Review

Pipe Dreams: Greed, Ego, and the Death of Enron. *By Robert Bryce, with a foreword by Molly Ivins. New York: Public Affairs, 2002. Cloth, $27.50; paper, $19.98. 320 pages.*

Randall Dodd

When Enron exploded, it threw light on numerous new forms of fraud, manipulation, corruption, and the looting of shareholder wealth. At the time, I saw all this as a silver lining on a dark period of American business history that might focus public attention on the many inadequacies in the way the United States regulates its financial markets. To some extent, it did draw attention to false corporate reports and excessive executive compensation. However, other issues were never adequately covered in the media and were soon forgotten. Despite the fact that Enron's success was due largely to its ability to create new derivatives markets with itself in the middle as the dealer or as a trading platform, I found myself having to answer journalists' questions about what derivatives had to do with it.

"Everything," was my short answer, and I followed up with a report that estimated the notional value of Enron's derivatives book at $774 billion—only six U.S. banks had larger amounts of outstanding derivatives than the energy company. I knew it was not a complete answer, but I also know that a complete answer was too long for most media outlets. In the aftermath of the Enron bankruptcy, whose value exceeded that of all prior failures in U.S. history, the debris left a puzzling set of questions about why it happened. If Ken Lay had the wit—and candor—of Yogi Berra, he could have said as Yogi did after losing the 1960 World Series, "We made too many wrong mistakes."

Now there is a book that takes the time to tell the whole story. In his book *Pipe Dreams*, the story of the rocket-like rise and meteoric fall of Enron, Robert Bryce hits all the critical points with indignant hooks and well-thrown upper cuts. Bryce takes each piece of the big puzzle, analyzes it, and then explains it in a package of human interest that includes character stories about the villains, fools, and victims. It is an exciting piece of economic reading.

RANDALL DODD *is director of the Financial Policy Forum.*

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The book is ultimately a tale about a business enterprise. Bryce explains the birth of the firm in operating pipelines to transport oil and later gas. He provides a background on the history of pipeline development and expansion. I was surprised to read that early pipelines were constructed of hollow pine logs and that a great boost in pipeline development came about during World War II as the Roosevelt administration sought to ship oil and refined products overland, and out of the range of German submarines, through the Big Inch and Little Inch pipelines from Texas to the East Coast. These twenty-four- and twenty-inch pipelines are now used to carry gas for the Duke Energy Corporation.

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Just as Enron expanded out of the mere transportation of energy and into oil and gas exploration, Bryce expands the narrative to include a brief history of the oil and gas business in Texas. This naturally includes the firm of Baker and Botts and its connections to the Hoover administration, and Brown and Root and its connection to Lyndon Johnson. Brown was also a friend of Judge James Elkins, who was the founder of Vinson and Elkins—Enron's law firm. It is a cast of characters fit for a Hollywood epic.

When Enron's business dealing went international, Bryce used the character of Enron executive Rebecca Mark to take the narrative on a high-flying, high-hemline account of ambitious energy and water projects around the world. The extravagant use of corporate jets by Enron executives turns out to be story in itself. The stable of top-line luxury planes was used to ferry executives not only to and from meetings, but also to vacation mansions, international shopping sprees, and even across-town flights from Bush International to Hobby Airport (Houston is big). Lay used the best of the fleet to fly his daughter home from France, a round trip for the plane and crew to carry one passenger one way, at an estimated cost of $125,000.

Enron expands into yet additional ventures, and *Pipe Dreams* follows apace. Energy trading becomes the next best thing. Here Bryce again provides useful background on derivatives, accounting, and mark-to-market methods. The history starts with the development of double-entry bookkeeping by Luca Pacioli, a Franciscan friar, who published a book on the subject in Italy in 1494. Bryce then explains how mark-to-market accounting methods, which allow a firm to report the present value of their portfolio of derivatives trades as earnings, becomes the cornerstone of Enron's fraudulent reporting and ultimate undoing.

