

**ASLEEP AT THE SWITCH: FERC'S OVERSIGHT  
OF ENRON CORPORATION—VOL. I**

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**HEARING**

BEFORE THE

COMMITTEE ON  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

—  
NOVEMBER 12, 2002  
—

Printed for the use of the Committee on Governmental Affairs



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**TUESDAY, NOVEMBER 12, 2002**

U.S. SENATE,  
COMMITTEE ON GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The Committee met, pursuant to notice, at 10:08 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Joseph I. Lieberman, Chairman of the Committee, presiding.

Present: Senators Lieberman, Levin, Thompson, and Collins.

### **OPENING STATEMENT OF CHAIRMAN LIEBERMAN**

Chairman LIEBERMAN. Good morning and welcome. Today, we continue a series of Senate Governmental Affairs Committee hearings on what Federal and private sector watchdogs did and did not do to expose and prevent the unethical and illegal behavior of the Enron Corporation in the months and years leading to the company's collapse.

Our goal from the beginning of this investigation last January has been to determine whether Federal agencies and others responsible for safeguarding our markets did all they could to prevent this economic catastrophe so that we can now act to prevent another such catastrophe from ever occurring again.

Today, we are going to focus on the role of an agency that had direct regulatory responsibility over Enron's energy business and that is the Federal Energy Regulatory Commission, known as FERC. The Majority staff of this Committee has completed an exhaustive investigation into FERC's role, and in my judgment, what they found is an embarrassing and unacceptable failure of the Federal Government to protect millions of consumers, stockholders, and workers. Again and again, FERC failed to ask critical questions about Enron's business practices. In the few cases when they did ask pertinent questions, the people at FERC settled for incomplete or incorrect answers.

The Committee's investigation has found the most egregious examples of lax FERC oversight in four areas: One, the company's treatment of certain wind farms and the special rate status for them, which Enron obtained and preserved; two, the operation of Enron Online, which was Enron's electronic trading platform, which it now appears Enron leveraged unfairly to its advantage against customers in the marketplace; three, the handling of transactions between Enron and its affiliated companies; and four, Enron's actions during the West Coast energy crisis last year,

which raised electricity prices in California, Oregon, Washington, and other States by literally billions of dollars.

In these four cases, FERC's oversight ranged from naive, at best, to negligent, at worst, and they lead me to offer the following five observations.

First, the agency more often than not trusted Enron's assertions rather than questioning them. Indeed, in some cases, FERC failed to pursue questions even after Enron had presented specific evidence of potential abuses in documents Enron submitted directly to the agency. For example, when Enron applied to FERC for special permission to charge customers higher energy rates through a number of wind farms that it had acquired, and it in its application included many details that constituted red flags, or should have, at FERC, the agency failed to subject that application to anything but a superficial review.

Under the special rate arrangement, Enron itself was not permitted to own wind farms, but in its application, Enron told FERC that it was providing the financing to the new owner of the projects, that Enron would retain a right to repurchase the projects, and that Enron would indemnify the new owner for tax liabilities incurred when it was repurchased. In other words, FERC was told many things that should have made Enron's contention that it did not own the wind farms highly suspect.

Yet, despite seeing all this information which was included in Enron's application, FERC approved the ownership arrangement and the special rate status was granted to Enron, and that meant that Enron was able to charge customers higher energy rates than they were allowed to otherwise under law.

Then, when Enron sought to have the special rate status extended, it submitted a self-recertification, which, like all such self-certifications that FERC receives, was never looked at or reviewed. The folks at FERC simply filed the application away and allowed Enron thereby to claim the special status for an additional period of time. Only after this Committee's investigation raised questions about FERC's handlings of these transactions did FERC open an investigation into Enron's original claims.

Congress obviously did not create and empower and fund the Federal Energy Regulatory Commission so that it could be a filing cabinet. We created it to protect consumers, to ensure just and reasonable energy rates, and to level the playing field for all businesses and utilities. Those purposes are, of course, more crucial than ever in the newly deregulated energy markets.

Second, the agency failed to anticipate or prepare for changes occurring in the energy markets, which are among the most volatile and rapidly evolving sectors of our economy. Americans depend on our regulatory agencies to keep the economy fair and efficient, to anticipate major developments, and to stay on top of where those markets they monitor are headed.

Despite the fact that Enron Online and other electronic trading platforms had grown into a powerful force by the year 2000 and were expected to dominate energy trading, FERC failed to even complete a basic study of whether regulating those platforms was its job or the job of another governmental agency, in this case, probably the Commodity Futures Trading Commission. Without

even that critical step completed, FERC and the rest of the Federal Government could not begin to develop any long-term public policy strategy about how to keep these emerging market tools fair and efficient.

Third, FERC reacted belatedly to many serious offenses, letting possible market abuses go uncorrected and unchallenged for many months. Too often, in place of effective oversight, the agency offered timid hindsight. For instance, in November 2000, a FERC staff investigation into the causes of the California energy crisis concluded that power sellers had the potential to manipulate the power market. I'm tempted to add to my prepared statement what my teenage daughter would say here, duh, right?

After coming to that obvious conclusion, which cried out for immediate follow-up, FERC took over a year to launch an investigation into the market behavior of individual companies during the California energy crisis, and that was only after Enron actually collapsed in early December of last year. Energy consumers on the West Coast should have had the Federal Government on their side during the energy crisis in 2000, not 6 months or a year later.

And the companies who may have tried to manipulate the market, or, in fact, any who may be thinking about doing it in the future, need to understand that FERC will be a sophisticated and sharp watchdog, not a listless and lackadaisical bystander.

Of course, this is made all the more clear and compelling by the recent plea of guilty by the head of trading for the Western markets for Enron in regard to—and we'll get into this in further detail—in regard to manipulation of the markets that he, as a significant employee of Enron's, was involved in.

Remember, FERC is the regulatory agency that led the movement toward widespread deregulation of the energy business. Of course, there was plenty of support for the deregulation in the private sector. But FERC was a supporter, and, therefore, it makes it particularly ironic, and I would say irresponsible, that FERC exhibited little or no vigilance to ensure that participants obeyed at least minimal rules of fair play in the deregulated marketplace.

FERC often seemed to view itself not as a regulator but as a facilitator, not as a market cop but as a market cheerleader, and that left consumers with nothing to cheer about.

When market players are given unprecedented latitude in a previously regulated market, there must be some effective checks and balances. No matter how passionately we believe in competition and capitalism as the best system for economic growth and opportunity, the invisible hand cannot do it all. We have seen this over our history, over and over again. The fact is that markets inherently have no conscience. To ensure the integrity of our markets, the invisible hand needs to be assisted by the fair hand of government oversight in the public interest and private sector self-regulation.

Fourth, FERC made no effort to address the gaps, flaws, and inadequacies in the regulatory structure that allowed Enron's most questionable business practices to go without scrutiny. For example, Enron had applied to the SEC requesting a special exception to the Public Utility Holding Company Act. Under FERC's rules, simply requesting such an exception allowed Enron to repurchase

a number of its wind farms while retaining that special rate status I referred to earlier, and apparently allowed it to earn tens of millions of dollars above what it would otherwise have earned from those projects.

For more than 2½ years, the SEC sat on the application without reviewing it. Did anyone at FERC pick up the phone and ask the SEC about the status of those applications? Did these two lead regulatory agencies, FERC and the SEC, ever talk to each other about these applications? To the best of our staff's ability to find an answer to those questions, the answer is a disquieting one, which is no.

It's frustrating enough when major market abuses escape government regulation because perpetrators are crafty enough to fly under the government's radar, but it is really infuriating when clear signals are right there on the screen and the people manning the stations do not see them or keep their eyes closed. FERC and the SEC had the opportunity, indeed the responsibility, to close that regulatory gap and did not.

Fifth, FERC all too often relied on shortcuts and cursory analysis of the markets to come to overly optimistic conclusions about the potential effects of market manipulation. An internal FERC staff report into the Enron Online trading platform which was released in August 2001 asked whether the possibility of financial problems at Enron could threaten the energy markets. That was August 2001. Its answer, no, was based on what, by hindsight, certainly looks like incomplete and unrealistic assessments.

First, FERC looked at the entire North American energy market rather than the individual regional markets, including, of course, most notably, the Western markets. And second, the report concluded that the chance of Enron failing financially was, in any event, remote. And though the same report recognized the competitive advantage Enron Online gave to Enron's own trading units, it ultimately concluded that these advantages presented no cause for concern. In fact, to their credit, FERC's staff itself later found that conclusion to be wrong.

So FERC's analysis here is really stunning, because Enron was a major player in our energy markets. By the time of its collapse, Enron had grown to become the seventh largest company in the Nation and the largest electricity and natural gas trading company, and that brings me finally to the larger policy question that is raised by the Enron scandal and by the staff investigation that will be presented this morning.

Can deregulated markets be left alone to police themselves, or does government need to be vigilant in monitoring behavior in those markets? And when we use "deregulation" here, it may be a confusing term. What happened when we so-called deregulated the energy markets is that we went from a system where FERC, for instance, was setting the wholesale prices of energy to a system where we allowed the market, and presumably competition, to do that. But isn't there still a need for a cop on the beat to make sure that those who are participating in the market competition are playing fairly and that there really is competition and transparency and honesty that will result in the best prices for consumers?

For me, the results of this investigation answers that question. Government must vigorously and energetically enforce the law to protect consumers and investors from abuse, particularly when markets, as the term is meant here, are deregulated.

Remember, it was James Madison who said that if men were angels—I should update that and say, if people were angels—no government would be necessary. Unfortunately, we see once again in this sad story that people are not always angels and that is why we continue to need government to protect the integrity of our markets and our economy.

Obviously, the American economy cannot function without energy, and our Federal regulators on whom the people depend for protection cannot protect those markets if they systematically fail to exercise the powers that we give them.

I hope that today's hearing helps to expose and correct the shortcomings in FERC's administration that we see here in this case so that American families and businesses can get the fair, transparent, and efficient energy markets they need and deserve.

Senator Thompson, it is good to be back with you. I don't know how to say it, but I am going to miss you. Not only are you going on to new roles in life, I will be going on to a new role in this Committee. But it is a pleasure to have you working with us today, together, as we have, whether each of us was Chair or Ranking Member, in pursuit of the authority that this Committee has and I look forward to your statement.

#### **OPENING STATEMENT OF SENATOR THOMPSON**

Senator THOMPSON. Thank you, Mr. Chairman. I appreciate that. I imagine that we are both a bit nostalgic this morning, but for different reasons.

Chairman LIEBERMAN. Yes. [Laughter.]

Senator THOMPSON. But I appreciate your comments and I have enjoyed very much our working together. I could not imagine, given all of the pressures of this place, being able to work with a Ranking Member or Chairman of the opposing party in any better fashion than you and I have worked together.

Chairman LIEBERMAN. Thank you.

Senator THOMPSON. I will never forget the campaign finance investigation when I was Chairman, when bipartisan support was very difficult to come by on occasion, and you always did what you thought was right, contrary to some of the wishes of Members of your own party. I will never forget that, and I have tried to remember that as you have been Chairman and taken some detours and things that I personally would not have taken, but I have always respected you. We have done a lot of good work with regard to this particular area that we are dealing with today, too.

I cannot help but, before I get into the remarks I had intended to give, sitting here listening to you, to think back over the last several years and how what you were saying was relevant to what we have been hearing for a long period of time.

When I was going out as Chairman about a year-and-a-half ago, I submitted a report called "Government at the Brink," and it pointed out what we had been hearing. It was a compilation, really, of GAO reports and IG reports and Committee hearings and all,

and basically, the conclusion was that we have got serious problems with regard to our government, our government departments, our government agencies, the way we do things. It is rife with waste and abuse and things are not operating the way they should and it is costing us a lot of money. Now, we know it is costing us in terms of our national security.

So, unfortunately, you can pick your agency. We can talk about the details of FERC and what its responsibilities are and how they have performed, but it is one of any number—and it is a regulatory agency, somewhat different from some of the others we have had—but we have had department after department, agency after agency, appear on the high-risk list every year. We are not doing much better than we did several years ago.

We are striving to get some accountability into the system. We are trying to get a performance-based system, really, so that we can have more accountability. I don't think it will do any good until we tie it to the budget process and there are some consequences to poor performance, but you can single out almost any agency. I think it has tremendous ramifications for homeland security. I think that it points out the need for the flexibility that the administration must have in reorganizing so many departments. We are talking about one little department here that a lot of people considered kind of a backwater until all of these problems hit.

But the idea of getting the right people in the right places and being able to get rid of the wrong people in the wrong places and more funding and more accountability and things of that nature are all lessons that we need to learn, not only with regard to FERC, but with regard to our national defense and homeland security. So it is an important subject, but it is the very tip of a very big iceberg.

It has been approximately a year since there were revealed financial matters that ultimately led to the collapse of Enron, then our country's seventh-largest company. Much has happened in that year, particularly following Enron's bankruptcy, the largest at the time until it was eclipsed by WorldCom's.

I am proud to say that much has happened and much has been revealed as a result of the hearings and investigations by our Committee, as well as our Permanent Subcommittee on Investigations. A review of recent criminal charges against Enron's CFO Andrew Fastow, for example, reads as if it was written in large part from the results of our investigations. Much of our investigation has also been conducted on a very bipartisan basis, a fact of which I am also quite proud and a testament to what can be done when we work together.

Our Committee and the Permanent Subcommittee on Investigations have investigated the roles of various actors in the Enron saga, the Board of Directors, auditors, securities analysts, credit rating agencies, and financial institutions, and we discovered that many of these actors with important roles in monitoring Enron or its financial condition generally adopted a "see no evil" approach that allowed Enron to present to the public a clean bill of financial health up until the company's collapse.

We are seeing positive movement addressing these issues raised in our investigations: Accounting oversight and other reforms man-

dated by Sarbanes-Oxley; tougher new SEC regulations and movement toward lessening conflicts of interest in the investment banking community; and tougher listing standards at security exchanges. Recently, we issued a bipartisan report with respect to the SEC, rating agencies, and security analysts that noted a number of deficiencies and areas of needed reform. We look forward to a response to that report, which brings us to the Federal Energy Regulatory Commission, FERC, and our hearings today.

Sometimes, you have to play the cards that are handed you, and I have been given a hand today that I prefer not to have been my last hand on this Committee. But as I look over the report that we are considering today, I am concerned about it.

Frankly, I think FERC fits a different category than some of these other regulatory agencies. I always thought FERC's primary responsibility was to try to achieve just and reasonable rates. It doesn't seem to me like they have the responsibility that a lot of these other entities have, and if the SEC and the Board of Directors and people who sit on auditing committees and security analysts and all these didn't catch a lot of these things, I am wondering what kind of responsibility we can really fairly place on FERC in these areas.

And as I look over the areas of concern, the wind farm transactions basically occurred between 1997 and 2000, as I understand it. With regard to the Enron Online issue, that ceased operation in December 2001. With regard to the affiliate transactions issue, FERC already has rules in place there and apparently responded pretty promptly to those issues.

With regard to California trading, obviously, that has been very controversial and there is probably enough blame to go around there, but everyone has to acknowledge FERC has limited authority with regard to that. It shares authority with regard to that and California would not allow long-term contracts, and everyone acknowledges that the State had a poor regulatory system.

So looking at all of that, it makes me wonder what the proper role is. Obviously, there are some shortcomings there that need to be addressed, but it seems to me somewhat of a different category than some of these other agencies that have more direct responsibility with regard to the investigative efforts and ferreting these things out part of things. They could stand improvement.

We can talk about improvement, and that is another irony of it. It seems to me like this ought to be a good news hearing. From at least one of the experts that the Majority has called, apparently, some very good things have happened under the FERC watch of this administration. The things that are of most concern with regard to FERC happened while on the watch of appointees of the prior administration.

I am not the one to partisanize the effort, but the fact of the matter is, up until now, when you think about FERC, most people's minds immediately jump to the suggestions and accusations concerning one contact between Mr. Lay of Enron and a former member, a former chairman appointed by the Bush Administration to FERC. There was a letter by this Committee to Mr. Wood questioning the ethical standards of FERC. There was a GAO investigation with regard to that contact, a contact that, as I understand,

Mr. Hébert made, or Mr. Lay and Mr. Hébert had with counsel, general counsel sitting in the room with Mr. Hébert on his side of the telephone conversation, but we had a GAO investigation about that.

And now, when I read the staff report that we are considering today, I see that we still have a section here, "Enron's Effort to Influence the FERC." Unfortunately, it is only with regard to Enron's effort to influence the Bush appointees at FERC. It refers to documents that have been obtained and refers to a PR and lobbying effort campaign of Enron, which undoubtedly is true. It refers to a Republican lobbying firm that had been hired. It refers to efforts or support from Mr. Wood and Ms. Brownell, which, of course, supplies some modest taint to them. And then it concludes, it is difficult to evaluate Enron's far-reaching efforts on decisions made at FERC and leaves that hanging out there.

But unfortunately, there is no reference to numerous contacts, several during the height of the California contracts, between Enron lobbyists and a current FERC commissioner who was appointed by the prior administration.

So I think to the extent that we can consider FERC, I think if you wanted to really get to the heart of decisions that were made that affected some of these problems, you would have more of the prior commissioners here to talk about it, quite frankly. Then we would be giving credit due to what is happening there. But if we want to really consider what we can do to make FERC stronger and better, I think that part of it is fine.

But when you consider the history of all this and the continuing reference in the report, about five pages' worth, of the implications of impropriety with regard to primarily one contact, I see, then we must put this in perspective as we go forward and try to make progress. Selective indignation is not going to work, and unfortunately, it overshadows some of the more positive aspects that we have been able to agree on and pursue together.

Hopefully, as we go forward today, we can flesh some of these issues out and put things in a bit of perspective. Thank you, Mr. Chairman.

Chairman LIEBERMAN. Thanks, Senator Thompson. You have raised some fair questions. Look, I would say, overall, the interest of the—as I believe the staff investigation, and certainly my opening comments of what I drew from it, suggest, the staff was not given any directions to limit their inquiry to events that occurred after the change of administrations in January 2001. In fact, they were asked to go back and look at the whole history here and let the truth of the investigation fall where it fell. So, clearly, a lot of the behavior that is criticized occurred before, and by FERC, occurred before January 2001.

Second, I hope and expect that Mr. Berick, who is our first witness, will be able to respond to some of the specific questions you raised, or perhaps wait until you question him more specifically to respond to the suggestion about the one commissioner in contact with Enron.

So at this point, I would like to go to David Berick. David is our first witness. He is a Senior Professional Staff Member on the Majority staff. He will summarize the findings of the Majority staff in-

investigation into FERC's oversight of Enron. Because the investigation covers a number of complicated issues, I suppose this is by way of warning, the staff testimony will be somewhat lengthy. But the importance of the subject definitely requires that.

