

Enron's online after-effects

Recent highly visible events in the US, including the Enron failure, the California electricity crisis and market power rulings by the government have all created considerable tumult and uncertainty, which are bound to have repercussions

The EnronOnline screens went black in early November. The ensuing collapse of Enron Corp has been prominent in the news ever since. Enron has seemingly become a vortex for many of the most compelling and complex business issues, including governance, disclosure, auditing and compensation. Regulators from markets around the globe have put the company under the microscope, while the US Congress and Department of Justice close in for the kill.

Our primary interest here is the impact on the online markets and energy trading in general. The downfall of the Houston energy giant threatens to affect deregulation, energy exchanges, traders and power marketers. The multi-faceted case will certainly be the catalyst for heightened levels of scrutiny and possibly new regulation. But has it sounded a death knell for online trading?

The market may be down, but it is certainly not out. In fact, some may argue it remains fairly healthy. The value of online trading is still clear to traders and marketers, and the relevant figures are demonstrating how remarkably fluid this market-place can be.

Following the demise of Enron's online trading platform, EnronOnline, competing online energy exchanges have been working overtime to accommodate new customers and significant increases

in demand. IntercontinentalExchange (Ice), Tradespark, and DynegyDirect have all seen an uptick in energy trading since EnronOnline closed. On January 9 this year, Ice traded a notional volume of \$4.3 billion, matching the highest daily EnronOnline volumes – and that was in a month where natural gas prices were down considerably (see figures 1 and 2).

And there has also been a significant benefit for the industry in general. Having witnessed the apparently indomitable Enron fail, energy companies are acknowledging the wisdom of spreading their deals.

Shifting volumes

Nonetheless, Ice has arguably been the biggest beneficiary. As one of the world's most liquid and fastest growing commodity market-places, it reported 2001 growth increases in the number both of participating firms and users by more than 400%. Equally impressively, the volume of trades executed on the exchange during the first quarter of 2002 grew nearly 10-fold over the previous year, with notional value growing fivefold.

The rapid growth was exemplified by a new daily record for natural gas trading of 500 billion cubic feet set on December 27, breaking the previous record set on December 4, 2001 by 18%. Average daily activity was up 30% in mid-January over the previous month.

And in February UBS Warburg (UBSW) bought EnronOnline's assets and began its operation of the exchange as UBS Warburg Energy (see *EPRM* March 2002, page 10). The investment bank didn't pay anything upfront for the unit, but will share a third of the future profits with Enron. UBSW retained many EnronOnline employees, including former Enron president and chief operating officer, Greg Whalley.

But ramping-up has been slow so far as the reborn exchange seeks to attract its former participants while touting more conservative trading

Figure 1: US gas prices, winter 2000–2002



US natural gas prices this winter season were less volatile than last season. High price points peaked just over \$3 per million British thermal units (mmBtu) in comparison to above \$10/mmBtu last year

Figure 2: Ercot* electricity spot price, 2000–2002



Electricity prices in the Texas region have fallen this season. The previous season's peaks were in the \$90-per-megawatt-hour (MWh) range, while this season's have peaked in the \$30/MWh range

guidelines. No figures indicating the volume of activity have been made available as yet.

Traders report they are utilising a wider variety of trading systems and sending many more instant messages to complete trades. Some feel liquidity has diminished considerably. EnronOnline had been a ready market-maker, acting as either the buyer or seller in every trade it executed. Now, traders are finding it more difficult to find counterparties for long-term and exotic transactions.

Price and regulatory impact

Trying to compare the spot markets for the winter season of 2001/2002 to the year before is difficult in the absence of EnronOnline. The winter of 2001/2002 has registered as the fifth warmest in the US in 107 years, according to the National Oceanic Atmospheric Association. With the 2000/2001 market crisis and demand substantially lower for natural gas and electricity this season, drawing conclusions would be misleading. But what we can deduce is that the loss of this powerful exchange has not caused any extreme upward price pressure.

In the US – the primary EnronOnline market – both natural gas and electricity price trends are substantially below those of last season (see figures 1 and 2). In addition, the corresponding New York Mercantile Exchange (Nymex) futures markets in these commodities show that trading activity is up, although open interest has been lower (see figures 3 and 4). Increased futures market activity can be correlated both to fewer opportunities to transact in the spot market and to defensive hedging to improve balance sheets.

US capacity growth in both natural gas and electricity is expected to drive prices even lower for the next couple of years, again relieving any pressure that may be caused by the unsettled nature of the online markets.

