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Enron's Actions Before News Event May Have Had Multimillion Payoff

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Government officials are probing whether **Enron** Corp. engaged in what might be a form of insider trading involving its own stock that enabled the company to pocket a gain of as much as $100 million, a person familiar with the matter said.

Under investigation is a transaction involving Enron stock by one of its off-balance-sheet partnerships. It occurred shortly before Enron released earnings on Jan. 20, 2000, that were accompanied by bullish projections about its broadband-capacity trading business that sent the company's stock up nearly 26% in a single day, to $67.38 from $53.50.

That day, Enron staged an event for securities analysts at which Scott McNealy, chief executive of **Sun Microsystems** Inc., made a surprise appearance. Mr. McNealy joined Enron president Jeffrey Skilling and announced that Sun would sell 18,000 computer servers to Enron, showing that both firms expected explosive growth in the broadband business.

One analyst, who attended that meeting in Houston, said excited analysts "literally ran for the hallways" to place cellphone calls about the arrangement, which came at the height of the technology boom. Mr. McNealy's appearance was accompanied by Mr. Skilling's projections that the value of contracts for access to Enron's national fiber-optic network would exceed $5 billion by 2004, up from about $160 million in 2000.

A Sun spokeswoman says Enron cooled quickly—and, it seemed, oddly—on the deal that had generated such excitement. "It started like a jitterbug and ended like a slow waltz," said Dottie Wanat, Sun spokeswoman in Palo Alto, Calif. Enron bought "only a few" servers as it turned out, she said, and within six months the deal effectively was dead.

The off-balance-sheet partnership of Enron that is the subject of the government inquiry didn't buy shares in the company, but instead removed a "hedge" designed to protect the partnership from swings in Enron stock just before the news announcement, the person familiar with the inquiry explained.

Hedges, which come in a number of forms, generally have the effect of protecting against a sharp decline in a stock's price but, in doing so, also can limit potential gains if a stock rises sharply. Investigators are trying to determine whether the Enron partnership removed the hedge on Enron shares on the expectation that the shares likely would rise, eliminating the need to keep the hedge protection in place.

Though details about the move—including which of the many Enron partnerships was involved—couldn't be determined, the transaction resulted in a gain of between $80 million and $100 million, the person added. It is unclear whether the hedge was put back on the Enron shares held by the partnership following the announcement.

While the timing of the hedging transaction by the Enron partnership raises questions, it isn't clear whether it would violate insider-trading laws, which are designed to prohibit individuals, as well as companies, from benefiting from the use of potentially market-moving information before it is released to other investors.

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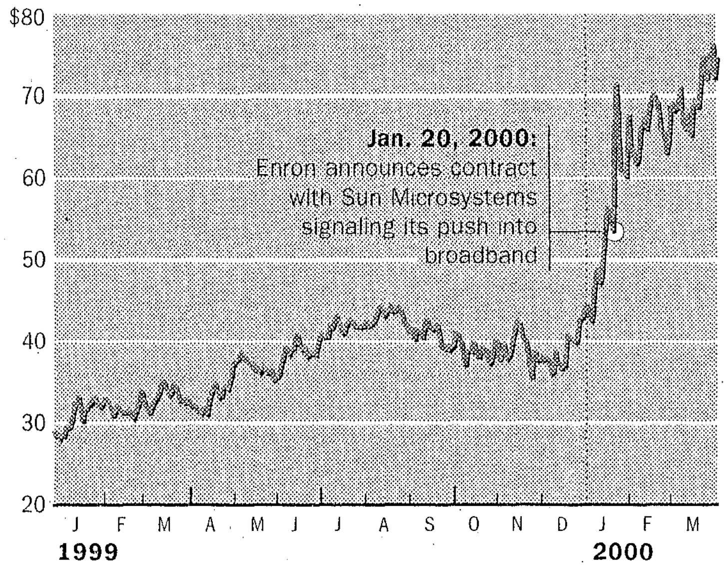
A Moment in the Sun for Insiders?

Prior to announcing a contract with Sun Microsystems, Enron may have deactivated a 'hedge' that would have capped its gains and losses on its stock. Below, daily close of Enron shares before and after the announcement.



Source: Thomson Financial/Datastream for chart data