I will say for my part that I think the staff has done a very good job and performed the role of oversight that is uniquely this Committee's in a way that is not only impressive, but is productive. Of course, that is why we have the current commissioners here, not just to defend the past, because some of them were not there, but to talk about what is happening now and what we can do to make sure that the shortcomings that the staff investigation has seen are not repeated in government oversight of our critically important energy markets.

Mr. Berick, I am going to ask you if you would please stand and raise your right hand. Do you solemnly swear that the testimony you will give the Committee today is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. BERICK. I do.

Chairman LIEBERMAN. Thank you. Please be seated, and the record will show that the witness has answered the question in the affirmative. Mr. Berick, please proceed.

**TESTIMONY OF DAVID M. BERICK,<sup>1</sup> PROFESSIONAL STAFF MEMBER, COMMITTEE ON GOVERNMENTAL AFFAIRS, U.S. SENATE**

Mr. BERICK. Thank you, Mr. Chairman, Senator Thompson. What I will describe to you this morning, as briefly as I can, are the findings of the Majority staff inquiry into the Federal Energy Regulatory Commission's oversight of the Enron Corporation. The findings I will highlight can be found in greater detail in the accompanying staff memo being submitted in conjunction with today's hearing, and I would ask that my written statement and the Majority staff memo be made part of the record.<sup>2</sup>

Chairman LIEBERMAN. Without objection, so ordered.

Mr. BERICK. As you related this morning, Mr. Chairman, in January, you directed us to initiate a broad investigation into the role of the Federal Government and private sector watchdogs in what was at the time the largest corporate bankruptcy in American history. The purpose of the investigation was to determine whether, over a period of years, of the 10 years preceding Enron's collapse, whether Federal regulators did their job correctly and took reasonable steps consistent with their missions and mandates to identify and, if possible, prevent the problems that led to Enron's implosion.

In investigating the role of FERC, the Federal Government's lead energy regulator, the investigation identified four specific areas of concern, which you've identified this morning. These are Enron's sale and repurchase of wind farms, activities related to Enron Online, the electronic trading platform run by Enron, and transactions conducted between Enron and Enron-affiliated companies, and finally, the role of Enron in the California power crisis.

<sup>1</sup>The prepared and supplemental statements of Mr. Berick appear in the Appendix on page 74 and 93, respectively.

<sup>2</sup>The Governmental Affairs Committee Majority Staff Report appears in the Appendix on page 219.

As you will see, the evidence in all four cases reveals a consistent pattern, that in the face of Enron's tireless determination to game the system, FERC displayed a striking lack of determination to scrutinize the company's activities, and this was not simply FERC becoming another victim of Enron's misrepresentations. Rather, on a number of occasions, FERC was provided with sufficient information to raise suspicions of improper activities or had itself identified potential problems, but failed to follow through.

In short, the record demonstrates a lack of vigilance on FERC's part and a failure to structure the agency to meet the demands of the new market-based system that the agency itself has championed. While we do not know with certainty whether the disclosure of any of the individual activities I will highlight here today could have prevented Enron's collapse, it seems highly likely that a more proactive, aggressive action by FERC would have limited some of the abuses that appear to have occurred, would have raised larger questions about Enron's trading practices and other business activities and would have exposed at least some of the cracks in Enron's foundation earlier. Perhaps scrutiny by a Federal agency would have also jolted the Enron Board of Directors and Enron itself into acting to change direction. At a minimum, we believe it would have alerted investors, analysts, and hopefully regulators of other regulatory agencies to look more closely at Enron.

FERC had and continues to have jurisdiction over Enron Corporation's many energy subsidiaries and activities. There were at least 24 electric, 15 gas pipeline, and 5 oil pipeline subsidiaries or affiliates of Enron subject to FERC regulation. Not surprisingly, then, FERC had thousands of contacts with Enron over the 10-year period examined by the Committee staff concerning Enron's FERC-regulated subsidiaries and affiliates.

In addition to these contacts with FERC, our investigation also uncovered evidence of an aggressive public relations and lobbying campaign that Enron undertook in 2000 and 2001 to defend its role in the power crisis in California and to seek to influence the composition, policies, and practices of FERC, as well as to shape the debate over the California crisis. After all, Enron was heavily invested in the success of the deregulation of energy markets because it represented opportunities for Enron's energy trading and energy services businesses, as well as new market opportunities in the United States and overseas. It was important to Enron, therefore, that the California crisis not be blamed on deregulation or on market systems or on individual market players, like Enron itself.

The Majority staff has concluded that among the many Enron-related questions that came before FERC in recent years, four stand out as egregious and cautionary examples of regulatory failure. In each case, despite ample opportunity and available information, FERC failed to answer, much less challenge, Enron's behavior. It is likely that this passive regulatory stance enabled Enron to distort its financial condition, failed to protect energy consumers and the energy industry, and failed to prevent or mitigate the ultimate effects of the company's collapse.

The first area I would like to cover are the wind farms in California that the Chairman addressed earlier. In January 1997, Enron acquired a number of wind farm projects that were consid-

ered qualifying facilities, or QFs, under Federal law and were, therefore, eligible for special rate treatment. Shortly after the acquisition of these wind farms, in August 1997, Enron completed its acquisition of a public utility company located in Oregon, Portland General Electric. Under Federal law, however, projects that are given special status as qualifying facilities cannot be owned by a public utility or its holding company. This has been interpreted by FERC to mean that it cannot own more than 50 percent of a qualifying facility.

Thus, because Enron now owned a public utility company, the wind farm projects that it had purchased would no longer be eligible for QF status. In order to maintain the QF status of the wind farms, Enron found it was necessary to divest itself of ownership in a number of these projects. In at least four cases, however, it appears that Enron did not truly divest itself of ownership, and, in fact, effectively retained the risks and benefits of ownership.

FERC had the responsibility to certify that ownership requirements and other pertinent requirements of QF status were met. Critical details of these apparently sham transactions were revealed to FERC, but FERC failed to adequately scrutinize these particular transactions and wound up agreeing with Enron that they, in fact, met the ownership requirement.

Specifically, in 1997, Enron sold a 50 percent interest in each of three wind farm projects to a special purpose entity named RADR, allegedly set up by Chief Executive Officer Andrew Fastow and his deputy, Michael Kopper. In August, as discussed in the staff memo, Mr. Kopper pled guilty to wire fraud and conspiracy to commit money laundering, based in part on a scheme he and others allegedly devised to enrich themselves and enable Enron to maintain secret control over California wind farms while appearing to maintain eligibility for QF status, and similar charges have now been filed against Mr. Fastow by the Justice Department.

However, minutes of a May 1997 meeting of the Finance Committee of Enron's Board of Directors indicate that there was formal corporate consideration of the RADR transactions. The minutes indicate that although the arrangement was expected to satisfy FERC's requirements for transfer of ownership, it was not "a sale for book purposes," and that Enron, therefore, planned to continue to recognize revenues from the project.

In addition, the minutes describe Enron's right to repurchase the projects, noting that Enron would retain "a call option to repurchase the assets in the future and sell in non-fire sale environment," an indication that the company saw itself as forced to divest its interest in the wind farms quickly because of its purchase of Portland General and was using the sales to RADR to temporarily park the projects until it could obtain a more lucrative financial return.

The minutes also reveal that Enron provided 97 percent of RADR's initial capital by way of a loan from one of its subsidiaries and that Enron intended to indemnify RADR against future tax, environmental, and other liabilities.

The nature of these wind farm transactions is further confirmed by a 2001 PriceWaterhouse Coopers due diligence report, prepared in anticipation of another related Enron transaction, which notes

that because Enron “retained all the risks and rewards associated with the projects,” and retained an option to repurchase the shares, the wind farm deal was not treated as a sale and the revenue from the projects was accounted for as income from joint ventures.

Information revealed to FERC in Enron’s formal applications for QF status should have, in our opinion, raised serious questions at FERC as to whether or not the wind farms’ ownership arrangements entitled them to this QF status. Among other things, Enron’s application stated that the company would loan RADR the money to purchase its interest in the wind farm projects, that an Enron affiliate would indemnify the owners of RADR for tax liabilities if the project was repurchased, that Enron would retain an option to repurchase RADR’s interest in the projects, and that land for the facilities would be leased from an Enron affiliate and that the same Enron affiliate would receive fees for providing operation and maintenance service for the facilities.

However, despite Enron offering up all this information, FERC appears either not to have understood or not to have tried to understand the actual financial arrangements described to it by Enron and their implications, and it seems that this was not out of the ordinary for FERC’s review of QFs.

A similar lack of scrutiny repeated itself in 2000 and 2001, when a number of the wind farm projects, including the three RADR projects, were reacquired by Enron and FERC once again was given the opportunity to review the transactions. However, in each of the repurchase agreements, Enron filed a self-recertification with FERC, informing it of the ownership changes and asserting that the facility, now majority or entirely owned by Enron, which was still then a utility holding company, should maintain its eligibility for QF status. Remember, Mr. Chairman, that the QF status is supposed to be granted only when facilities are not controlled by a public utility or its holding company.

Two fundamental weaknesses in the regulatory system emerge. First of all, as a matter of policy, FERC never reviewed the RADR self-certifications, and to this day still never reviews self-certifications for QF status no matter what the applications may say unless an outside party raises an objection. Instead, FERC simply files them away as it did in the case of RADR.

I want to note that these repurchase agreements and filings for RADR were not the only time that Enron took advantage of the weaknesses inherent in FERC’s self-certification system. In November 1998, Enron self-certified a new ownership arrangement for another wind farm project known as Cabazon. In this case, Enron self-certified that it had transferred 50 percent ownership in the project to a nonprofit organization, The Nature Conservancy, within the meaning of FERC’s QF ownership requirements.

In fact, Enron did not actually transfer an ownership interest. Rather, it only transferred a right to 50 percent of the net profits, a condition which did not actually meet the FERC ownership test. Indeed, The Nature Conservancy did not consider itself to have any ownership interest in the Cabazon project. However, because this ownership change was the subject of a self-certification, it was not reviewed or contested by FERC.

Second, Enron also took advantage of a regulatory black hole between FERC and the Securities and Exchange Commission on the RADR repurchase transactions as well as other wind farm repurchases. Enron told FERC in its self-recertification application that it was now eligible to own the wind farms because it had applied to the SEC, requesting a special exemption under the Public Utility Holding Company Act, which would permit it to retain QF status for the wind farms.

It did have such an exemption pending at the SEC. The application remained pending, however, for 2½ years, and, in fact, the SEC is only now scheduling a hearing to consider the merits of the application. Meanwhile, from the moment the application was on file at the SEC, for FERC's purposes, it was deemed to have been approved. The two agencies never communicated with each other about the substance of the application. Instead, FERC's practice was and still is to treat a company's good faith application to the SEC alone as sufficient for the company to qualify for this exception. As a result, Enron got the benefits of the QF status and retains them to this day.

The second area that the staff believed was significant was FERC's review of Enron's electronic trading platform, Enron Online. In 1999, Enron Corporation played a leading role in a fundamental shift in the way natural gas and electric power were traded by creating Enron Online, an Internet-based trading platform for natural gas and electric power. Online energy trading quickly became a significant portion of the energy trading market. In 2001, it was estimated to account for approximately 38 percent of natural gas and 17 percent of electric power marketed in the United States. Until Enron's bankruptcy, Enron Online was widely acknowledged to be the leading platform for such trading. Enron, in turn, lauded itself for its trading capabilities and rapidly expanded the range of commodities it traded on Enron Online, from paper to broadband communications capacity.

The public implications of this fast emerging energy trading method did not greatly interest FERC until May 2001. At that point, FERC's general counsel initiated a staff-level inquiry into the status of electronic trading in the electric power and natural gas markets in general, and the role played by Enron in particular. FERC staff were asked to evaluate Enron Online's dominant position in electronic trading in the energy industries and to determine whether that position might be exploited to manipulate prices and otherwise distort the energy market.

A non-public report discussing these matters was completed on August 16, 2001. The report found that, unlike some online trading platforms which operate as third party many-to-many exchanges, matching willing buyers and sellers, Enron Online operated as a proprietary extension of Enron's trading units, including entities regulated by FERC. In other words, in this so-called one-to-many exchange, an Enron trader was a party, either as a buyer or a seller, to every trade on Enron Online. Therefore, only Enron would know valuable information about the actual volumes and prices transacted on its trading platform and, of course, how the prices changed in any particular transaction were set, or how they com-

pared to those charged in other similar transactions, or even whether the transactions actually had occurred.

The financial risks of all the trades conducted on Enron Online remained with Enron subsidiaries, and since Enron's traders were a party to every trade, this risk was substantial. It also meant that the solvency of Enron as a whole was important to the viability of Enron Online and to Enron's trading activities.

With this observation in mind, the report asked whether financial problems at Enron would threaten the energy markets. The report answered the question in two ways. First, it concluded that Enron did not have sufficient market share to disrupt the energy market if it failed. As we describe in our staff memorandum, this conclusion was based on a cursory analysis of the entire North American energy market rather than a more thorough attempt to scrutinize individual regional markets, which would have yielded a much more complex, and, we believe, a much more troubling, picture.

Second, the report concluded that, in any event, the chance of Enron failing financially was remote. The report provided little support for this conclusion and it has obviously been disproved over the last year.

Finally, the report found that Enron Online gave a competitive advantage to Enron's own trading units by reducing their transaction costs, giving them wider access to the market, and providing them better market intelligence. But yet it concluded that there was no reason for concern. This conclusion also appeared the result of wishful thinking, and there is now evidence, described in an August 2002 FERC staff report concerning FERC's own investigation of Enron and other participants in the Western energy market, that Enron, in fact, likely did exploit this advantage to manipulate prices, particularly in the California and Western markets.

In short, though the FERC report identified a number of areas that could have and should have raised concerns with the Federal Government's lead energy regulator, FERC staff concluded that there was no reason for concern and no cause for action. Quite simply, FERC's review was too cursory, settled for incomplete answers, drew the wrong conclusions, and the agency ultimately failed to follow up on the warning signs it did raise.

Another troubling facet of the 2001 report is that it was not distributed to any of FERC's commissioners prior to or during Enron's collapse to inform their decisionmaking with regard to this event. It is unclear at what point any of the information contained in the report may have been provided to the Commission. Thus, a report that might have served as a warning wound up being little more than a footnote in the story of Enron's collapse.

Another serious concern is that FERC did not initially even address the question of whether or not, and the extent to which, FERC and the Commodity Futures Trading Commission, both of which had some regulatory responsibility for energy trading, had jurisdiction over Enron Online and other similar electronic trading platforms. This was despite the fact that Enron and other similar systems were at the time expected to become the dominant way in which both electricity and natural gas were traded.

A FERC legal memorandum analyzing FERC's jurisdiction over Enron Online and other electronic trading was to have been prepared in conjunction with the August 2001 report I mentioned earlier. This jurisdictional memorandum was not, however, completed until July 2002, after you, Chairman Lieberman, raised questions about it. This failure to address the agency's jurisdictional authorities created yet another regulatory black hole, leaving any thorough scrutiny of Enron Online and other electronic trading platforms to languish. And as we discuss in the staff memo, there is indication at Enron that they believed that this trading platform, for all intents and purposes, was virtually unregulated.

One final footnote about the 2001 Enron Online inquiry is that it also examined the issue of how pricing information from Enron Online might distort published price indices, such as those reported by trade publications like Natural Gas Intelligence and Gas Daily. The FERC staff noted that such indices were comprised of anecdotal, unconfirmed information and that information provided from a source such as Enron Online could be subject to manipulation.

At the time the staff was examining this very issue, the Commission was promulgating its order on refunds for the California market, which included a methodology for determining baseline electricity generation costs tied to these published price indices. The concerns expressed by the Enron Online inquiry staff concerning these indices were apparently never communicated to the commissioners considering the refund issue, nor was other relevant information compiled by the Office of the Chief Accountant concerning electricity generation costs in the California market.

The significance of these failures is highlighted by the FERC staff's August 2002 report in its ongoing Enron investigation, which found that published price indices in the California market were unreliable and may have been distorted or even manipulated by data from Enron Online. The 2002 report recommends that, as a result, the Commission modify its California refund—

Chairman LIEBERMAN. Mr. Berick, let me just interrupt you for a moment. In a few cases here, you have described FERC staff reports which were not communicated to or conveyed to the commissioners. Did you reach a conclusion about why that happened, why they were not transferred to the commissioners?

Mr. BERICK. Well, we didn't reach a conclusion, Mr. Chairman. We tried to understand as best we could what happened, why this information was not passed on, and it just seems to have been a variety of factors, some that it was not deemed to be a priority. In other cases, it appears that there was a change in administration. The general counsel, who asked for the Enron Online investigation, and the Chairman that he worked for, Mr. Hébert, left the Commission at about the time that this was being completed and the ball was apparently simply not passed on to the incoming team.

Chairman LIEBERMAN. So you found no evidence that there was a decision by the staff to suppress their work. They just, for various reasons such as you have described, or perhaps just decisions that in hindsight by the bureaucracy don't make sense, decided not to convey those reports to the commissioners.

Mr. BERICK. Right, but we concluded that there was important information that was relevant to deliberations that the Commission

had ongoing and it should have been communicated to the commissioners. It was something that should not have ended up on the shelf.

Chairman LIEBERMAN. OK. Please proceed.

Mr. BERICK. Our third area of review was Enron's affiliated transactions. Obviously, whenever a company conducts transactions among its own affiliates, there may be cause for concern about fair dealing. One concern is that where one affiliate has captive rate payers, a one-sided deal may impose financial burdens on those rate payers. Another concern obviously is that one affiliate may treat its sister affiliate with favoritism at the expense of other companies or customers, or in ways that are detrimental to the market as a whole.

Based on our review, we concluded that the existing regulatory rules and tools in the hands of FERC proved inadequate to deter Enron, as the company now appears to have engaged in a number of inappropriate inter-affiliate transactions.

Just one example are the loans of two of Enron's pipelines obtained on behalf of the parent company, Enron, in November 2001. As Enron struggled to avoid bankruptcy, the company announced that J.P. Morgan Chase and Citigroup had committed to loan it a total of \$1 billion. But the loans were actually made to two of Enron's FERC-regulated interstate pipeline subsidiaries, Northern Natural Gas Company and Transwestern Pipeline Company, and were secured by assets of those pipeline companies. The vast majority of these loan proceedings were subsequently transferred to Enron in the form of unsecured loans from the pipelines to their parent company.

After Enron declared bankruptcy a few weeks later, the pipeline companies, which did not file for bankruptcy, were left to pay off the entire amount of the obligations to the banks, a matter of concern because, ordinarily, such costs would be passed on to shippers who use the pipelines and ultimately to natural gas customers.

In this case and in other cases discussed in the staff memo, FERC is now investigating potential wrongdoing concerning Enron's inter-affiliate transactions and seeking to strengthen some of the relevant accounting rules. However, it is troubling that the agency failed to address the broader policy question earlier. As parts of the energy markets have been deregulated under FERC's watch and at FERC's urging, the issue of transactions among a company's affiliates have taken on increased importance.

