is believed
Enron reported earnings from the third quarter of 2000 through third quarter of 2001 that were almost $1 billion higher than it should have been. By doing this the value of Enron’s stocks increased a lot and as a result of this many of the executives of Enron made millions of dollars.

Enron is facing a lot of lawsuits, Enron’s officers and directors and its auditors are accused with violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Enron is claimed to have engaged in massive insider trading while issuing false financial statements and making false and misleading statements about the Company’s purportedly “record” results and strong operating performance. As a result of these false statements, the Company’s stock traded as high as $90.75, allowing Enron executives to sell 17.3 million of their own Enron shares for proceeds of $1.1 billion. Enron is accused to have violated the Sections 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated there under, by issuing a series of material misrepresentations to the market between January 18, 2000 and October 17, 2001, thereby artificially inflating the price of Enron common stock. The Section 10(b) is one of the most important sections of the Securities Exchange Act of 1934. This section proscribes the use of any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the SEC may prescribe. Among the rules that the SEC has promulgated pursuant to the 1934 act is SEC Rule 10b-5, which prohibits the commission of fraud in connection with the purchase or sale of any security. Insider trading is one the most important purposes of Section 10(b) and SEC Rule 10b-5. Insider trading occurs when a party to a securities transaction uses material nonpublic information in connection with a securities trade. The Insider Trading Sanctions Act of 1984 permits the SEC to bring in a federal district court against anyone violating or aiding in a violation of the 1934 act or SEC rules by purchasing or selling a security while in
the possession of material nonpublic information. The court may assess as a penalty as much as triple the profits gained or the loss avoided by the guilty party.

Enron did not disclose any information of its LJM partnerships, which had a large potential impact on their financial statements. If Enron had disclosed the partnerships, or not reported cash infusion as revenue and mentioned losses transferred to the partnerships, then it would have more accurate financial statements, even though, the stocks might not have been as highly valued. This would probably have prevented Enron’s credit rating to collapse, and Enron would still be in business today.
Sources

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