Also having a major effect on the market is the Federal Energy Regulatory Commission (Ferc), the US interstate energy regulator. The commission is probing whether Enron manipulated electricity and natural gas markets in western states, particularly California. Ferc informed Enron on February 15 that it was investigating whether the company “exercised undue influence” over wholesale electricity prices in the western US that resulted in “unjust and unreasonable rates” in long-term power contracts. The door has been opened wide for increasing scrutiny of the energy markets.

Legislation set for debate in the US Senate could repeal a Congressional exemption that allows trading of electricity, natural gas, oil, gasoline and other energy commodities without disclosure of information on those deals to federal regulators.

Industry sources are concerned that data on derivatives trades is hard to come by, allowing firms to manipulate prices for their own benefit. Some argue that lack of oversight has made the markets more opaque than transparent, and trading regulator the Commodity Futures Trading Commission may welcome an opportunity to increase its scope.

Longer term

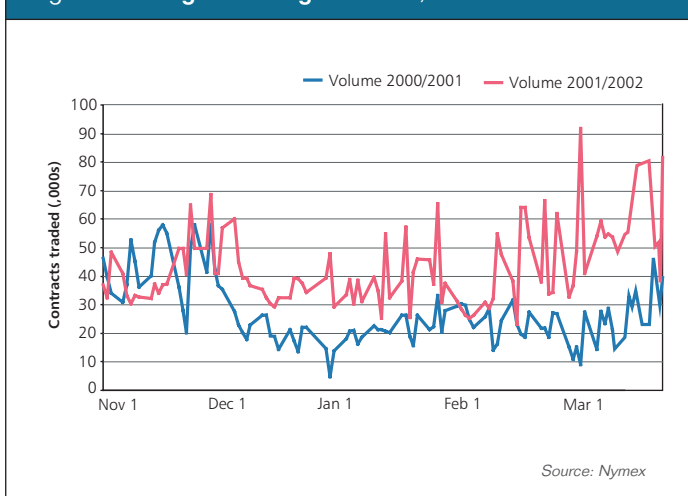
Following September 11 and the Enron meltdown, energy traders are taking fewer chances and returning to conservative business practices. They now want to transact on established platforms with indisputable financial standing. Moreover, energy firms are hesitant to throw their full weight behind the online trading platforms. With many companies being squeezed by analysts and ratings, further sizeable investment in the near future is doubtful.

Analysts have predicted extensive growth in the online energy trading markets. Technology research firm Forrester Research has forecast that almost half of energy trading will be conducted online by the year 2005 and online energy trading will exceed \$3.6 trillion annually by 2005. But do the participants still have such faith?

On the whole, the resounding answer seems to be yes. While a more cautious approach may be taking hold, these companies readily acknowledge that the benefits still outweigh the risks. Other related markets – such as emissions and weather – may take longer gaining traction, but could actually benefit from increased market-place stability. **EPRM**

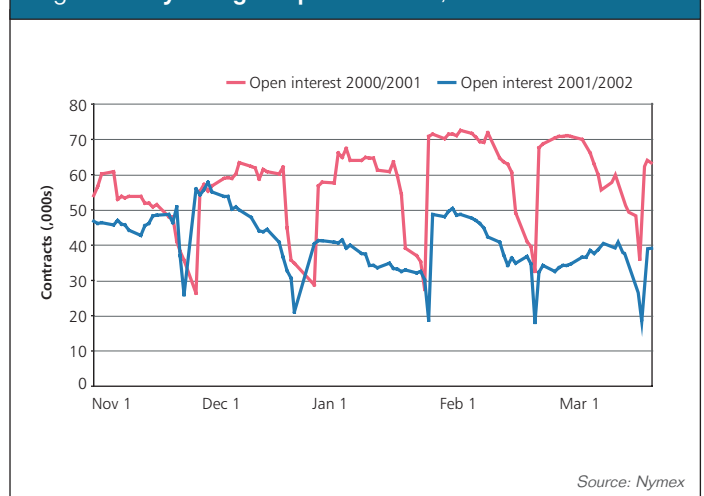
Eric Fishhaut is vice-president, technology strategy at energy market information specialist GlobalView Software in Chicago, Illinois
e-mail: eric.fishhaut@gvsi.com

Figure 3: US gas trading volumes, 2000–2002



The trading volume for this year's New York Mercantile Exchange (Nymex) winter season front-month natural gas future shows growth compared to the previous year

Figure 4: Nymex gas open interest, 2000–2002



The open interest for this year's New York Mercantile Exchange (Nymex) winter season front-month natural gas future shows decline as compared to the previous year