Until Enron's collapse, however, FERC failed to adequately identify such transactions, especially the financial transactions, and as in the case of the—or in the case of the transactions between marketing affiliates, like Portland General, traditional utilities, FERC's regulations proved to be inadequate. Thus, it turns out that this is another area where the agency did not adequately anticipate problems in the market that it was instrumental in constructing.

The final area in which the Committee staff reviewed FERC's oversight of Enron regards the company's role in the California energy crisis. As you will recall, severe energy shortages in California began in the spring of 2000, about 2 years after the State's energy deregulation plan was put in place. The State's investor-owned utilities and regulators blamed the crisis on power sellers and market-

ers, who they said were unfairly manipulating the system to gin up profits. The power sellers and marketers, on the other hand, claimed that the flaws lay in the actual structure of the new California system and they, in turn, were the chief culprit for the crisis.

However, FERC as far back as 1998 had received reports from energy experts in California raising concerns about the exercise of market power and began a staff investigation into the causes of the California crisis in the summer of 2000. The investigation reached what might be considered a curious conclusion, that power sellers had the potential to manipulate the power market, but that there was no evidence to indicate whether an individual company engaged in actual market abuse. The report concluded that identifying individual cases of market abuse would require further investigation.

Despite this initial report clearly articulating the potential for market abuse and the Commission's own orders essentially agreeing with that conclusion, it would take a full 15 months, until February 2002, after Enron's collapse, for FERC to order a formal staff investigation into the market behavior of Enron and other individual companies.

Even as FERC was avoiding the question of what individual companies were doing, Enron itself initiated an internal investigation into its own trading practices in California in October 2000—

Chairman LIEBERMAN. Excuse me again. What motivated Enron to initiate that investigation of its own practices?

Mr. BERICK. They were concerned about the legal implications of those practices. They had received a subpoena from the California Public Utility Commission and there was concern about additional regulatory actions that would be taken—might be taken against them, and in terms of preparing for their own defense, they began to investigate the extent and characteristics of the trading practice that they had engaged in.

Chairman LIEBERMAN. OK.

Mr. BERICK. And that internal investigation would ultimately result in a now well publicized memorandum that was produced in December 2000 which asked some searching questions about a range of strategies that Enron traders use, such as the so-called "Get Shorty," "Death Star," "Fat Boy," "Ricochet" trading strategies, and it also discussed the sanction provisions of the California Independent System Operator Tariff.

Unfortunately, as we discussed, Enron appears to have been more concerned about its own behavior than was the government's leading energy regulator. As stated earlier, FERC itself did not begin to investigate these practices until more than a year later, after Enron's collapse.

In August 2002, that investigation—and again, I am referring to FERC's ongoing Enron investigation—that investigation produced an interim report describing the manipulating trading practice that Enron traders allegedly engaged in. Those findings have, in fact, further prompted three formal FERC investigations into the behavior of individual companies, including Enron.

More confirmation about what FERC may have found, had it been more vigilant and diligent, was revealed last month when Timothy Belden, who headed Enron's Western trading desk, pled

guilty to a charge of conspiracy to commit wire fraud based on allegations that he and others at Enron engaged in trading strategies designed to manipulate energy markets in California from 1998 to 2001.

The Committee Majority staff believes that the rules and regulations of a Federal agency such as FERC cannot effectively deter unreasonable market action if the agency fails to hold market participants accountable. It should not have taken Enron's collapse to finally trigger FERC's investigation of the role of Enron and other individual companies in the California energy crisis.

In conclusion, Mr. Chairman, all four stories convey the same general message. The Federal Energy Regulatory Commission was a poor match for Enron's efforts to subvert the spirit, if not the letter, of the regulatory system. FERC's failure cannot be attributed simply to Enron's aggressive public relations and lobbying campaigns or to the deviousness of its methods.

In many cases, the Commission had specific and sufficient information that should have raised suspicions about improper behavior on Enron's part. In other cases, FERC recognized potential problems, but through poor management or poor internal communication or sheer lack of will, never followed its suspicions through to their logical ends. Even after Enron declared bankruptcy, FERC dragged its feet, for example, in the case of the wind farms, and failed to step into the breach, reinforcing a pattern of performing too little, too late.

To be fair, FERC has taken some tentative steps to remedy this unacceptable state of affairs, such as creating a new Office of Market Oversight and Investigation. But simply rearranging the bureaucracy is not sufficient. FERC must work in concert with other regulatory agencies. It must request and be given sufficient resources to monitor and police the marketplace. And it must be more cognizant of what goes on under its own regulatory roof.

But most importantly, FERC must reorient itself to a changed and increasingly complex regulatory environment, an environment that FERC itself has fostered but failed to adapt to. Had FERC proven more aggressive on any one of the fronts I have described in my testimony today, it might have unearthed Enron's abuses sooner, perhaps mitigating the company's collapse, protecting consumers from hardships, and competitors from Enron's alleged market manipulations. Instead, through a striking lack of vigilance, FERC abdicated many of its core responsibilities as a Federal regulator.

Thank you, and I look forward to answering your questions and Senator Thompson's questions.

Chairman LIEBERMAN. Thank you very much, Mr. Berick. I thank not only you, but all the members of the staff who worked so hard over a long period of time to assemble the information and reach the conclusions that you have presented to us this morning on their behalf and yours.

I am going to go to the end and then go back to the beginning. Let me ask you this, and this goes to the broader question I discussed in my opening statement about what is the role or necessity of Federal oversight in a deregulated energy market environment. As I said, I reached the conclusion that you can't just say, OK,

FERC is not going to set the prices after an administrative process, wholesale prices of energy anymore, go out and let the market reach the right conclusion, because as we see here in your testimony, in your report, private parties, human nature unfortunately being what it is, particularly in a very increasingly sophisticated climate with Enron Online and all the rest, will seek advantage for themselves and there will be consequences that can, as they were in this case, be disastrous, particularly for Western American energy markets and billions of extra dollars that consumers, including business consumers, obviously, had to pay.

In your conclusion, you talk about the importance of more aggressive implementation of regulatory oversight authority that FERC has and the need, I think, for additional staff, dedication of FERC staff to these matters. Is there any need for additional law here, or do you think that the law, as it exists, gives the Federal Energy Regulatory Commission the authority it needs to protect the energy markets in a deregulated environment, it is just that they didn't use the power they had?

Mr. BERICK. Well, I think they did not use the authority that they had. That doesn't mean that they couldn't benefit from enhanced authority, and in FERC's testimony today, they asked for additional authority for criminal and civil penalties under their organic statutes, the Natural Gas Act, Federal Power Act, to try to expand the range of regulatory tools that they have. This was something that was also a recommendation in the General Accounting Office report that was prepared for you, again, suggesting that they have a significant amount of authority today, but they could, in fact, benefit from some additional enhancements and expansions of that authority.

Chairman LIEBERMAN. I take it you would agree with that request that the Commission will make today, and I agree with it also, but it also highlights the fact that we are asking, based on the work that was done, the investigation and the report, that FERC not only have oversight but enforcement authority when the rules of the road are violated, is that correct?

Mr. BERICK. Yes. One of our basic conclusions here is that FERC's role is fundamentally changing, and I think FERC has acknowledged this, but has not been able to deliver on the need to change the way it approaches its role from one of being a rate setter to a market overseer. I mean, it is endemic to the restructuring of the regulatory process and FERC is now no longer in the process of setting rates. They are now in the process of overseeing the market and the behavior of participants in that market. And consequently, they have to change their view and their institutional structure to better deal with that challenge.

Chairman LIEBERMAN. And part of that is to have the authority to take action—to initiate action, civil and criminal, against those who are not playing fair, is that correct?

Mr. BERICK. Yes, but they have other authorities which they can use, such as denying the ability of a company to have market-based rate authority. Again, it is a fairly, maybe draconian or overly draconian measure, and that is why they are requesting this additional expansion. But there are tools that they have and there is

authority that they have to take action against companies that manipulate or abuse the market or operate unfairly in the market.

Chairman LIEBERMAN. OK. Let me go back to some questions that were raised in earlier parts of your testimony, which covered a number of issues—wind farms, the Western energy market crisis, Enron Online—but a central and very troubling point from your testimony is that FERC had direct oversight of a number of Enron's activities that now appear to have been at least improper, and in some cases illegal.

The fact is that Mr. Kopper of Enron has now pleaded guilty to criminal and civil fraud with regard to the wind farm transactions that you have described. Mr. Belden, the head energy trader in the Western region for Enron, has also now pleaded guilty to a Federal criminal charge in connection with trading practices in the California market, which had disastrous consequences for that market.

Am I correct that you are saying that FERC had a direct regulatory role in these areas which might have prevented some of the abuses from occurring that have now been acknowledged by Mr. Kopper and Mr. Belden?

Mr. BERICK. Precisely. That is, I think in some ways, one of the most troubling aspects of the investigation that we did, was that FERC looked, for example, in the wind farm issue, specifically at the ownership issue. That was the principal purpose of the reviews that they conducted of all three wind farm transactions, was to look at whether or not these transactions met the ownership test, which was that they could not be owned more than 50 percent by Enron. They looked specifically at that issue.

Regardless of whether or not we can have expected FERC to have caught all of the fraudulent activities that Mr. Fastow or Mr. Kopper are alleged to have engaged in, we have, and we cite this in the staff memo, we have the internal Finance Committee minutes that indicate that, in fact, this was a corporate decision to structure these transactions this way.

So our point is that if FERC had probed, there would have been something to find, even within the official corporate records, irrespective of the ultimate frauds that may have been committed.

Chairman LIEBERMAN. In the wind farms case, I referred in my opening statement to a regulatory gap between FERC and the SEC. Is it fair to say that you concluded and the staff concluded that Enron skillfully took advantage of that gap?

Mr. BERICK. Precisely. They knew that FERC would consider—well, they knew that because they were using the self-certification process that it was something that would not receive, or was not likely to receive actual review, and they approached the SEC in such a way that they did not expect the SEC to actually act on the application. So they very carefully took advantage of the sort of regulatory black hole, the regulatory gap that existed between the two agencies.

The fact that it was allowed to go on for 2½ years just simply speaks to how extensive and continuing that gap was, because the two agencies never discussed this issue, not just with regard to these particular applications, but they never discussed this issue in a generic way to make sure that, in fact, as people, as companies like Enron were making applications to the SEC that might have

been relevant to proceedings underway or decisions that needed to be made at the FERC, that they were in coordination with one another. So it was not done specifically and it was not done generically.

Chairman LIEBERMAN. Let me finally in this round just deal briefly with another regulatory vacuum that Enron seems to have been able to exploit, which was with regard to Enron Online, the Internet-based commodity trading system. We have the issue of whether FERC can regulate Enron Online and should have, and second, we have the question of whether the CFTC also had regulatory jurisdiction over Enron Online and what the two agencies do or don't do to resolve that issue, which I presume is still an issue. I wonder if you could briefly address that question.

Mr. BERICK. Well, as I mention in my testimony, Enron considered, at least some at Enron considered Enron Online to be virtually unregulated because of this sort of regulatory gap. FERC had never asserted jurisdiction over these trading platforms, even though they had been in place for quite a while. As I mentioned, Enron Online was created in 1999. We don't see FERC actually even beginning to look at the question of its jurisdiction or the implications of these trading platforms until May 2001, and then they never actually resolved the issue of their own jurisdiction and how it might interact with those of another agency, in particular, the Commodity Futures Trading Commission. The memorandum was just never completed until the question was raised by this Committee.

Chairman LIEBERMAN. And as your testimony indicated, in the meantime, Enron not only set up the system, but was using it and in that sense was gaining advantages. It was gaming the system that it had created in the absence of any oversight of that system, correct?

Mr. BERICK. That is correct, and again, what is striking is the findings in the August 2002 FERC staff report—

Chairman LIEBERMAN. Right.

Mr. BERICK [continuing]. Which concludes that, in fact, the very nature of Enron Online, how it was structured, the one-to-many type of structure that allowed only Enron to actually know what was being traded on that system, was likely to have been used by Enron to manipulate prices in the California market.

Chairman LIEBERMAN. OK. I have used up my time on the first round. It is a very disquieting picture of a system that has changed, gone to deregulation, and the private sector players, including Enron, just seemed to be so far ahead of those who are supposed to be protecting the rest of us that they gamed the system, with disastrous effects for consumers, investors, and employees of a lot of companies, and for the economy of the Western part of our country. So there are some very striking lessons I hope we will learn, and together go on to try to act in a way that prevents any such gaming from occurring again.

Senator Thompson.

Senator THOMPSON. Thank you very much, Mr. Chairman.

Mr. Berick, over what period of time did the wind farm transactions take place?

Mr. BERICK. They occurred in 1997, were the initial sales to RADR, and the repurchases were in 2000.

Senator THOMPSON. I beg your pardon?

Mr. BERICK. The repurchases occurred in 2000. The initial sales were in 1997.

Senator THOMPSON. All right. And with regard to Enron Online, you mentioned that it started up in 1999?

Mr. BERICK. That is correct.

Senator THOMPSON. And was first looked at by the Commission in May 1999—I am sorry, May of—

Mr. BERICK. May 2001.

Senator THOMPSON. OK. And with regard to the California trading and marketing abuses, the California electricity supply crisis apparently began in May 2000, and in June 2000, California suffered its largest planned blackout since World War II, is that correct?

Mr. BERICK. Yes, sir.

Senator THOMPSON. All right, sir. So with regard to the situation that Mr. Wood and others came into, you call in your report recent initiatives by the FERC as tentative. You say the newly-created Office of Oversight and Investigation is nothing more than rearranging the bureaucracy. In contrast, Mr. Joskow, one of your expert witnesses, I might add, has said he is very pleased that this office was created and that the office is off to a good start.

I will give you a two-part question. The other part is that nowhere in your statement do you refer to one of FERC's most visible recent reforms, and that is the standard market design rule-making. Mr. Joskow, in his statement, calls this a courageous reform effort, intended to facilitate market competition and improve performance.

So apparently the issue here is whether or not you are really giving appropriate credit to Mr. Wood and FERC as it is currently constituted with regard to its overall performance, and specifically with regard to the Office of Oversight and Investigations and the standard market design rulemaking. Would you comment on that?

Mr. BERICK. Certainly. Obviously, it is too early to tell how well the Office of Market Oversight is going to perform, since it is just now being established. We did look, with the help of the Congressional Research Service, at sort of the resources and staffing that office was being given by FERC and it raised some fundamental concerns with us.

Less than 10 percent of the agency's FTEs are going to be in that office.

Chairman LIEBERMAN. Why don't you define FTEs for the record.

Mr. BERICK. Full-time equivalent. That is essentially one individual working full time.

Less than 10 percent of FERC's FTEs are going to be assigned to that office, and even if we give FERC the benefit of the doubt and concede that all 250 FTEs that are identified in its budget request as having something to do with enforcement and market oversight are included, so we are essentially giving credit for more than double the number of people actually in that office, that number is still significantly less. It is less than 20 percent.

And if we compare that to other Federal agencies that engage in similar types of activities, the Commodity Futures Trading Commission, the FCC, we find that those agencies have significantly larger resource commitments, both in terms of FTEs and in terms of dollars. So while it seems to be a step in the right direction, it seems to be too small a step in the right direction.

And the other thing that we would observe, and this is sort of fundamental to the staff investigation, is that there are a range of activities which we have discussed—the wind farms, for example—that are not going to be fixed by the new office. They are regulatory responsibilities that FERC has. Another example would be the inter-affiliate transactions, the holding company transactions, which are not going to be fixed or addressed by this new office.

So our point is twofold. The steps that they appear to be taking seem to be too small, and that the steps that they are taking are not broad enough to encompass the range of regulatory shortcomings that we identified in the investigation.

Senator THOMPSON. So you are concerned about the allocation of resources, and I understand the issue. I think you may find yourself in the minority with regard to the witnesses here today on that issue, but we have had bigger disagreements on this Committee than one as to whether or not there are sufficient resources allocation.

Chairman LIEBERMAN. I got kind of uneasy when you said, “you may find yourself in the minority.” [Laughter.]

Senator THOMPSON. Some of us—

Chairman LIEBERMAN. Until I heard you conclude that question.

Senator THOMPSON. Some of us almost certainly will, yes. [Laughter.]

But on another subject, how do you view the Commission’s decision back on December 15, 2000, FERC’s order? In an effort to remedy the California dysfunctions, as a part of the order, FERC rejected wholesale rate caps in California. A lot of people consider that a significant action and not enough, insufficient, all of that. Did your analysis encompass that and what do you think about it?

Mr. BERICK. We didn’t really look at that issue. It was obviously an issue that we covered fairly extensively last year in the Committee’s hearings on the California energy crisis. This would have been last June, in 2001. We had two hearings on this issue and we did not spend a significant amount of time on it in this review, other than to acknowledge that, in fact, the Commission had made that decision and that it did raise the question as to whether or not—we raised the question as to whether or not that was sufficient.

Senator THOMPSON. Mr. Berick, I think, in looking at your report here, you have done a lot of good work, thorough in many respects. I think there is a question as to whether or not you are giving sufficient credit due and whether you are placing blame where that is due. We have spent an awful lot of time with regard to FERC, and you heard my opening statement, including a GAO investigation about a contact that a former FERC commissioner had with a representative of Enron. Of course, the dates speak for themselves. Quite clearly, a lot of these problems, or most of these problems started—all of these problems, I guess you might say, started during the prior administration. We can argue whether or not the

new people who really had a majority on the Commission, according to my notes here, only on June 14, 2001.

But more specifically than that, and it goes to the fairness of your assessment here, is the fact that when we got to looking through the documents here that were subpoenaed or gathered by the Majority, it appears that there were several contacts between Enron lobbyists and Commissioner Breathitt that were not referred to in any way, and you spent quite a bit of time, once again, reminiscent of prior hearings and prior actions of this Committee, about five pages on Enron's efforts to influence FERC, but nowhere are those contacts mentioned.

You do mention Enron's lobbying campaign, and clearly they did lobby. Clearly, they did whatever they felt like they could do and get away with. You mentioned, of course, again, that Lay met with various individuals. You mentioned that they met with members of the Clinton Administration, but in the context of discussing an open meeting, discussing the current crisis in California and what to do about it, and I assume there were many people in that meeting, but you mentioned their lobbying-public relations campaign designed to indirectly influence the outcome of FERC's decision-making with regard to California.

So if the issue is whether or not Enron was influencing FERC's decisionmaking, that is very precise. I must ask whether or not you have been fair in your assessment here. You mention Enron's corporate head of government affairs, with the assistance of a Washington, DC, lobbying firm. You mention the firm. It is a Republican lobbying firm.

