Business

Dynegy to settle trading charges

SEC: Gas deal misled investors about activities

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Dynegy Inc., the parent company of Illinois Power Co., said it would pay $3 million to settle charges that it had improperly accounted for a complex $300 million natural gas transaction and had issued misleading statements about its **energy** trading activities, federal regulators said Tuesday.

The Securities and Exchange Commission said Dynegy overstated its **energy** trading activity by engaging in round-trip, or wash, trades with CMS **Energy** Corp. of Dearborn, Mich. Round-trip trades are simultaneous, pre-arranged trades of **energy** with the same party, at the same price and volume. They create neither a profit nor a loss, but the trades can influence the market by helping bid up prices.

They also can allow firms involved in the trade to appear to have greater trading volumes.

"This is the first enforcement action resulting from an **energy** trading company's use of so-called round-trip trades," said SEC lawyer Harold Degenhardt. "Dynegy misled investors about the level of its **energy** trading activity by failing to disclose that the company's publicly released numbers included results inflated by such sham trades."

Dynegy admitted no wrongdoing in agreeing to the settlement. In a statement, Dynegy officials said that the company's independent auditor, PricewaterhouseCoopers LLP, is conducting a three-year reaudit, and that the company intends to amend its annual reports for 1999 through 2001 to reflect restatements related to a financing transaction known as Project Alpha.

Dynegy also said it would file amended quarterly reports for 2002, following the audit review of those interim reports.

Shares in Dynegy closed at $1.20 Tuesday, up 3 cents on the New York Stock Exchange.

Robert McCullough, managing partner of **Portland**, Ore.-based McCullough Research, said such trades have broader implications.

"Once you've lied to someone about the quantity of the trade, there's nothing to stop someone from lying about the price of the trade," McCullough noted. "The good news is that one body of the federal government has investigated the quantity, but we've yet to get a report on the price issue.

"The price has an impact on what the consumers see on their bills. The existence of these sham trades effectively gave traders an ability to manipulate prices."

With respect to Project Alpha, the SEC said that the project was conceived to reduce the gap between Dynegy's net income and its operating cash flow. The gap had been widening as Dynegy recognized unrealized gains and losses as required by mark-to-market accounting.

The unrealized gains had an impact on net income, but added no cash flow.

In April 2001, Dynegy developed Project Alpha to boost its operating cash flow by $300 million, or 37 percent, thus reducing the gap between its net income and cash flow, the SEC said. The deal also gave Dynegy a $79 million tax benefit.

"Dynegy defrauded the investing public by failing to disclose [in its 10-K] the true financing, as opposed to operating, nature of the $300 million," the SEC said. "In reality, the $300 million was a loan masquerading as operating cash flow on Dynegy's 2001 statement of cash flows."

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