As Enron's Derivatives Trading Comes Into Focus, Gap in Oversight Is Spotlighted

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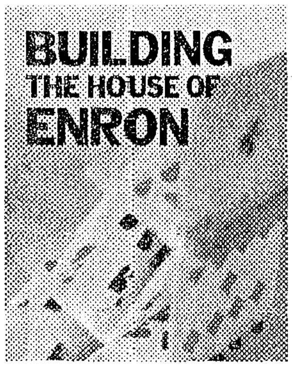
WASHINGTON—As the significant role that derivatives played in **Enron** Corp.'s downfall comes into focus, lawmakers and regulators are lining up in favor of more oversight of these risky investments.



Enron assembled a complex structure of partnership deals. In the end, it came toppling down. See an interactive graphic at WSJ.com.

While the Houston-based company's core energy operations involved natural-gas and electricity transmission, its largest and most-profitable business was trading derivatives—unregulated financial instruments that derive their value from an underlying commodity or wager on the future. Now, information is surfacing that Enron's derivatives trading may have been used to mask weakness in the company's other businesses such as fiber-optic bandwidth, retail gas and power, and water systems.

"Enron was more of a hedge fund than an energy company," said Rep. Richard Baker (R., La.), chairman of a Financial Services Committee panel that is looking into the derivatives issue, in an interview.

After listening to testimony at his committee's Enron hearing last week, Senate Governmental Affairs Chairman Joseph Lieberman said he would hold a hearing specifically on the need for derivatives regulation. The Connecticut Democrat was responding in part to the testimony of San Diego University law professor Frank Partnoy, who outlined a series of methods that he said Enron used "to create false profit and loss entries for the derivatives Enron traded."

To ensure that Enron met Wall Street quarterly earnings estimates, it used derivatives and off-balance-sheet partnerships, or so-called special-purpose vehicles, to hide losses on technology stocks and debts incurred to finance unprofitable businesses, Mr. Partnoy said. In addition, he said, "it appears that some Enron employees used dummy accounts and rigged valuation methodologies." The entries, he said, "were systematic and occurred over several years, beginning as early as 1997."

Based on independent research and conversations with Enron traders, Mr. Partnoy said he learned that some traders apparently hid losses and understated profits, which had the effect of making derivatives trading appear less volatile than it was. Randall Dodd, director of the Derivatives Study Center, an independent, nonpartisan Washington group, said in an interview that he has reached similar conclusions. Mr. Dodd is advising three government agencies and three congressional committees investigating Enron.

Declining to address specific allegations, Enron spokesman Vance Meyer said in a statement, "Derivatives were not our business. They complemented our core business of buying and selling natural gas and power." Mr. Meyer also said: "I think it's safe to say that we are not going to agree with every view about Enron presented in the congressional hearings, but we do respect the process and hope, when all is said and done, that something positive will come out of it."

In 1989, the energy company, originally a utility that produced and transported natural gas and electricity, had begun shifting its focus to energy trading. The derivatives included not only Enron's very profitable trading operations in natural-gas de-

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