You mentioned its effort to strongly support Pat Wood as chairman, and also Ms. Brownell. Of course, now they have to deal with that. Mr. Lay called Karl Rove to express support for Ms. Brownell, talking about their nominations further. Mr. Skilling met with Secretary O'Neill, Ken Lay, Linda Robertson, a 30-minute meeting with the Vice President, Larry Lindsey apparently somewhere along the line.

You say it is difficult to evaluate the impact of Enron's far-reaching efforts to influence decisionmaking at FERC, and unless we are missing something here, when staff went through the records, it appears that there were 46 contacts, most of them telephone conferences, between lobbyists for FERC and Commissioner Breathitt from August 2000. Of course, we know the California blackout was in June 2000. From August 2000 through December 2001. Were you aware of those contacts?

Mr. BERICK. Yes, we were, Senator Thompson. As you know, we asked FERC for all of their contacts, all of the agency's contacts, staff contacts and commissioner contacts, and there were, you know, hundreds of pages of just identification of individual contacts.

What we tried to focus on in the contacts you are referring to are contacts related to the California energy crisis. There were lots of other issues. There were issues on deregulation of the market, and the establishment of regional transmission organizations. There were lots of other issues before FERC that Enron had interest in and that, obviously, commissioners spanning many years had communications with.

Where we devoted our effort was to the specific issue of the California market, because that is where there was the greatest concern about whether or not Enron had manipulated that market, and we were also struck by the scope of Enron's efforts to shape the debate of both FERC and the influences on FERC for resolving that issue. There was really a very pronounced—

Senator THOMPSON. Let me make a couple of observations. How can you tell from looking at a document whether or not California was at issue when that conversation took place, when that conversation, that conference call, whatever it is, is at the height of the California crisis, and it is between an Enron lobbyist and a member of the Commission? Why would you assume, on the one hand, that one commissioner's conversation would not have to do with California, and on the other hand, some member of the Bush Administration's conversation would have to do with California?

Mr. BERICK. Well, we went on the documentation that was provided. We did not interview any of the commissioners on any of their contacts. We went on the basis of the documentation that was provided to us, and we did go back. We did ask for documentation from former commissioners who are no longer on the Commission. FERC was very good about helping us go back and get additional information from past commissioners. We went on the basis of the information that was provided to us in the documents.

Senator THOMPSON. But the issue, according to your report here, the fact that they had a public relations campaign designed to directly or indirectly influence the outcome of FERC's decisionmaking with regard to California assumed that their support of Pat Wood only had to do with California, because it is in here. Enron's support of Ms. Brownell was a California issue? It is in here.

Mr. BERICK. If I may, Senator, it is—

Senator THOMPSON. Yes, one more point and then I will let you respond. You have testified that your concern with Enron goes back a number of years, and that you had concern concerning the wind farms transaction. You had concerns concerning Enron Online transactions. You had affiliate transactions concerns. And then you had the California situation.

When it comes to contact with commissioners, then, why would you only focus on the California aspect? Was it because of the fact that some members of the current administration, or Mr. Hébert, who was disappointed, had a one-time contact apparently with Mr. Lay? Was that the reason that you focused in on the California aspect of the four areas of concern? That is the only area of pursuit that is the subject of your report here, about five pages, when all the time, the issue was how the Commission was being affected or how Enron was trying to affect the Commission and there is clearly more than one commissioner.

Mr. BERICK. The Enron documentation on California is fairly explicit about the fact that they were very concerned about the implications for energy deregulation and for the future of that part of their business with regard to California, and the documentation is very explicit about the fact that they viewed FERC as being central to resolving that crisis. And they also make it clear—again, this is Enron making it clear—that the membership of the Commission

was a very important element to them in terms of making this problem, this political problem, go away.

Senator THOMPSON. Well, then by that same token, when you have got a California crisis that certainly goes from May 2000 until the end of that year—we all remember December 15, when FERC rejected wholesale cap rates, which some people interpreted as a pro-Enron decision by the Commission—you have that crisis brewing all this time and you have records in your file showing numerous meetings between Enron lobbyists and Commissioner Breathitt.

I think the proper way to handle this is wait until Commissioner Breathitt has an opportunity to address these sheets. But May, August 23 and 24; September 7, 15, 28, 29, and 30; October 18, 19, 26, 30, and 31; November 7, 16, 27, and 28; December 4, 5, and 8; all these are in your file and in your record, Mr. Berick.

I think in view of the fact that we have spent so much time, including letters and GAO investigations of criminal activity and everything else with regard to Mr. Hébert's telephone conversation he had with Ken Lay and the issue of Ken Lay's support for his chairmanship, let us just assume for the moment you were only concerned about California with regard to the Commission. I find it difficult to understand why you wouldn't in your report, since you are dealing specifically with that issue, why you wouldn't in your report mention that fact. Were you aware?

I understand you had a lot of information and you are focusing on specific things, and I am not necessarily saying that you were attempting to skew the results here. I do question your fairness in the way you treated this. In retrospect, don't you think it would have been better to deal with this on more of an even basis? If you are going to mention contacts with the administration, or even more relevant, contacts with the Commission, should these not have been referred to in your report also, in view of the long history that we have had, this Committee has had, with FERC and questions of undue influence and things of that nature?

Mr. BERICK. Senator, I guess I am going to repeat what I said before, is that there were, as you know, voluminous documentation of contacts. There were many contacts with current commissioners, former commissioners, on a variety of subjects. There are a lot of other areas that we could have pursued in the investigation and which we did pursue in the investigation. But at the end of the day, we based our analysis on the documentation that was provided to us.

Senator THOMPSON. We also had documentation—excuse me.

Mr. BERICK. I am sorry.

Senator THOMPSON. No, go ahead and finish if you want to. I started to say, we also have—and I am not implying that there was anything wrong with these contacts any more than I would have suggested there was anything wrong with Mr. Hébert's contact. But he had to undergo a criminal investigation because of his one contact. I am just talking about what has been in the press and what people have been subjected to for all of this time and questions of a level playing field, and it pours over into the rest of your report, unfortunately, and the question as to whether or not you are giving due credit for what is happening now.

We have records here in the file also from the law firm that represented Enron, and apparently, it is Ms. Breathitt's father's law firm that represented Enron and partners in that firm, along with Enron in-house lobbyists, with these numerous meetings and they were paid hundreds of thousands of dollars, apparently, including Johnny Hayes, who was with the TVA and then during most of when this was going on was the treasurer for the Gore campaign.

I mean, it is hard—this is my last day on the Committee. This is not what I wanted to be doing my last day. But as I say, some days you have got to play the hand that is dealt you and we can't not recognize what is sitting in the living room.

Were you aware of what I just said? It is in your records, in your files.

Mr. BERICK. We had—yes—

Senator THOMPSON. We have no independent subpoena power or authority. These are all Committee records—

Mr. BERICK. Yes, sir—

Senator THOMPSON [continuing]. In the Majority's possession where we had to go to look through them. Were you aware of these things?

Mr. BERICK. Yes. We have the documents, and I have reviewed those documents.

Senator THOMPSON. You just didn't consider them to be relevant for your purposes?

Mr. BERICK. Didn't consider them relevant to the California issue that we were examining. There are, again, many issues, including an issue you discussed this morning about the Hébert-Ken Lay contacts. As you have observed, the Committee did ask the general—actually, the Committee did not. At that time, it was Senator Lieberman on his own behalf asking for that investigation. We did not pursue that issue in this staff memorandum and in this staff investigation.

Senator THOMPSON. Well, I appreciate—

Mr. BERICK. We could have raised that issue, but we didn't. We focused on particular areas that we believed had important policy relevance to the Commission and its behavior and to very significant questions involving the energy markets and—

Senator THOMPSON. Do you think the Quinn, Gillespie lobbying firm had more impact on those policy issues than Commissioner Breathitt did?

Mr. BERICK. What we say in the memo is where we came out on this, which was it is clear that Enron engaged in a very extensive campaign to influence deliberations by the Commission directly and indirectly on the California issue.

Senator THOMPSON. Well, I think we are—

Mr. BERICK. At the end of the day, we have acknowledged that the Commission, in adopting the price caps in June 2001, took a position contrary to what Enron stated its position was. But the facts—

Senator THOMPSON. But on December 15, 2000, it didn't take a position that it was totally contrary to what Enron wanted. December 15, rejecting wholesale rate caps.

My only point is, and I think you are making my point, Mr. Berick, in what you just said. You say in your report it is difficult

to evaluate the impact of Enron's far-reaching efforts in decision-making with FERC. I am totally at ease with the notion that Enron did whatever it could wherever it could, and I am not suggesting that there is necessarily anything improper. Unfortunately, I come across the names of people I know here, some of these Enron lobbyists, lawyers, friends of mine. At least they were until today when they hear about this hearing. [Laughter.]

But it is there. It is in the records, it is in the files, and I felt compelled to raise the issue with you. But as I say, you have made a very extensive report, and I think for the most part, made a valuable contribution with most of this report.

Thank you very much, Mr. Chairman.

Chairman LIEBERMAN. Thanks, Senator Thompson.

Let me just do a few follow-ups. The first, I suppose, I should say in defense of the Quinn, Gillespie firm, that it is not a Republican firm but, for better or worse, a bipartisan firm. Mr. Quinn would probably want to assert his strong Democratic lineage.

The second is that this is the first that I have heard of this question of the law firm, which I gather Commissioner Breathitt's father has some part in. I was troubled when you mentioned at the start of the hearing you were going to bring it up, that I hadn't heard about it.

I have heard Mr. Berick's answers. I actually asked my staff about it back here and they went out and did a—with the options that the modern world provides—a NEXIS search and find a number of news stories at the end of October of this year, including, not surprisingly, from some newspapers in Tennessee because of the presence of the two people in the firm in Tennessee about this matter that they were lobbying on behalf of Enron and did have communication with Commissioner Breathitt. I regret that I didn't know about that before, but has, I gather, been a matter of public record, and, of course, all the documents that the staff, the Majority subpoenaed were shared with the Minority staff, as well.

I just want to give you the opportunity, Mr. Berick, and I think I understand what you are saying, that the contacts with this firm, which I gather from Senator Thompson and I communicating informally up here is a Louisville-based firm—

Senator THOMPSON. I think so.

Chairman LIEBERMAN [continuing]. But has some connection to these two folks from Tennessee.

Senator THOMPSON. They have offices in Nashville.

Chairman LIEBERMAN. This firm didn't jump out at you and its contacts with Commissioner Breathitt didn't jump out at you because the information that we subpoenaed and got showed a very significant number of, I presume, law firms and other lobbyists having contact with all the FERC commissioners on Enron's behalf. Am I hearing your explanation correctly? I understand that is part of it, and the other part of it is that you were focused on the California energy transactions and didn't see any connection between this context and that matter.

Mr. BERICK. First of all, Mr. Chairman, there were, again, voluminous contacts. I hope you will forgive me for this, but Bill Massey's declaration of the number of contacts he had with Enron goes on for several pages in the documentation he reported to us.

Again, it doesn't mean that there weren't contacts. There were a number of contacts that both current commissioners and former commissioners had with Enron. We did not pursue all those because they did not appear to us to be significant issues related to anything that went to the heart of Enron's corporate activities and Enron's collapse, which was where we tried to go with this hearing.

What activities that FERC engaged in or that Enron engaged in were related to Enron and Enron's collapse and what we could do to make sure that, as you said in your opening statement, we didn't find ourselves in a similar situation with the collapse of the largest energy trader, seventh largest corporation in the United States? What kinds of lessons should we learn here?

The particular matter that Senator Thompson has raised with the law firm, as I understand the record, involved an Enron dispute with Tennessee Valley Authority over some power contracts, and at the time, again, it didn't—at the time then, at the time now, it wasn't really at the heart of the kinds of policy issues that we felt were critical to examining. We could have. We could go back to those issues.

There were many issues that came up in this investigation which we could have pursued, but the selection we made was based upon those that we felt were relevant to the future of the way in which these markets are regulated and that is how we made the decision of which issues to pursue and which issues not to pursue.

Chairman LIEBERMAN. So your understanding, and again, we should save most of these questions for Commissioner Breathitt to answer, but your understanding from the documents obtained under subpoena was that the matter that the Louisville and Nashville offices of this particular firm was discussing with the FERC had to do with the TVA, is that correct?

Mr. BERICK. Yes.

Chairman LIEBERMAN. OK. And just to clarify, and I don't know if you could put a number on it. I presume that in the documents the staff went over, can you put any number on—did all of the Enron commissioners during the period you investigated—were all of them contacted by lobbyists, individually by lobbyists on behalf of Enron?

Mr. BERICK. I don't know. I would have to say many commissioners reported contacts with Enron in one form or another, either direct contacts or meetings involving industry associations or those kinds of things, workshops, industry conferences—

Chairman LIEBERMAN. Right.

Mr. BERICK. I have no idea how many total we are talking about, because we went back 10 years. We went back to all the commissioners.

Chairman LIEBERMAN. So you would say most of them had contacts with Enron lobbyists?

Mr. BERICK. Or with Enron. Not just through lobbyists—

Chairman LIEBERMAN. Or with Enron directly?

Mr. BERICK [continuing]. But with Enron itself or representatives of Enron.

Chairman LIEBERMAN. And just to understand why you didn't focus on Commissioner Breathitt and her contacts, but you tell me

and we will review this internally, were her contacts more numerous than other commissioners, do you recall?

Mr. BERICK. No, they weren't.

Chairman LIEBERMAN. They were not? Her contacts with people on behalf of Enron were not more numerous than the contacts that other FERC commissioners had?

Mr. BERICK. No, they weren't.

Chairman LIEBERMAN. I don't have any further questions. I am inclined to go on to the next panel, unless you would like to—

Senator THOMPSON. No, Mr. Chairman, I think I must follow up a bit. Maybe we ought to ask the question more precisely. Were there any other commissioners who had that level of contact with Enron lobbyists through 2000 and 2001, because as you said, you went back and asked for contacts over a 10-year period. If the point is that there are other—during the focus of your investigation, which I understand is 2000 and 2001, basically, there are other commissioners with other contacts, we should be talking about them, too. We should not be singling out one commissioner.

This is just the information that we had. We started out with the information that the commissioners themselves provided for us, and at least I am not aware of anywhere near this level of contact. But the records speak for themselves. I would suggest, Mr. Chairman, we go back and check on that. Maybe Mr. Berick cannot remember that.

But I would say that you need to think through your answer to the TVA question. Now, it is true that some of these meetings were with Johnny Hayes, who had been commissioner of TVA. This is on August 24. I assume that his prohibited activity, his banned activity was past and I think he has a 2-year ban with regard to Federal agencies on things he was directly involved in, but the facts will speak for themselves. I can only assume that he is OK as far as that is concerned, and there are some meetings there with Mr. Hayes.

It is also true that Mr. Hayes apparently received \$200,000 directly from Enron and also another \$300,000 from this law firm, the Wyatt law firm, and that was a part of a \$500,000 fee that the Wyatt law firm had been paid by Enron. So perhaps we can find out about the TVA aspect.

But there is a memo in the file here. We went to the law firm of Mr. Hayes—of course, he is not a lawyer, but the Wyatt law firm, and they supplied information that is in the Committee files and Mr. Bone, who was a partner in that firm, who was in most all of these meetings with Commissioner Breathitt made a memorandum.<sup>1</sup> I am not sure what the date of it is. I am not sure it is dated, but it was clearly during the Presidential campaign, and Mr. Bone, who was at that time, as I say, lobbying for Enron, said, "very friendly meeting with Linda Breathitt." I won't read all of it. We can go over it with Ms. Breathitt.

"We had a good opportunity to talk about the issues and her position as the swing vote. We visited Gore headquarters and had lunch with Johnny Hayes. Next point, the FERC will be responding today to the request of President Clinton and Secretary Richard-

<sup>1</sup>The Bone Memo appears in the Appendix on page 734, Vol. IV.

son. FERC will be very responsive to the crisis with investigations in California and possibly a hearing in California. She is very impressed with Steven Keene and spoke highly of him." Steven Keene, of course, is with Enron, also. This has nothing to do with TVA. This has to do with California.

I have no further questions, Mr. Chairman, unless the witness wants to respond to that.

Chairman LIEBERMAN. Do you want to respond to that?

Mr. BERICK. No—

Chairman LIEBERMAN. Let me ask, and then I do want to move on to FERC, but why did you make the reference to TVA? Was that in the information that was submitted by Commissioner Breathitt or FERC to—

Mr. BERICK. No. The files that I think that Senator Thompson is referring to were provided to us from Enron, our request from Enron for contacts with FERC and my review of those documents showed that, to the extent that there was an issue involving FERC, it had to do with the TVA contact.

Chairman LIEBERMAN. Right. In fairness, we ought to give you a chance to go back and look at it. You looked at tens of thousands of documents to get to the priority choices you made about the four areas you were going to investigate. These are all the pages that were submitted to us, and every one of these pages contains, depending on the size of the description, between five and ten individual contacts between Enron employees or representatives and commissioners or staff of FERC. There have got to be several hundred contacts here, and I would—

Senator THOMPSON. Mr. Chairman, if I may, I would suggest, if that is not public, that ought to be made a part of the public record.<sup>1</sup> I assume what you have got there goes back over a 10-year period and it may or may not be relevant. But I think that the record ought to speak for itself and let people decide for themselves what is relevant.

Chairman LIEBERMAN. That is fine with me, and I guess I want to just state for the record, and I know you are not questioning this, but just in case there is an implication, that there was no directive from the Chairman, certainly, to the staff to—

Senator THOMPSON. I know that, Mr. Chairman.

Chairman LIEBERMAN [continuing]. To go and kind of get the Republicans and protect the Democrats. This investigation and the conclusions that Mr. Berick and I, in my opening statement, reached fall equally, in fact, probably at least as much, maybe some would say more, on previous FERC commissioners than the current ones because the aim here is not partisan. The aim is to figure out how we can protect consumers from being taken again.

Senator THOMPSON. Mr. Chairman, there is no question about that, and you have always been fair and even-handed as we approach these things. There are a lot of people involved. You and I both get the results of these things sometimes as we walk in, especially after having been off as long as we have. But unfortunately, we have a history of several months with regard to this issue and

<sup>1</sup>Records from 10 year-period appears in the Appendix beginning on page 1 of Vol. IV.

I think the record just needs to speak for itself with regard to all the other issues.

There have been other good people. I cast no aspersion on any commissioner or any lobbyist. I have lobbied and I have been lobbied. But there have been other good people who have suffered from the subjections or implications and so forth that have been made in the public. I just think the record ought to be complete. And if Enron was fervently and feverishly lobbying other commissioners in 2000 and 2001, we ought to know about that.

Chairman LIEBERMAN. When the hearing is concluded, Mr. Berick, you and I can sit and talk and see what more can be done to pursue some of these matters, if appropriate, and then, dare I say, it will be up to Senator Collins as the next Chair to determine whether she wishes to proceed with those investigations.