In doing so, he identifies several public-interest concerns. The first is that the firm is reporting earnings that, unlike those from cash flows, have not yet materialized and might never actually be realized. Another problem with mark-to-market methods is that the calculation of present values allows for both errors and manipulations. Whereas reporting the current market value of an exchange-traded security or derivative involves the straightforward reporting of the market price, the present value of an over-the-counter (OTC) derivative position relies largely on the reporting firm's own calculations. As a result, Enron could report earnings of $1 million on a trade that might be more soberly valued at $100,000 or even $10,000. The difference might be legally justified due to different views about interest rates, volatility, and the forward price curve of the commodity or asset.

He details how Enron duped Wall Street analysts and how conflicts of interest made some willing to be duped.

Here I found my only significant disappointment with the book. Perhaps my view is biased by my own fascination with derivatives and the fact that Bryce interviewed me in the process of writing the book. Yet I cannot help thinking that the author could have made more time and space to describe derivatives and special purpose entities (also called special purpose vehicles) and explain all the ways they were misused by Enron. Derivatives are financial contracts such as forwards, futures, options, swaps, and structured securities; they are used to hedge or speculate on the change in price of a commodity or asset. Special purpose entities are essentially shell corporations, usually set up in tax-haven countries like the Cayman Islands, that are used to issue debt or securities that are "structured" by the inclusion of derivatives.

The same is true for issue of marking-to-market derivatives position. For example, he could have taken the analysis of mark-to-market a step further. If a derivatives dealer enters a forward derivative to buy 5 million units (1,000 cubic feet) of gas at a future date for $5 million and then enters another, identical contract to sell at $6 million, then the dealer has locked in a $1 million profit. The profit is certain as long as the counterparties do not default on their contracts, and this risk can be substantially reduced through adequate collateralization. Why should the present value of this profit not be reported as current earnings? If it is valid to report such earnings, then the public interest concern is not to abolish mark-to-market methods but, rather, to establish measures to ensure their integrity and the transparent reporting of the results.

Leaving behind the above point, *Pipe Dreams* provides an excellent account of the fall of Enron. The book's opening chapters are subtitled with dates that time-stamp each period in Enron's ascendance. Then, beginning with chapter 26, the time-stamps are joined by the closing price of Enron's stock, and the successive chapters chronicle the firm's demise and the reflection in its stock price. In doing so, Bryce addresses the failed effort to create a central derivatives market in bandwidth, the extravagant pay to top executives in cash, stock options, and benefits, and the further looting of the firm by executives through their participation in special-purpose entities. He details how Enron duped Wall Street analysts and how conflicts of interest made some willing to be duped. Also included are accounts of how Enron benefited from efforts by the current Bush administration to pressure foreign governments to accommodate Enron's overseas investment plans and how it benefited from corporate welfare through the federal government's Export-Import Bank and Overseas Private Investment Corporation.

One anecdote that I especially enjoyed was the story of Enron's creating, through Rice University, the "James A. Baker III Institute for Public Policy Enron Prize for Distinguished Public Service." The prize was given to such dignitaries as Colin Powell back in 1995, but on November 13, 2001—about four weeks after it was disclosed that Enron overreported earnings by $600 million and four weeks before it declared bankruptcy—the prize was given by Ken Lay to Federal Reserve Board chair Alan Greenspan.

Bryce does an exacting job in his portrayal of the roles played by Enron executives Ken Lay, Jeff Skilling, Andy Fastow, Rebecca Mark, Lou Pai, and others. It yields great tragic narratives of brilliance and cunning giving way to arrogance, hubris, and debauchery. The portrayal of these persons helps explain the corruption and the conflicts of interest. It helps tell of Enron's political influence through President George W. Bush, Senator Phil Gramm (R-TX), and his wife, Wendy Gramm. Senator Gramm supported derivatives deregulation in the Senate, while his wife supported derivatives deregulation as chair of the U.S. Commodity Futures Trading Commission and later served on the Enron Board of Directors and its audit committee.

Overall, *Pipe Dreams* is the best book I have seen on Enron and its failure. There is a spot or two where I would want to read a more thorough analysis, but that shortcoming can probably best be attributed to my quirks and the book's need to appeal to a less quirky audience. In any case, it does not spoil the overall work. In short, it is a great read because it is well written. Its economical writing style and cascading series of misdeeds will keep you as engaged as an Elmore Leonard yarn.