Mr. Berick, I thank you very much for an extraordinary piece of public service. I think there is a lot for all of us to learn from the conclusions you have reached, and particularly from the four cases that you focused on. I hope that we will do that together with the commissioners at FERC. Thank you very much for your work.

Mr. BERICK. Thank you, Mr. Chairman.

Chairman LIEBERMAN. Thank you.

I now call the four commissioners of FERC as the second panel, the chairman, Hon. Patrick H. Wood, III, members Linda K. Breathitt, Nora Brownell, and William L. Massey. Would you please remain standing and raise your right hand. We are getting the alignment together with the name plates.

Do you swear that the testimony you are about to give this Committee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. WOOD. I do.

Ms. BREATHITT. I do.

Ms. BROWNELL. I do.

Mr. MASSEY. I do.

Chairman LIEBERMAN. Please be seated. The record will show that the four witnesses all answered the question in the affirmative.

It is our understanding, Mr. Wood, that you are going to be testifying on behalf of the Commission, but we are going to give each of the other three commissioners a brief opportunity to make any additional comments that you think necessary and appropriate after Mr. Wood completes his testimony, and Commissioner Breathitt, obviously, you may want to respond to the questions Senator Thompson has raised.

We understand that either all of you or most of you have had to rearrange your schedules to be here—this was a postponed hearing—and we thank you very much for that and for your cooperation in general.

Commissioner Wood.

**TESTIMONY OF HON. PATRICK H. WOOD, III,<sup>1</sup> CHAIRMAN,  
FEDERAL ENERGY REGULATORY COMMISSION**

Mr. WOOD. Good morning, Senator Lieberman, and Senator Thompson. Thank you both for the opportunity to respond today.

In the mid-1980's, the Federal Energy Regulatory Commission began its effort to restructure the wholesale natural gas industry to take advantage of competition between and among producers and sellers of natural gas to reduce prices for end use customers and to incent the drilling and production of this important natural resource that just 10 years before was thought to be swiftly dwindling.

Congress followed up the FERC's effort with the 1989 Wellhead Decontrol Act, and independent calculations of customer savings of this FERC-initiated restructuring ranged from \$200 billion to \$600 billion to date. I was proud to be a part of that pro-customer effort as a staffer to a member of the Commission, and that is a big part of why I am back today.

One of the other major industries under FERC regulation is the electric power industry, and thanks to the 1992 Energy Policy Act and subsequent FERC implementation of Congress's vision through the 1990's, restructuring of the power industry has begun, as well. For restructuring to be successful and yield benefits for customers, however, there must be some basic preconditions: Sufficient energy infrastructure, balanced market rules, and vigilant market oversight.

Upon joining the Commission last summer, I concluded that none of these preconditions was firmly in place in the electric industry. After a summer of internal and external assessment with my colleagues here, we adopted a strategic plan which gave equal primacy to all three of these goals. In the past submissions to Congress by prior administrations, the oversight goal was subsumed in other strategies, and I would call attention to the strategic plan as the final three pages of my filed testimony.

Unlike the other agencies that were cited earlier, ours is charged with a significant role in infrastructure and in compliance with the Nation's environmental and safety laws. We issue licenses for the Nation's non-Federal hydropower facilities. We oversee their environmental and safety compliance. We issue certificates for construction and expansion of the Nation's extensive natural gas pipeline network, including the many environmental and land owner issues and rate matters associated with such activity. We also regulate the rates and services of the similarly extensive oil and refined products pipeline network.

These infrastructure responsibilities naturally dominate the agency's resource allocation and account for 53 percent of our program and support employees. Fifty-seven percent of the rest of our employees handle the market oversight function at FERC, which is a total of 335 program and support employees, and the other 250 staff are dedicated to our second strategy, which is balanced market rules. Employees from all nine of the agency's offices contribute to the achievement of our strategic plan.

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<sup>1</sup>The prepared statement of Mr. Wood with attachments appears in the Appendix on page 130.

We look forward to getting our fiscal year 2003 request in place so that we can continue to hire the necessary expertise and talent to achieve the oversight goals that my colleagues and I have set for the agency. The increase of 50 staffers in my first budget request reversed a decade-long trend of agency downsizing by over 20 percent, and in my estimation, these new employees are badly needed.

As with this summer's GAO report on FERC's oversight performance, I welcome constructive criticism of our agency's performance. I also appreciate, Senator Lieberman, your personal and sincere effort to help our agency do its job better. We owe our best effort to the Nation's energy market customers and to the many fine companies whose investment over the years has underpinned this national economy.

To focus for just a moment on today's topic, vigilant market oversight, I am pleased with the progress that we have made in the past year. It started, quite frankly, with a mindset change at the top, a commitment from the four of us that our ability to oversee these industries for the benefit of customers must be second to none. For me, this is a need borne of my past job as a State utility regulator, which depended on FERC to do its job well so that I, as a State regulator, could do my job well. We are today in Chicago at a meeting of all the national State commissioners. In fact, Linda, Nora, and I have all formerly been on our respective home State commissions and share this commitment that we are partners with States in doing this job well.

This commitment of mine and of ours has led to the creation of the Commission's Office of Market Oversight and Investigation, which reports directly to the commissioners in our now-frequent closed meetings. This is an idea I adapted from our sister agency, the Commodity Futures Trading Commission. No longer are investigation issues handled at the staff level alone. Now, they are all brought to the attention of the full Commission and senior staff management from all program offices as the open meeting laws allow.

We hired the new office head, Bill Hederman, sitting here behind me, earlier this year after a national search. He has been very successful in attracting talent from within and from outside the agency to do the hard, probing work necessary to be a vigilant market policeman. Of course, OMOI is not the only part of the agency involved in market oversight functions, but now there is a primary office charged with leading this responsibility.

The oversight role is also shared with States and with regional bodies, such as the Electric Independent System Operators and Regional Transmission Organizations. Full integration of this oversight capability into FERC's culture and processes is underway, and I share none of this gentleman's concern that it will not be successful. In fact, I am here to make sure that it is successful.

Participants in the energy market know that we are serious now. Reports to our confidential hotline are up significantly, as are formal complaints filed with the Commission regarding issues of fair treatment. In our more proactive posture and with better analytical resources, the Commission has begun a number of non-public investigations of issues in all four of our industries. As the GAO report points out, it is not enough to wait for someone to file a com-

plaint at FERC. We need to use all forms of inquiry to effectively police the industry.

Everyone, from customers to investors, benefits when there are clear rules of the road. By and large, we have these in the gas, and had these in the gas industry since the 1980's and 1990's, when a series of FERC rulemakings set forth the contours of a restructured wholesale natural gas marketplace.

Clear rules are not present in the power industry, however. One of the key actions we took in my first meeting as chairman in September of last year was to initiate a broad and open process to develop a sensible framework for the Nation's wholesale power markets. This has led to publication of a formal proposal in July, referred to as the standard market design, and this is now open for public comment through January and February. Had this framework been in place 3 years ago, combined with the more methodical and objective oversight capability, as our next panel will discuss further, I believe the California experience would have been largely avoided.

But we cannot live in the past. As the current Commission seeks to redress the past wrongs through pending enforcement trials and investigations, which we are doing in close coordination with our sister Federal agencies, we are focused on the future, focused on getting sufficient energy supply and demand infrastructure in place across the Nation, focused on establishing a sensible regulatory framework to govern the restructured energy markets, and focused on effective and watchful oversight of these crucial infrastructure industries so that customers continue to benefit from an efficient and reliable energy marketplace. Thank you.

Chairman LIEBERMAN. Thanks, Mr. Wood.

Commissioner Breathitt, do you have a statement you would like to make?

**TESTIMONY OF HON. LINDA K. BREATHITT, MEMBER,  
FEDERAL ENERGY REGULATORY COMMISSION**

Ms. BREATHITT. Yes. I have a brief opening statement. Mr. Chairman, and Senator Thompson, I am here today in a supporting role of Chairman Wood as he testifies with respect to the FERC's oversight of Enron Corporation and the lessons learned from its financial collapse. I associate myself with the content of his testimony.

I do want to add that I have supported the initiatives taken by the FERC after Enron's collapse. I believe the proceedings the chairman detailed in his testimony should go a long way toward ensuring that an Enron-type debacle does not happen again and toward ensuring that energy consumers receive adequate supplies at reasonable prices.

Beyond these initiatives, I believe Chairman Wood's effort in forming the Office of Market Oversight and Investigations, that we call OMOI, should enhance the agency's ability to review energy market developments, identify problems in market function, and take corrective and punitive steps, as necessary. If this office successfully performs its mission, which I expect that it will, FERC will have taken an important step toward restoring confidence in

regulatory oversight of the energy industry and restoring stability to this important component of our Nation's economy.

Finally, I would note that as I near the end of my tenure as a FERC commissioner, I believe I will be leaving an agency that is well aware of the need for vigilant oversight of the entities it regulates. The fallout from the collapse of Enron, as well as WorldCom, Quest, Tyco, and others, have painfully reminded us of the dangers of unchecked corporate behavior. The need to effectively encourage appropriate corporate behavior by regulated entities and discipline bad corporate behavior when necessary will continue as the Commission moves to more competitive and transparent markets for energy products. Thank you.

Chairman LIEBERMAN. Thanks, Commissioner Breathitt. Commissioner Brownell, do you have a statement?

**TESTIMONY OF HON. NORA M. BROWNELL, MEMBER, FEDERAL ENERGY REGULATORY COMMISSION**

Ms. BROWNELL. I do, just a brief statement. I certainly join the Chairman and Linda Breathitt—in fact, I think you see before you a FERC that is working as effectively as any agency in government to address the tragedy that has occurred in our market, and let me tell you, when we came to the FERC, what we found was a market meltdown, an agency under siege, and a staff who were both overworked, overwhelmed, and looking for leadership.

Under Chairman Wood's leadership, with the introduction of a business plan, we have addressed many of the issues that the report raised today. But I appreciate that report, because, frankly, we all need to work more productively and affirmatively in anticipating what markets need, because, Senator, you said markets have no conscience. Well, adolescent markets have no self-control and markets do not develop without rules, and we are making rules.

We are, indeed, dealing with the past as effectively and efficiently as we can, but we can't rush to judgment because we need to get this right. We have seen a \$90 billion market capital loss in the energy sector, a loss that this country cannot afford when our economy begins to grow again. We see growing transmission constraints. We see power quality disturbances which affect our industries, like the car manufacturing industries, very severely, in ways that we are not counting. We don't see the investment in technologies that can address many of the environmental issues that we face and our grandchildren will face.

So I look forward to working with you, this Committee, and other committees in addressing these issues. But I feel quite confident that while we may have been slow out of the starting gate, we have addressed a wide range of issues in a very short period of time.

Chairman LIEBERMAN. Thanks very much, Commissioner Brownell. I accept the addendum to my comment. Maybe I would only add that this may be, instead of an adolescent market, an infant market, which definitely doesn't have a capacity to self-control and needs a little parental guidance every now and then.

Ms. BROWNELL. To be sure, a lot of parental guidance.

Chairman LIEBERMAN. Thank you. Commissioner Massey.

**TESTIMONY OF HON. WILLIAM L. MASSEY, MEMBER, FEDERAL ENERGY REGULATORY COMMISSION**

Mr. MASSEY. Mr. Chairman and Senator Thompson, I will be brief. I agree that the Commission's response to the Western energy crisis was generally timid and ineffective. The agency should have imposed price controls immediately when the market skyrocketed in the summer of 2000. This is what I championed and was extremely disappointed that the Commission did not impose such price controls for almost a year, until June 2001. Such controls imposed early could have stopped a lot of the economic carnage which turned into a disaster.

I agree that the Commission should have been more vigilant in its market oversight. I support Chairman Wood's new efforts in this respect. I believe that he has a strong commitment to oversight and market structure and is willing to put in place sufficient staff resources so that never again should we face the kind of travesty that we faced with the Western market meltdown.

The agency needs to be very vigilant in its market monitoring and its oversight and intervene forcefully whenever abuses are found or whenever markets spin out of control. I believe this new unit that Chairman Wood has created is a strong step in the right direction. Of course, the proof will be in the pudding. If we're back here 2 years from now because of the failure of oversight, then I will be wrong about that. But I don't think we will be. I think the agency is moving in the right direction.

I agree that the rules regarding affiliate abuses should be strengthened. We have a couple of proposed rulemakings that are being commented on now. One would substantially strengthen our affiliate abuse rules across the board for natural gas pipelines, electric utilities, power sellers, and others. That is pending and I hope that we can finalize that rulemaking soon. We also proposed a rulemaking with respect to the so-called "sweep accounts" that pipelines and electric companies have with their affiliates, and we have proposed strong new affiliate regulations.

With respect to Enron Online, perhaps the agency should take a very close look at whether we should be regulating platforms such as Enron Online, and I support any effort to come to reach a conclusion about this at the agency as soon as possible.

Thank you, Mr. Chairman. I look forward to your questions.

Chairman LIEBERMAN. Thanks, Commissioner Massey. I remember when I was at law school we used to refer to a few of the Supreme Court Justices as the "great dissenters," and maybe the record will show that going back some number of years, you deserve that title, which is a title of honor at the FERC. The record of what you have tried to do is clear and I appreciate it.

Commissioner Wood, let me begin with the general question, which in some sense, I think, you dealt with in your opening statement, but am I correct that when you served on the, I forgot what it was called, but the utility commission in Texas, that was a traditional regulatory commission which heard petitions and applications by the local utilities for rate increases and then set the rates?

Mr. WOOD. Yes, sir. I should add, though, in our years, they were rate decreases that we were going through in Texas.

Chairman LIEBERMAN. Well, that is even better. [Laughter.]

So it was a so-called regulated environment?

Mr. WOOD. It was similar to what we are doing here, quite frankly. Our State statutes were changed in 1995, which was the year I—

Chairman LIEBERMAN. OK. So you were one of the early ones that had it. In Connecticut, in my previous position, I was Attorney General of Connecticut. We had an assistant AG who was over at the Department of Public Utilities and the commission and represented ratepayers in rate proceedings and then, ultimately, the commission determined what rate of profit, essentially, the particular utility would have and set the rate.

To make a complicated story more simple than I should, there was a similar process going on at FERC with regard to wholesale energy rates. We got to deregulation and, of course, we relied on the market then. But I take it you agree that in what I have just described as a deregulated market, where not a commission or government set the rates, but competition does, that there is at least as much need for governmental oversight, is that correct?

Mr. WOOD. Without question. I should add that in both the gas industry and the electric industry, the delivery of the commodity, so to speak, is still regulated by FERC and by States. The transmission of power, the transportation of natural gas, those are set by FERC. We have a staff and law judges that do the traditional rate case work for gas pipelines, for electric power companies.

Chairman LIEBERMAN. Right.

Mr. WOOD. It is the commodity of the power itself, much like the commodity of gas in the 1980's and 1990's, that is going through the more deregulated treatment, but not the conduit that moves the commodity.

Chairman LIEBERMAN. But there is definitely a role for oversight, or in another sense, normally, it would be called regulation, but it is to make sure that the players—

Mr. WOOD. Play by the rules, that they play by the rules.

Chairman LIEBERMAN. That they play by the rules, that they are playing fair, which obviously, looking back, did not happen here.

Let me give you a chance to respond to the staff conclusions about the Office of Market Oversight and Investigations that you created. My inference is that they feel as I do, and as your fellow commissioners do, that this was a significant step forward, to establish the office, but that it may not have enough resources to be effective. You know, it is the "We are from the Congress and we are here to help you" commission, or maybe that is what we are saying. [Laughter.]

So I want you to deal with some of that. But then the larger question, I think, is whether the rulemaking on market rules will actually address the larger institutional issues raised by the staff investigation, for example, the concern that FERC didn't look more closely at the wind farm transactions or Enron Online or was not adequately vigilant about transactions with holding companies because they are not, in the narrow sense, directly related to the oversight of market behavior.

So as productive, constructive a step as setting up the Office of Market Oversight and Investigations at FERC is, will it, in fact,

get to some of the shortcomings that the staff investigation found, I think convincingly, in the Enron case?

Mr. WOOD. I think, and to take the four issues, the Enron Online would actually be something that would come out of the new office. The type of expertise—I do take some umbrage, I suppose, at it being characterized as, I guess, a bureaucratic reshuffle, and not having seen the report, I don't know what the exact words were, but we have had, in fact, some extensive hiring from the outside of significant people with other Federal experience and a tremendous amount of private sector experience for the 90 employees that we have hired to date. It is, in fact, the farthest thing that this agency has had from a bureaucratic reshuffle.

But again, it ties back, as I said in my opening statement, Senator Lieberman, to the mindset change. The staff on this agency now know that the four of us, and hopefully our future people that follow us, are intellectually thirsty about these issues that come forth and that we need to be trained, as the staff do, the commissioners need to be trained—it is a group effort—to understand the markets and to really engage on the issues that come forth.

So, again, you could put 600 people in OMOI, but if the commitment is not there at the top that not only we want this, but we care about it and we view it as a core part of our mission, as we move away, as your first question pointed out, Senator, from the world of just traditional cost-of-service regulation to one that is more market-based, we have got to make that a core part of our mission. The staff have to know it. The staff have to know when they are coming to work here that this is not just a Pat Wood fad, but that this is a core part of what FERC is all about. I think people understand that now and I expect in my term as chairman that we will continue to deepen and expand the roots of the market oversight function.

But there are more people than just market oversight that do the work that we are talking about. For example, the wind farms issue is kind of what fall in the traditional licensing and traditional regulation parts of our agency, which do involve market oversight but are not involved in the investigations and the kind of forward-looking training and the reviews of data that come in to see what has happened in prices in competitive markets or in handling the hotline complaints that come in from third parties, either confidentially or publicly filed with the Commission. So there are a number of things that would go on.

To take the third item, the California investigation, we are presently doing that with existing staff because the Market Oversight Office was not set up at the time that we began the investigation into events in the West back in last January and February, but I would expect that future aspects of that type of work going forward would be centered out of this office, drawing upon resources across the agency. Certainly, an investigation of that breadth is going to overwhelm just one office and will necessarily require us to be a matrixed organization, and I like that. I want that.

Chairman LIEBERMAN. Let me ask you this. Understanding that the staff work went back over 10 years in FERC's records, most of which time, obviously, you were not there, do you take issue with any of the conclusions that the staff investigation has reached re-

garding the, let us say the timidity of FERC's actions with regard to the four issues that the staff chose to focus on, the Western markets—California obviously was one, the wind farms, the Enron Online, the holding company, and the inter-related entities transactions. Do you think that, since you are in charge now and you will be for some period of time, familiar as I believe you are with the staff investigation, do you think that they reached solid conclusions?

Mr. WOOD. I am on the record as saying I was concerned at the time, as a State commissioner looking in from the outside, that FERC's slowness to move on the wholesale market issues that were under their domain in 2000 were of concern to me, and they still are. I think we have got to be, if not ahead of the curve, right on it, not well after it, and I do think that that series of events, unprecedented, admittedly, would have probably taken anybody by surprise.

But it is the kind of retooling that I am looking for that it would not take us by surprise, that we would be so on top of, as I should say, to our staff's credit, in recent weeks, the issues that come up in just looking at daily gas trades. We find the list, usually look into them.

Chairman LIEBERMAN. Yes.

Mr. WOOD. Those kind of things, when you nip them in the bud, they don't develop into catastrophes like you have out West. But I do think that one probably, I have said publicly and I will say again today, is along the valid track.

The QF issue is an interesting one because it is a statute that—

Chairman LIEBERMAN. Why don't you spell it out for the record.

Mr. WOOD. I am sorry, the wind farms, the renewable power. Congress really wanted to make sure that we had renewable power when they passed the PURPA back in 1978, and that began a lot of the investment in renewables and in cogeneration and some of these more environmentally benign resources, and in that statute and in the late 1970's, the implementation of that by the FERC, there was a very strong desire to make sure that there was not a bureaucratic obstacle to those resources getting built. They were, in fact, as I think Mr. Berick pointed out, paid a premium over what the general power would be, so there was basically a legislative enticement for those resources to come to the marketplace.

So the FERC set up a self-certification process that was reviewed in Mr. Berick's opening remarks that allowed a party to self-certify and then get into the marketplace without waiting for a 6-, 8-, or 10-month procedure at our agency to basically approve that they go forward. I think that there have been 9,000 of these since 1978 and we have had about 20 of them actually—and 90 percent of the 9,000 have taken the self-certification route. About 10 percent have taken the route that we are going to go to the Commission and have them affirmatively rule on our case, because we need it for financing generally, have taken that route.

And of the 90 percent, I think about 20 have been protested by the utility that has got to pay. I mean, it was set up in the Carter years' FERC to, in fact, get the incentives lined up so that the utility, and this was revisited back in 1995 when the Commission re-

visited these rules, there is a person there who has got an incentive to make sure that somebody is not lying, and that is the utility that is paying the extra charge and the State commission that stands behind that utility.

For that reason, FERC in 1995 said, if, Enron, you come in and tell us that you are changing this or selling that, you have got to tell the local utility in California and you have got to tell the California PUC that you are doing that. That has been used about, probably again, 20 times over the past two decades to trigger an action at FERC, where we actually review and find out if, in fact, those people qualify for the benefits or not.

I think this particular example has, of course, due to the Fastow admissions, been triggered by us into a proceeding of FERC to review the qualifications for the benefits. But quite frankly, I do think, over time, the balance of 9,000 applications and 20 that were asked to be looked at and one that now has actually been found perhaps to be false—again, that is pending before our Commission. It may well be benign. I do not want to prejudge that. But I do think that one probably, I would say, is a little—maybe a bit of a hard slap that we deserve—

Chairman LIEBERMAN. But otherwise, accepting that, you would say that the staff conclusions have merit and that you will embrace them to the best of your ability as you go forward in your chairmanship?

Mr. WOOD. Sure. Absolutely. Again, as I mentioned, I appreciate constructive criticism. We are a public agency. We work for the good of the customer and we want to make sure that we do that as best we can.

Chairman LIEBERMAN. Let me ask you a final question before I yield to Senator Thompson. Just speak for a moment, if you would, about the changes in law that you request in your testimony and whether there are any additional changes that you might suggest for us in law or whether you think the remedy to the illnesses, the ailments that the staff report shows are largely going to come from the retooling that you are doing and perhaps from some more adequate staff—or more staff. Let us assume what you have got now is adequate to the task and more people—

Mr. WOOD. Well, we have asked for more, and I believe the conference report—

Chairman LIEBERMAN. Yes.

Mr. WOOD [continuing]. Does indicate our increase of that. I do think, again, as I mentioned, that a good part of this, a good part of our ability to do this job better, again, comes from our personal commitment to that, from an empowered staff who, despite what you have heard today, have done a fantastic job over the last decade. Again, as it has been downsized by 20 percent from when I worked here as a staffer back in 1991–1992, it is 20 percent smaller than it was and has quite a bit more to do.

Chairman LIEBERMAN. Yes, it is a problem. Look, the big picture that I come away with is that the rules of the game changed. We went to a deregulated environment. Some, very aggressive, sophisticated, find the angles, be as clever as they can to make the most money they can. Players, including Enron, got into it and the FERC just did not keep up with them. The world had changed.

This is a regulatory agency that was now operating in a deregulated environment and the consumer paid the price and it was an enormous price.

But let me not go on further with that, and ask you to describe in a little more detail the legislative changes that you recommend in your report.

Mr. WOOD. Thank you. We had asked and was included in the, I guess now-retired energy bill, for an increase in civil penalty authority to be administered by the Commission in the Federal Power Act. We subsequently recognized that we did not have that in the Natural Gas Act, either, and have asked for that, but that was not in the electricity title because it is a gas issue.

Chairman LIEBERMAN. OK.

Mr. WOOD. So the civil penalty side would be as enhancing our authority at FERC to use those tools. We have also joined in the, I think, broad support for enhanced criminal authority, which would be administered, as it is today, by the Department of Justice for violations of the Power Act and of the Gas Act.

Chairman LIEBERMAN. OK. So part of reaching to the whole Enron saga and scandal is to beef up the enforcement authority of FERC and FERC working with the Department of Justice?

Mr. WOOD. Yes, sir.

Chairman LIEBERMAN. Thanks, Commissioner Wood. Senator Thompson.

Senator THOMPSON. Thank you very much, Mr. Chairman.

Ms. Breathitt, would you like the opportunity to respond to some of the things that have been said here this morning, specifically, the 46 or so contacts that you had with Enron lobbyists over 2000 to 2001?

Ms. BREATHITT. Yes, sir. I don't have the same information that you have. I don't know what the 46 are, and—

Senator THOMPSON. We are going to be giving you copies of the listing of the Wyatt law firm.<sup>1</sup>

Ms. BREATHITT. OK.

Senator THOMPSON. We got these from the Wyatt law firm. And basically, as you can see there, telephone conferences with Mr. Bone, Mr. Hayes, and others.

Chairman LIEBERMAN. Commissioner Breathitt, if I might, with your permission, Senator Thompson, this information was obtained by the Committee staff as a result of requests and subpoenas in some cases, both to FERC and to Enron, which I presume gathered some of it from its attorneys.

Senator THOMPSON. Yes, and the attorneys, in some cases, the attorneys themselves who represented Enron.

Chairman LIEBERMAN. Right.

Senator THOMPSON. Including the Wyatt firm that Mr. Bone was affiliated with at that time.

Ms. BREATHITT. With respect to my wonderful father, he has been associated with the Wyatt firm for a number of years, as counsel on a fixed-priced salary, and a rather low one at that. He wanted to be able to come and go as he pleased in his retirement

<sup>1</sup> Listing of contacts between Commissioner Breathitt and Charles Bone appear in the Appendix on page 699, Vol. IV.

years and did not share in any of the profits of the firm. He has since retired and has no financial arrangement with the firm and has not had for a year.

With respect to the California energy crisis and whether or not there was a relationship with Enron lobbyists, I don't know how Mr. Bone and/or Mr. Hayes accounted for the contacts, but the trip that I made to Nashville in August was a vacation day that I recall I went to visit my aunt and uncle, had lunch with my nephew, and I did visit the Gore campaign that day and saw Charles and Johnny, who gave me the tour of the Gore campaign. But that was a day that I went to Nashville to visit my aunt and uncle and have lunch with my nephew, as well. I grew up 70 miles north of Nashville and it was a town that I frequented a lot.

Senator THOMPSON. I might say, Mr. Bone's memo,<sup>1</sup> which we will make a part of the record, also says that you wanted to make sure you emphasized that you were in Nashville visiting family.

Ms. BREATHITT. I don't know what he said, but I do have family there and have had for 50 years.

Senator THOMPSON. That is consistent with what you said. That is my point.

Ms. BREATHITT. Yes. The Enron contacts that I have disclosed were ones that I had records of. We don't keep telephone logs in my office, and to the best of my recollection, I disclosed to the Committee everything that we had records of and that I could remember. Enron and Enron's lobbyists, the times spent that I talked to them were very disappointed that I had not been a proponent of mandatory RTOs.

Chairman LIEBERMAN. Just define RTO for the record.

Ms. BREATHITT. Regional Transmission Organizations. They were very interested in having mandatory RTOs having unfettered, open access through the transmission lines. They were very interested in having a single transmission tariff. They were a big proponent of unbundled retail sales, and I have probably been the most reticent member of the Commission on those issues.

With respect to California, on the December 15, 2000, order that you referenced, Senator Thompson, we began and continued in successive orders putting in price controls, each one going further than the one before, and that particular order also eliminated the tariff for the power exchange, which, in some regards, one of the Enron trading strategies called "Fat Boy," which was a strategy to sell power when the IOUs under-scheduled their load, that was impacted when the Commission instituted an under-scheduling penalty back in December 2000 when we eliminated the California power exchange and put in that under-scheduling penalty. We also allowed resources owned by the IOUs to directly serve their own load rather than selling them through an exchange.

In all of the ensuing orders, we continued to go further with our price controls, and in April 2001, we adopted a "must offer" provision, which has been considered the regulatory response by the three-member Commission at the time, that had the most positive effect in controlling the California energy collapse and the high prices, and that was the April 2001 order.

<sup>1</sup>The Bone memo, dated February 6, 2002, appears in the Appendix on page 734, Vol. IV.

It was around that time that we began to consider capping the whole Western market and it was, I believe, my idea for all of us to go to Boise and talk to Western members about whether we should extend our price plans and price caps West-wide. We came back and we did so in June, and when my new colleagues joined me and Commissioner Massey at the time, it was the June order that was in the process of being written when they came that furthered the price controls.

So I would like an opportunity to, Senator Thompson, to look at this document and be able to respond to it. It is difficult for me to do so today when it has just first been handed me, but—

Senator THOMPSON. I might say, Ms. Breathitt, and you will have all the time that you want, that it is true that we asked you for these contacts and asked you in a supplement and you responded. We have many more here than what you responded to, but it is understandable that the firm would have better records and more complete records than a commissioner would. I understand that.

I am trying to establish some basic points here without casting aspersion on you, certainly not your father or your father's firm. He is a distinguished public servant. But this is relevant information, and if I can do it in a short fashion, I will try to do so.

What seems to be the case is that Enron, and I am looking again at one particular memo that I hopefully will make a part of the record, from the firm and Mr. Bone,<sup>1</sup> that apparently Enron went to Mr. Hayes and Mr. Hayes went to the firm and they wound up representing Enron. The firm did some work for Enron with regard to TVA and Mr. Hayes and Mr. Bone in the firm did some work with regard to FERC.

So let me see if we can establish it by the numbers here. It is accurate, anyway, Mr. Bone was a partner in the Wyatt law firm, is that correct?

Ms. BREATHITT. Yes, and he was at the time, and Mr. Bone has been a friend of mine for a number of years, and I don't know how he recorded our phone conversations, but during that time, I have to assume that a lot of them were more than likely political in nature.

Senator THOMPSON. Well, there are several—I can understand that. Mr. Bone has been a friend of mine for a number of years. If you look here, there are a number of phone conversations, very few of them are with Mr. Bone alone. They are Mr. Bone and Mr. Hayes; Mr. Bone and Mr. Hayes and Mr. Shapiro, who is with Enron; Mr. Bone, Mr. Hayes, and Mr. Delaney, who is with Enron; Mr. Bone, Mr. Hayes—

Ms. BREATHITT. I don't know a Mr. Delaney, and I—

Senator THOMPSON. Telephone conference with Commissioner Breathitt with Charles Bone, Johnny Hayes, and Mr. Delaney, October 19—

Ms. BREATHITT. I don't know who that is.

Senator THOMPSON. OK.

Ms. BREATHITT. And I don't recall conference calls.

Senator THOMPSON. What about Stan Horton with Enron?

<sup>1</sup>The Bone memo, dated February 6, 2002, appears in the Appendix on page 734, Vol. IV.

Ms. BREATHITT. Stan has been in my office to see me as head of the pipelines—

Senator THOMPSON. As he has other commissioners, I am sure.

Ms. BREATHITT. We have numerous courtesy visits. But I—I don't know how—I have talked to Stan on the phone. He has also been in my office numerous times.

Senator THOMPSON. Steve Kean.

Ms. BREATHITT. I have known Steve since I was a State commissioner in 1993. He was very prominent at NARUC meetings and did State regulatory work.

Senator THOMPSON. Linda Robertson.

Ms. BREATHITT. Linda Robertson ran their Washington office and has come to see me in my office. I don't recall ever talking to her on the phone—

Senator THOMPSON. Kathleen Magruder.

Ms. BREATHITT. I don't know who Kathleen Magruder is.

Senator THOMPSON. She is with Enron, also, but you can't testify to what you don't know, but Mr. Bone's, the firm's records indicate that all of these conversations—most all these telephone conferences, is the way they describe them anyway, had to do with, often with Mr. Hayes, often with one or more of these other Enron people, which gets down to the point, is it fair to assume that these Enron—and you know during this period of time, August 2000 through 2001, Mr. Bone was representing Enron and the firm was representing Enron, were they not?

Ms. BREATHITT. I don't know when Mr. Bone started representing Enron, because—

Senator THOMPSON. Well, you know it is some—

Ms. BREATHITT [continuing]. I just don't—yes, he did disclose that to me.

Senator THOMPSON. And you know Mr. Hayes was, although he is not a lawyer, he was representing Enron?

Ms. BREATHITT. I don't know about Mr. Hayes representing—

Senator THOMPSON. Well, he was talking to you on behalf of Enron, was he not?

Ms. BREATHITT. He was with Mr. Bone twice when we had dinner, but I don't know what his relationship was with Enron.

Senator THOMPSON. Well, according to their records here, over that period of time, there are either nine telephone conversations or meetings that involved Mr. Hayes. During that time, do you recall the subject of Enron ever coming up?

Ms. BREATHITT. Yes.

Senator THOMPSON. And, of course, it came up with regard to Mr. Bone and, I assume, these other Enron lobbyists? That is all I am trying to establish.

Ms. BREATHITT. Yes. I have—

Senator THOMPSON. Everybody has got their pitch to make and they were making theirs and this was before a lot of the problems that we now know Enron had were surfaced.

Ms. BREATHITT. Yes, and I don't think I was one of Enron's most popular commissioners.

Senator THOMPSON. Well, that—

Ms. BREATHITT. I didn't share a lot of their points of view and philosophies.

Senator THOMPSON. I am making no assertions about that. Were you aware of the fact that—well, you were aware of the fact, I assume, that the Wyatt law firm was being compensated for their work. Were you aware of how much they were being paid?

Ms. BREATHITT. No, not at—I was not.

Senator THOMPSON. Were you aware that Mr. Hayes was being paid by the law firm—

Ms. BREATHITT. No.

Senator THOMPSON [continuing]. For the work that he was doing?

Ms. BREATHITT. No.

Senator THOMPSON. Let me hand you a copy of a fax and a copy of, I don't know if the staff can give that to Commissioner Breathitt, a fax apparently from you to Charles Bone in August 2000.<sup>1</sup> Now, the accompanying letter where Governor Patton is recommending you for Chairman of FERC—

Ms. BREATHITT. Yes.

Senator THOMPSON [continuing]. Is dated August 23, 2000. Do you recall when you faxed—apparently, you faxed a copy of that letter to Charles Bone. Do you recall when that was, because the date is not reflected on the fax.

Ms. BREATHITT. No, I don't.

Senator THOMPSON. Do you—

Ms. BREATHITT. In August—no, I don't. August of—let me see what this is.

Senator THOMPSON. This letter, I might state while you are looking at that, this letter is a recommendation from Governor Patton to President Clinton. It says, "I am writing you about a matter concerning a citizen of the Commonwealth, Linda Breathitt, having been appointed by you on October 24, 1997, and confirmed by the Senate. She is a sitting Commissioner," and then he says, should the chairman leave the Commission before his nomination is confirmed, "I would urge you to appoint Linda Breathitt to be the next FERC Chairman," native Kentuckian, excellent choice for a number of reasons, goes ahead and gives your experience there as chairman of the Kentucky Public Service Commission, outstanding service on FERC and what not.

So the governor was recommending you for the chairmanship and you sent a copy of that, apparently, to Mr. Bone. What was the purpose of your doing that?

Ms. BREATHITT. I don't—I am not arguing that I sent it, because here is the fax cover sheet, but I don't recall why I would have sent it to Mr. Bone.

Senator THOMPSON. Well, you said a lot of your conversations were political, and we know, of course, that before the election, during this period of time, Mr. Hayes was the treasurer of the Gore campaign and Mr. Bone was actively involved in it. If you look on his website, he, of course, points out that he has been very active with Mr. Gore for a long time. I can only assume that you were trying to get Mr. Bone to assist you with this nomination to be chairman, would that be a fair assessment?

<sup>1</sup> Communication from Commissioner Breathitt to Charles Bone, dated August 23, 2000, appears in the Appendix on page 781, Vol. IV.

Ms. BREATHITT. I don't remember sending this, but I am sure I did because there is a fax cover sheet that is in my handwriting. But it is known to many people that Mr. Bone and Mr. Hayes, as being from the same city as Mr. Gore, were well known to him.

Senator THOMPSON. When did you become aware that Mr. Bone and the Wyatt firm was representing or was going to represent Enron?

Ms. BREATHITT. Sometime in the latter part of the year 2000.

Senator THOMPSON. Well, Ms. Breathitt, you had 21 conversations or meetings with Mr. Bone from August 2000 to December 8. The files indicate that—

Ms. BREATHITT. But I don't—see, there is an entry here that I—I have no idea who a Mr. Delaney is. What if these were about me?

Senator THOMPSON. Well, is there anybody else on either of those two pages who you do not recognize, other than Mr. Delaney?

Ms. BREATHITT. But what if—I am not—I don't know if I had conversations on all these days. What if they could have been about me?

Senator THOMPSON. Well, no. These are records that the law firm has submitted to this Committee—

Ms. BREATHITT. Oh, but there—

Senator THOMPSON [continuing]. Which indicate law firm contacts with you. That is what they purport to be. One of the records that they sent was an August 1, 2000, letter confirming recent conversations with Enron, that the firm had about representation of Enron with regard to TVA. Then there is another letter of August 22 concerning representation of the Wyatt firm for Enron with regard to development of policies at the DOE and the Federal Energy Regulatory Commission.

Ms. BREATHITT. We don't regulate the Tennessee Valley Authority.

Senator THOMPSON. I understand that. That is why I didn't understand our previous witness's testimony that he thought all these contacts with you had to do with TVA. That wouldn't make much sense, would it? It certainly, and again, I am not casting aspersion because of this. Enron was very active and they had contacts with everybody that they could have contacts with. Here, they chose to go a particular route that had to do very close to you in terms of the law firm affiliation and all, long-term friends and your father's affiliation with the firm.

But I would think that we could agree that they were, from August 2000 through at least the end of 2001, that representatives of the firm and Enron were talking to you from time to time about Enron matters. Isn't that the clear import of this?

Ms. BREATHITT. Yes.

Senator THOMPSON. All right.

Ms. BREATHITT. And as I mentioned, I have been the most reticent, least philosophically attuned to where Enron was going, in my opinion—

Senator THOMPSON. I can appreciate that, because there are a lot of people with regard to the administration who try to point out time and time again that they did exactly the opposite of what some of these people wanted them to do, but that does not keep them from having to do investigations for several months.

Ms. BREATHITT. That is right. And I certainly am not faulting your being critical of this inquiry and line of questioning because I think it is appropriate to get any lingering questions or concerns addressed that the initial questionnaire, as we were calling it at FERC, that we received in March, be discussed.

But there were numerous contacts by Enron over the 5 years that I was there, and I am certain that colleagues of mine, former and present, have had Enron contacts, as well, because they came to see us frequently. They were an aggressive company and they were not shy about advocating what they wanted with respect to what was legal to talk about, and pending matters are not permissible to discuss.

Senator THOMPSON. Well, Mr. Bone says in his memo of your meeting in Nashville that the FERC will be responding today to the request of President Clinton and Secretary Richardson. FERC will be very responsive to the crisis with investigations in California and possibly hearings in California. Linda did not want to address the issue specifically today, but indicated she would be pleased to meet with us in Washington at an early date. She is very impressed with Steven Kean and spoke highly of him.

Ms. BREATHITT. Yes, I have known, as I mentioned—

Senator THOMPSON. I might add this. She acknowledged that this is not a partisan issue in any way and is very conscientious about trying to solve the crisis. Is this a fair—

Ms. BREATHITT. Yes.

Senator THOMPSON [continuing]. Recounting of the meeting, do you think? All right.

Ms. BREATHITT. It was not a lengthy meeting. I was taking a vacation day to go see relatives, have lunch with my nephew. I wanted to see the Gore campaign. I had never seen a Presidential campaign in operation, and they were both friends of mine, and I considered it an informal trip to Nashville with multiple reasons.

Senator THOMPSON. Well, I think any time you have an opportunity to go to Nashville, you ought to take it, would be my feeling. [Laughter.]

Mr. Chairman, I have no further questions. I would think it would be appropriate for all of our sakes to make a part of the record these documents that we have been referring to that came from the Wyatt law firm. I hate to get into the details of any one's records or firm's records, but I believe that they all have to do with the issues that we have been dealing with here today. Perhaps, if you would prefer, staff could get together and agree upon a submission to make sure that no privacy is unnecessarily violated. But I do think the basic documents would be well served to make a part of the record and let them speak for themselves.

Chairman LIEBERMAN. Senator Thompson, I have no objection to that and I think I would like to take you up on your offer that our staffs get together, and I think in fairness to Commissioner Breathitt, we ought to have similar responses to the questionnaires, including, by Mr. Berick's recollection, Commissioner Brownell, Commissioner Massey, both of whom had contacts with representatives of Enron, as well. I think, Commissioner Wood, you indicated that you had not after you came onto the Commission, but in any case—

Mr. WOOD. I did, a few.

Chairman LIEBERMAN. You have? OK. Then in fairness, we ought to agree on some system for reflecting—

Senator THOMPSON. I agree with that.

Chairman LIEBERMAN. Thank you.

Senator Levin, I suppose it is appropriate to begin by congratulating you on your reelection.

Senator LEVIN. Thank you so much, Mr. Chairman.

Chairman LIEBERMAN. Though you return with me in the Minority, nonetheless, maybe that makes it even a happier turn of events that you did come back, so we get ever closer to that magic number. Anyway, welcome. Thank you for taking the time to be here today.

#### OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you. I am delighted to be back here with Senator Collins, if I may take the liberty of saying so.

Chairman LIEBERMAN. Yes, indeed.

Senator THOMPSON. Already buttering her up. [Laughter.]

Senator LEVIN. Mr. Chairman, I have an opening statement which I would ask to be included in the record.

Chairman LIEBERMAN. Without objection.

#### PREPARED STATEMENT OF SENATOR LEVIN

The Enron scandal continues to teach us painful lessons about corporate misconduct and the need for government action to police our markets, protect consumers and investors, and punish corporate wrongdoing.

The Enron scandal began by exposing dishonest accounting at a number of major U.S. companies that, unbeknownst to most, had begun to eat away at the reliability of their financial statements. It has since exposed the conflicts of interest that have made investors distrust investment reports issued by leading U.S. financial firms. It has exposed how those firms have become willing participants in shell companies, phony trade deals, and complex financial transactions used to inflate earnings, hide debt, and increase stock prices. And Enron has exposed how, all too often, corporate executives have walked away from corporate disasters with millions in their pockets, often from exercising stock options, while pension funds, investors, employees, and creditors have lost everything.

Today's hearing provides another painful lesson in corporate abuse. The spotlight today is on U.S. energy markets and how lax government oversight failed to protect U.S. consumers and markets from false data and price manipulation by corporate wrongdoers.

Energy companies today are reeling from media reports of deliberate market manipulation, round-trip trading, and bogus derivatives that are really bank loans. These allegations are not confined to Enron, but have spread to other energy companies as well. Prominent energy firms have seen their credit ratings slashed, their profits collapse, and their stocks nosedive. Employees are being laid off by the tens of thousands. Public trust in energy deregulation has suffered a serious blow.

While most of this market turmoil is attributable to corporate misdeeds, a portion of the blame also falls on the shoulders of regulators who failed to police the energy markets. Those markets have undergone sweeping change over the last decade, moving from a system of highly regulated monopolies to one that is supposed to incorporate market-based competition. But market-based systems are not automatically fair, efficient or honest, because there are always those who engage in deceptive and unfair practices. That's why it is the job of government to police the markets, determine what is happening, and put a stop to those unfair or deceptive practices.

We will hear today that the Federal Energy Regulatory Commission, FERC, has not kept pace with the changes in the energy marketplace and has failed to ensure just and reasonable rates as it is required to do.

While part of FERC's inaction can be attributed to statutory limitations on what it can regulate, another part comes from a hands-off approach to market-based pricing.

ing that resulted in FERC's failing to detect significant market manipulation and other corporate misconduct. And Enron is apparently not the only wrongdoer that has evaded FERC oversight. News reports of possible misconduct by other major U.S. energy companies have become commonplace. They include reports of company traders' giving false price data to reporting firms, companies engaging in billions of dollars in phony roundtrip trades, and deliberate strategies to manipulate California energy prices.

If we are to restore confidence in these circumstances, we need a re-invigorated FERC that is explicitly dedicated to promoting transparent and fair energy markets, safeguarding investors and consumers, and stopping corporate misconduct. FERC has recently taken steps to rectify its shortcomings and strengthen its market oversight. Congress also has a role to play in clarifying and strengthening FERC's oversight and enforcement authority. I congratulate our Chairman, Senator Lieberman, for his efforts to shed light on these problems and to get us all to learn from the lessons taught by the Enron scandal.

Chairman LEVIN. First, let me compliment the Committee and its staff on a very detailed and objective report which really deepens our understanding of what went wrong and how FERC oversight needs to be strengthened in order to restore investor and consumer confidence. Commissioner Brownell spoke of a \$90 billion loss of capitalization in the U.S. energy markets. That is a loss to all of us.

To restore these investments and the confidence of investors in the energy industry, we need a market that people are confident is not rife with deceptive and unfair practices, and that means we need a lot stronger market oversight by FERC, and I believe this report and this hearing will contribute to that goal.

I want to start with Chairman Wood with the wind farm issue. As you have indicated, Congress adopted a number of laws which were aimed at encouraging alternative energy sources, such as solar and wind power. One of those laws allows alternative energy generators that are independently owned—not owned by a regulated public utility or a utility holding company—it allows them to charge higher rates for electricity and to sell all the power that they want to public utilities, which must buy it at the higher rates.

Now, those benefits, higher rates and guaranteed electricity sales, as you know, are supposed to go only to the qualified facilities that meet the law's requirements, the "QFs." And those benefits mean that every alternative power generator wants to be a qualified facility, a QF, eligible to charge the higher rates.

We have heard the story of how Enron had three wind farms that were in danger of losing QF status because Enron was buying a public utility and then would become a utility holding company, in turn, which meant that the wind farms would no longer meet the law's requirements to be independent of a public utility. We heard how Enron, in order to help the wind farms keep their QF status, supposedly sold them to a shell company called, I think it is called RADR, that was allegedly independent of Enron.

That was 5 years ago. We now have found out that RADR was not independent of Enron. It was secretly controlled by Enron officials, and both the Justice Department and the Securities and Exchange Commission have filed legal action against those Enron officials, Fastow and Kopper, for their actions regarding RADR.

The indictment of Kopper states that Mr. Kopper and other Enron officials had "devised a scheme to enrich themselves and enable Enron to retain secret control over the California wind farms

while appearing to maintain eligibility for QF status.” That is the background.

Now, the hypothetical question. What if numerous public utilities that owned alternative energy generators, like a solar or wind power generator, sold their facility to a special purpose entity that was owned or controlled by one of the utility’s senior officers? The individuals who owned the facilities would not themselves be utility owners. They would just be officers of the utilities. Would that arrangement comply with the FERC regulations that require the qualified facilities to be independently owned?

Mr. WOOD. I don’t have an answer to that because I haven’t thought about it, quite frankly, and looked at those regulations in that light. I will be glad to do that and respond to you, Senator.

Senator LEVIN. Would you do that and get back to us? I think you indicated there were about 9,000 qualified facilities, is that correct?

Mr. WOOD. Nine thousand filings at FERC to certify or self-certify, yes, sir.

Senator LEVIN. And how many of those QFs are 50 percent owned by public utilities?

Mr. WOOD. Of the—I would think it should be none, if they are not—

Senator LEVIN. None?

Mr. WOOD. If they are not qualified, then they should not be eligible for the benefits.

Senator LEVIN. Well, but you can be 50 percent owned by a public—

Mr. WOOD. I am sorry. Can you ask that again, Senator?

Senator LEVIN. Sure.

Mr. WOOD. I think I missed it.

Senator LEVIN. Apparently, you can retain your qualification to be a QF provided you are no more than 50 percent owned by a public utility.

Mr. WOOD. That is how I read PURPA, yes, sir.

Senator LEVIN. So now my question is, how many of those QFs are 50 percent owned by—

Mr. WOOD. Or less.

Senator LEVIN [continuing]. Not more, 50 percent or less?

Mr. WOOD. I will get back to you on that, too, sir.

Senator LEVIN. Well, about how many?

Mr. WOOD. I would have no idea to even say if it is 10 percent or 90 percent. I have no—

Senator LEVIN. Well, but shouldn’t you know?

Mr. WOOD. I don’t know.

Senator LEVIN. I mean, given the experience we have had with those wind farms, shouldn’t FERC know?

Mr. WOOD. Well, if they are eligible, sir, I think that is not the problem. But I don’t—

Senator LEVIN. Well, it is a problem—

Mr. WOOD. If they are 49 percent—

Senator LEVIN [continuing]. Because we have SEC and we have the Justice Department saying that can just be a sham ownership.

Mr. WOOD. Right. That would be—

Senator LEVIN. So if we have—

Mr. WOOD. If you pierce the sham, it is clearly more than 50 percent.

Senator LEVIN. But if you see a pattern that public utilities are owning 50 percent of these QFs, isn't it important, then, to see whether or not, in fact, there is an independent QF or not?

Mr. WOOD. Sure. Yes, sir.

Senator LEVIN. Shouldn't you then be piercing some of the veils here?

Mr. WOOD. I think so, but as I mentioned in my address to, or in response to a question from Senator Lieberman, we have kind of a front line for this effort, as well, that is, the company actually paying the payment to the QF, and that would be a large utility or a co-op or mostly large utilities, and the State commission standing behind that. So we do have other people that are helping us in this effort and we have, in fact, used that trigger line up to now, certainly, as really the first check for when we ought to look deeper, and we have in the past looked deeper at some of these that were a little harder to understand.

Senator LEVIN. Yes, but that first check didn't work.

Mr. WOOD. It didn't work here.

Senator LEVIN. And may not be working other places. So isn't there an obligation and responsibility to take some initiative to, at least on a random basis, look at these QFs that may be 50 percent owned, and then isn't there some obligation on the part of you as a regulator to see if that other 50 percent might not be some special purpose entity that was created by that public utility?

Mr. WOOD. I think that is a reasonable request, sir. Yes, sir.

Senator LEVIN. As of this moment, until you said that was a reasonable request, there was no—

Mr. WOOD. We have not done any further investigation of that since we initiated the—we have the particular transaction that came up with regard to these series of renewable facilities that came forth, set for an enforcement trial as we speak, and I think we will learn a lot from that effort as to how these transactions were structured and that should certainly inform if we want to do any further investigation of related transactions.

Senator LEVIN. I would hope that FERC would undertake a systematic review of these QFs, particularly the ones where there is a significant percentage of the ownership which is in the hands of a utility.

Mr. WOOD. Of a utility, yes, sir.

Senator LEVIN. The whole self-certification troubles me, as well. How many of these challenges have come—I think you said there is a total of 16?

Mr. WOOD. Twenty, or 16?

Senator LEVIN. Twenty?

Mr. WOOD. I will take 16, if that is something we have got.

Senator LEVIN. Twenty. What you hope the market would automatically produce would be people who have an interest in keeping the prices lower would file the protest or the request for investigation. You have had 20 of the 9,000. Now, how many of those have come from competitors and how many of those 20 have come from consumer groups?

Mr. WOOD. I would—I do not know, the 16 or the 20, how those break down, but I think primarily they are coming from the utility who is paying the payment—

Senator LEVIN. I didn't mean the competitors, I mean the utilities that are paying.

Mr. WOOD. Right. That would be a competitor, I suppose, yes, sir.

Senator LEVIN. They have to file, don't they, a filing fee there of \$16,000?

Mr. WOOD. For a declaratory order for those, is that what—yes, sir, that would be correct.

Senator LEVIN. And then, if they prevail, do they get that \$16,000 back?

Mr. WOOD. I hadn't thought about that. I don't know. I could look into that. I don't know that we have got that.

Senator LEVIN. Take the consumer group out there—

Mr. WOOD. The State PUC certainly can file, as well.

Senator LEVIN. Right, but just take a consumer organization, a public interest group or a consumer's group. They may not have \$16,000, right? So for them, that is an impediment. What I am saying here is I would hope FERC would be a lot more aggressive in doing policing. Sometimes, the market will do the policing for you, but sometimes it won't. It seems to me you have got to be a lot more aggressive, because you have a responsibility here to make sure that there are just and reasonable prices that are charged by utilities. That is the requirement of law, is that correct?

Mr. WOOD. That is correct.

Senator LEVIN. It seems to me we already know the market does not do that automatically. For a number of reasons, it does not do it. First, you may have entities in there that are willing to, as the Chairman said, go beyond what is legal, that are pushing the envelope here, that are cutting corners. Second, you may have people that are simply defrauding others. And then you have this financial barrier also, the \$16,000, which may not be a lot to a public utility but could be to a consumer organization that wants to challenge it.

So it seems to me that you have that responsibility and you acknowledge, I think in response to the Chairman's questions, that the staff report relative to those recommendations is a constructive report and that you intend to carry it out. I would look forward to this random sampling, as well, of these QFs in order to see whether or not there is a pattern here—that this is not a unique situation where there was a phony, a sham ownership of 50 percent that was set up—

Mr. WOOD. Right.

Senator LEVIN [continuing]. In order to make sure that the intent of the statute is carried out.

I see the red light is on, so my time is up.

Chairman LIEBERMAN. Senator Levin, because of the small number of Senators that have been here today, we have been quite generous with time, so if you have a few more questions you want to ask on this round, you are welcome to.

Senator LEVIN. I do, but I think I see Senator Collins looking at me like she has another commitment to go to.

Senator COLLINS. I do, actually.

Senator LEVIN. If that is all right with the Chair, let me yield at this time and perhaps come back.

Senator COLLINS. Thank you, Senator Levin.

Chairman LIEBERMAN. Thanks.

Senator COLLINS. You read that correctly. [Laughter.]

Chairman LIEBERMAN. Senator Collins, congratulations to you, both on your reelection and what I presume will be your, dare I say, ascension to the Chairmanship. This is a wonderful Committee, which you have been just a superb member of, and you are very prepared in every way, ability and honor, to be an excellent Chair of the Committee and I look forward in my new capacity and yours to working together with you to fulfill the mandate of the Committee.

#### OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you, Mr. Chairman. I look forward to continuing to work with both you and Senator Levin. We have been partners on a number of investigations over the years and I am sure I will enjoy working with you in my new capacity, as well.

Chairman WOOD, I know that you would agree that consumers are entitled not only to a well-designed market, but also one that is carefully monitored for market power abuses, and I believe that under your leadership, there are many encouraging signs that FERC now understands that dual mission.

However, the potential profits from gaming a market in a necessity for which there is often no short-term substitute would seem to be so enormous that I can envision a scenario where the gamers continually come up with new schemes and the regulators are constantly scrambling to catch up with the latest innovative scam.

Why should consumers feel confident that we now have the ability to police the markets in a way that will prevent the kind of gaming that has occurred, particularly when, although you have requested additional authority and additional resources, you have got to receive what you have asked for?

Mr. WOOD. I think as to the last point, Senator Collins, I think we can certainly, within the context of what we have got today, move forward assertively on the market oversight, the monitoring. We have the ability under current law today, if there is a violation of a rule, some gaming incident that was in violation of a rule, that any profits from that transaction could be remitted back to the customer who paid them. Certainly in New England and New York, in the Mid-Atlantic here, there are more sophisticated efforts that have been underway in those more open markets for the last 5 years or so that do monitor these transactions on a transaction-by-transaction basis and look at patterns and look at specifics and do the spot audits that Senator Levin was talking about in a different context.

So I do think, quite frankly, in the parts of the country where we have moved to a more open market on at least the wholesale level, where there are predictable rules of the road, where there are independent institutions that oversee those regional marketplaces, that there has been—not perfectly, to be sure, but there have been, in large measure, a very responsible market, even in times of relative scarcity because of the stress.

It is important, however, to—I mean, there are two preconditions in addition to oversight that we have got to have, which are infrastructure, both the power plants, the power lines, the gas lines to get it there, the abilities of customers to reduce their demand at times of peak because they get a price signal, which I think we visited last summer. I was reviewing our transcript from you.

And then also balanced market rules, a good institution set up to look at the rules. As a full Commission, about 4 or 5 months ago, we put forth our vision in response to a lot of these issues, that we do need a standardized approach toward markets that has a lessons learned aspect to it, from what has worked well in markets and what has not worked well.

But that is not a fixed-in-time process. I think we learn from what has worked well in New England, in PJM, in Texas, Australia, England, and other places. We learn what doesn't work well in those places and in California to craft a vision for the future that, while it is getting a lot of vetting right now, I think it is absolutely critical to make sure that we address your core issue, which was how can we convince customers that they will be better off? We have to actually do the full bore of the infrastructure rules and oversight to make sure that works.

I do appreciate the attention of the Committee today toward the oversight issues, but the infrastructure and the balanced market rules are just as critical to making sure we have an effective marketplace for customers.

Senator COLLINS. Let me follow up with two questions, one on infrastructure and one on the consumer side. Let me do the consumer side first.

One of our expert witnesses on the next panel tells us that much more attention needs to be paid to the development of an active demand side in electric markets so that consumers will be able to respond to short-term swings in market prices. But I must say, creating a demand side in many ways seems to me to be equivalent to talking about the weather. Everybody talks about it, but nobody seems to be able to do anything about it.

Are there really, truly concrete, practical programs that can be currently implemented to create a meaningful opportunity for consumers to respond to price changes, and if so, what are they? The average consumer has no idea when prices are going up and down.

Mr. WOOD. Right.

Senator COLLINS. We have talked about having special meters that perhaps large industrial users could use. I would like to get your thoughts on that issue.

Mr. WOOD. A great question. In fact, I will tip my hat to Tom Welch from your State and Bill Nugent and then the other commissioners in New England for—and Nora has been kind of our lead on this, so if she wants to pipe in, feel free.

But we have engaged in basically a laboratory with FERC as the wholesale regulator and the six New England States as the retail counterparts to put together a demand side or demand response initiative, to try to see how can we integrate this resource that we need so bad. We need it like we need a new power plant in certain regions of the country. It is that effective to basically check market power on a scarce day or to avoid building a new power plant.

Sometimes, you do not need new power plants if people have an incentive to reduce their demand at the summer peak, for example.

So the test case, the pilot project in New England, we have approved—prior to this summer, we approved the first one in the PJM, which is here in the Mid-Atlantic, demand response initiative as a FERC-regulated item, as well, and we have got an item on next week’s agenda dealing with that still. But the response to that was mixed. I think it is certainly better than not having done it at all, but I think of all the things in our kind of vision of the future that are so critical to make work well so that this really does deliver consistent benefits for consumers, the demand side is the one with the fewest data points underpinning it. Even looking at foreign countries, we don’t have a real clear market-driven demand response.

You can certainly regulate them, where you are cutting checks, as we are having in the PJM. You are basically paying people a fixed amount—it is not very precise, but you are paying them a fixed amount of dollars to shut off at peak.

Senator COLLINS. Commissioner Brownell, do you have anything?

Ms. BROWNELL. Yes. In fact, I met with some of the people working on the NEDRI project in New England, which is a wonderful laboratory, by the way, lots of cohesive vision among the State commissions there, and they have come up with a number of suggestions that I think will be implemented in the not-too-distant future.

But I think the important message that we took away from our discussions during RTO and SMD development was there is agreement that everyone needs demand side management, but no one knows how to price it, no one is as familiar as they need to be with the technologies, the real-time pricing technologies that will enable customers, even the smallest customers, to manage these loads more effectively.

And we treated them like programs. They are temporary. They are pilots. They get enacted late. That was one of the problems in PJM, that when we approved it in May, because it came in so late, it was difficult for customers to really participate.

So we need to institutionalize them. We need to recognize there is a real value. This is not something that you just throw subsidies at. This is an important part of balancing the market and allowing customers to speak. And you have probably heard me say before, I think we have been very condescending about the ability of customers to make buying choices, including to manage their electric load. I think they are fully capable, and, in fact, in some of the experiments we have seen, they are willing to do so.

So I think that the secret is, get the technology right, get the pricing right, empower people, and make these an institutional part of the market. There are lots of competing forces, of course, for whom that is a very difficult concept to grasp. But I think we are getting there and we will have some measurable results in New England in the not-too-distant future.

Senator COLLINS. Thank you. Chairman Wood, I want you to pretend that the Chairman of this Committee is not here for this next question. There is a clear need for additional transmission, but I am very concerned about the question of who pays for it.

For example, last week, the system operator in New England announced that because Southwest Connecticut does not have sufficient power to meet its demand, it needs a transmission upgrade slated to cost at least \$600 million. Now, some people have argued that the cost should be borne not only by those who live in Southwest Connecticut, but by consumers throughout New England, and I question the fairness of that approach, especially since Connecticut has the highest residential electricity consumption of any New England State. Indeed, the average monthly household consumption in profligate Connecticut is 711 kilowatt hours, compared to just 479 kilowatt hours in thrifty Maine. [Laughter.]

Now, under these circumstances, is it fair to impose on the rest of New England the cost of this upgrade, and similarly, a related question would be, is it consistent with relying on market forces to spur people to respond to higher prices? In other words, if people in Connecticut are using an inordinate amount of electricity that produces this need for a transmission upgrade, why should consumers in Maine, who have limited their electricity use, have to pay for part of that upgrade, and doesn't that send us in exactly the wrong direction as far as using market forces to control demand?

Chairman LIEBERMAN. Forget all those nice things I said about Senator Collins. [Laughter.]

Mr. WOOD. This is actually in our standard market design rule-making one of the most, I don't want to say contentious, because as you are, people are civil about this, but it is a gut issue about cost allocation and cost responsibility following the people who cause the cost to be incurred.

We had a full-day conference that we all sat in on with a lot of what we call the very smart guys and gals from around the country last Wednesday, in fact, on this issue of funding for transmission expansions, and there was a curious alignment of people in the deep South with New England about this approach, which is called participant funding, which is more directly defined as "the beneficiary pays."

I think the take-away from that was, in a market environment where you have price signals, which you have got certainly coming in New England with the implementation of some new market rules later this year, with proper rights being vested in transmission rights, which we have in New England, New York, and PJM, and an independent administrator, which you have certainly got in New England, that it is a lot easier to allocate the cost and identify the beneficiaries and allocate them.

So in your case, I think of all the places in the country, New England, New York, and PJM are probably closest to being able to discretely identify who the beneficiary is and then make sure that that party pays for it.

The current policy, however, with ISO New England and with the six States up there is kind of a split one, which was explained to us pretty eruditely by Chairman Dworkin from the State of Vermont, who was very kind to point out that they are always 5 percent of the total amount of load, and I don't know if he is thriftier than Maine or not, but he was definitely of a mindset that

we ought to move to the more beneficiary pays approach on transmission, but they are not there yet.

There is a two-part work. There are very big transmission facilities there, spread over the region, because they are viewed as benefiting the entire reliability of the region. If there are more localized facilities, lower voltage, for example, that can pretty much keep the power located in the neighborhood, then those are billed directly too.

So I am not sure what the actual transmission needed in Connecticut would be, but I think under the current rules in New England, some of that could, in fact, be spread across the entire region, but some of it would also be direct billed to the people that take service in that particular area.

So it is in transition in New England, from the world of just dump it in the bucket and spread it over everybody, the peanut butter method, to the more, I guess, precise method of allocating. But it is not all the way there yet. For instance, Mr. Dworkin pointed out from Vermont, we have "rolled in." We, Vermont, have paid for some of these upgrades in the Boston area, in central Massachusetts and in the Rhode Island area, but we haven't built anything in Vermont yet to get our fair share.

So I think when you are halfway through a policy of peanut butter going to direct bill, you have got to make sure everybody got their fair share of peanut butter the first time, and then you can call an end and then move to the new system. So I think that is going to be kind of hairy to work through, but I think we can get there in New England, to that "beneficiary pays" system. But recognize that they are partly down the other road than the one your question advocates and I think it is going to take some careful unknitting of that garment to get it back.

So I think we will work with them and we will work with you on that, and I think we certainly want to, at the core, get the needed infrastructure in place. If we don't have that infrastructure in place on both the gas side and the electric side, even good old sturdy New England, which has an overbuild of 20 to 30 percent extra generation, if they can't get to where the customers are, it just as soon not ever be built anywhere. So you have got gas coming in from Nova Scotia, from Western Canada, from the South. I think New England is set off beautifully as far as an energy future. We just have to make sure the infrastructure is in place to bring it all the way to the end-use customer.

So we will work on the cost allocations, and it is, admittedly, a hairy issue right now, but it is something we can certainly work through. But the core issue we want to really address through our rulemakings is that the incentive be given to build in the first place, because we do need it.

Senator COLLINS. Thank you, Mr. Chairman.

Chairman LIEBERMAN. Thanks, Senator Collins. I must tell you that the proposal for paying for the new transmission to the Southwest part of my State was made by the ISO. But thus far, the question of how this is going to be paid for has received very little attention in Connecticut because there is a tremendous controversy, as the Commission may know, about the siting, in other words,

about whether additional transmission capacity should be built and a lot of residents of various areas don't want it to be built.

But it did sound to me like Commissioner Wood was suggesting just the kind of independent, centrist, moderate solution that you would typically— [Laughter.]

Chairman LIEBERMAN [continuing]. Be sympathetic to. Anyway, thank you.

I just have a last question of you, Commissioner Wood, and obviously, I appreciate Senator Collins' questions—before that last one— [Laughter.]

Because they obviously say, not surprisingly, that she shares the interest that I and other Members of both parties on the Committee have that FERC learn, as you have tried to do now, from the Enron scandal and that we feel that you are being as aggressive and sophisticated as the players out in the deregulated energy market and that we have an obligation sometimes to push and other times to support you, including with resources as best we can.

My last question is that I gather that you have said somewhere that you hope to complete FERC's investigation into the California and Western markets by next February. I always like deadlines and I understand that there may be a degree to which the Commission is under some pressure, explicit or implicit, to reach a judgment so that you can restore confidence in the markets, in some of the companies involved, but I would just give this precautionary word, which is that though we have concluded that Enron behaved very badly here, and on the basis of that, we cannot conclude that all the other participants in the energy markets in the West or elsewhere behaved badly. We also don't know that they didn't.

I mean, at a certain point, obviously, you have got to decide that it is over, but I want to urge you not to feel the pressure to reach a conclusion before you really have the basis for reaching a conclusion that the other significant players in the Western energy market did not also act badly, because the worst thing, I think, from FERC's institutional point of view would be to have someone or some entity afterward make a compelling case that some of the other players out there gamed the system as much as we now know Enron did.

Mr. WOOD. Thank you for that. I think the main reason, Senator, we embarked last January and February on setting up the investigation is there have been and continue to be lingering doubts about what exactly happened in California, and we wanted to, I think as I mentioned to your colleagues on the Energy Committee, we want to really get as far down that food chain as we possibly can to understand what happened. If there are bad actors, take them out to the woodshed. As your question pointed out, there are some good actors who the world doesn't think are good that are living under this cloud right now, and we are cognizant of the need to lift that cloud.

It is a time line, quite frankly. I asked the lead of the investigation to tell me realistically how much time he needed to get through all this effort and he said that the first anniversary of its public starting would be sufficient time for them, and all the array of consultants that we have from the outside working with them,

to analyze terabytes worth of data to complete that effort and bring it to the public so that they know what we know.

I appreciate that concern and welcome it, and we are not here to make short shrift of a very serious topic, but to do a thoughtful effort that you will be proud of, that we will be proud of, and that the customers of energy users in this country will think is respectable.

Chairman LIEBERMAN. I appreciate that. Thank you all very much for your testimony, for your work.

We will call the third panel. I thank them for their patience. Commissioner Massey, is your term ending soon, Commissioner Massey?

Mr. MASSEY. My term ends in June 2003.

Chairman LIEBERMAN. Oh, you have some time. Commissioner Breathitt, I thank you both for your service and we look forward to continuing to work with you, Commissioner Wood and Commissioner Brownell.

On this last panel, I want to welcome back and again thank you, Dr. Paul Joskow and Dr. Frank Wolak. Both Dr. Joskow and Dr. Wolak testified before our hearing last year on June 13, and that was on the California energy crisis. We have asked them to come back today to share with us their thoughts about the events that have transpired since June 2001 and the lessons that we and FERC should learn, particularly, of course, from the Enron debacle, which happened, which collapsed officially or visibly after your testimony here in June 2001. We greatly benefited from your testimony on that occasion and we look forward to it now.

I thank you for your patience, and obviously, your full testimony will be included in the record.

Dr. Joskow, please proceed.

**TESTIMONY OF PAUL L. JOSKOW, PH.D.,<sup>1</sup> DIRECTOR, CENTER FOR ENERGY AND ENVIRONMENTAL POLICY RESEARCH, MASSACHUSETTS INSTITUTE OF TECHNOLOGY (MIT)**

Mr. JOSKOW. Thank you, Senator Lieberman. It is a pleasure to be here again. As you indicated, I last testified before the Committee in June 2001, and I thought it would be most useful for me to update the comments and observations I made at that time in light of 18 months of additional experience.

A lot has happened in 18 short months and my written testimony contains a long list of lessons learned. I do hope it will be included in the record.

Chairman LIEBERMAN. It will.

Mr. JOSKOW. I would like to highlight a few of what I think are the most important lessons and then to offer a few comments about how FERC is doing.

Creating well-functioning, competitive wholesale and retail electricity markets is a significant technical and institutional challenge. It is easy to do it badly and it is hard to do it well. Careful attention to the details of electricity market design and supporting institutions, drawing both on U.S. and international experience and active involvement by and cooperation between Federal and State

<sup>1</sup>The prepared statement of Mr. Joskow appears in the Appendix on page 146.

regulators in defining and implementing these details is very important.

Electricity's unusual attributes also create unusual opportunities to exercise market power and to engage in a wide range of behavior to drive prices up to supra-competitive levels. If you doubted this 18 months ago, I hope that you are convinced now.

Good market designs and appropriate supporting contractual and institutional arrangements can help to reduce the incentives and ability of suppliers to drive up prices. However, that is not enough. An effective, credible, and professional market monitoring and enforcement system must be in place to measure and evaluate market performance, to identify actions necessary to improve market performance where it is poor, to enforce market rules, and to punish those who violate them.

At the same time, it is important to guard against counter-productive regulatory initiatives that undermine the behavior and performance of well-functioning competitive markets. Hard competition is to be encouraged, while unfair competition, unreasonable levels of market power, and misleading or fraudulent presentations of financial and market information must be mitigated by effective oversight and appropriate sanctions when abuses are found. Finding the right balance between regulating too little and regulating too much continues to be an important challenge.

More broadly, I think, as we look out into the future of the electric power industry, it is going to be important to adopt policies to support an evolution to an industry structure where merchant generators make most of their money by building and operating power plants cheaply and reliably and selling most of their output under longer-term contracts to financial intermediaries, to load-serving entities, and directly to large consumers. That is, we want to design markets so that firms earn their money by being the lowest-cost suppliers, rather than being good at engaging in behavior to increase price spikes and to game market rules.

In response to the events and revelations of the last 18 months, public and investor confidence in competitive electricity markets has been shaken and several States that planned to introduce restructuring, wholesale and retail competition initiatives have delayed or suspended their programs. Unless the credibility of the markets, the market participants, and those who regulate them is restored, it is unlikely that there will be support from additional States to extend electricity restructuring and competition initiatives or that capital will be forthcoming at a reasonable cost to pay for needed investments in generating capacity and vitally needed transmission infrastructure. A credible commitment by FERC to protect consumers from poor wholesale market performance is a necessary condition to restore public confidence.

In my June 2001 testimony, I was extremely critical of FERC's responses to the California electricity crisis, and I have reproduced some of those criticisms in my written testimony here. While there is plenty of blame to go around for those events, it is quite clear that FERC did too little and acted too late to avert the crisis. The question is, has anything changed, and I think the answer is yes.

I think that FERC has made a lot of progress in the last 18 months under Chairman Pat Wood's leadership and has responded

positively to the criticisms that I made in mid-2001. I am generally pleased with the tone that has now been set at the top, the institutions that are being created to monitor electricity and gas markets, and with the electricity market reform initiatives that have been undertaken.

The Chairman and the other FERC commissioners have repeatedly made it clear to market participants that they are committed to creating well-functioning, competitive wholesale markets and that they will not tolerate efforts to manipulate prices, violate market rules, engage in fraud and other market abuses, and they have taken some actions to show that they are serious about these commitments.

However, as Commissioner Massey said a little while ago, the proof is in the pudding. Several important investigations and rulemakings are in progress and their outcomes and consequences, necessarily, remain uncertain. Institutional cultures also can take a long time to change. Only time will tell whether this view at the top has been fully institutionalized within the agency and whether FERC delivers on its renewed commitment to mitigate market power, punish those who violate market rules, and ultimately to adopt sound policies that improve electricity market performance.

Let me just end, if I could have 10 more seconds—

Chairman LIEBERMAN. You can take a little more time, if you want.

Mr. JOSKOW. I have been working on electric power regulation and industry restructuring and competition for 30 years, and I really want these reforms to work. It is especially important for us in New England. We have gone very far down this path. Clearly, this was a much more difficult initiative than many had anticipated, but I do feel, finally, that we have leadership at FERC that is taking these challenges very seriously. While I don't agree with all of their proposals, I do very much hope that we will all encourage them to continue the efforts that they have begun in the last 12 or 18 months. Thank you.

Chairman LIEBERMAN. Thanks, Dr. Joskow.

Dr. Wolak, welcome back and thank you for being here.

**TESTIMONY OF FRANK A. WOLAK, PH.D.,<sup>1</sup> DEPARTMENT OF ECONOMICS, STANFORD UNIVERSITY**

Mr. WOLAK. Senator Lieberman, thank you very much for the opportunity to appear before you. Although my oral comments focus on the lessons learned from the California crisis, my testimony also provides a diagnosis of the crisis and the interventions that led to its solutions.

At the start, I would like to emphasize that the California crisis was not a market failure but a regulatory failure, and consequently, the key to preventing future California crises or even Enron bankruptcies is for the Federal Energy Regulatory Commission to focus on regulating rather than simply monitoring wholesale energy markets.

Under the former vertically integrated regime, aggressive wholesale market regulation was largely unnecessary because State reg-

<sup>1</sup>The prepared statement of Mr. Wolak appears in the Appendix on page 159.

ulators were the primary line of defense for consumers. They set the retail prices that the utility could charge for all its customers, and this effectively set the maximum wholesale price at which a utility could produce or purchase power. And in addition, the integrated resource planning process between State regulators and utility insured that the utility had sufficient energy capacity in generating facilities or long-term contracts to meet its load obligations.

But as the events in California from May 2000 to June 2001 visibly demonstrate, if all electricity is purchased from a wholesale market, State regulators have little, if any, ability to control wholesale prices. The wholesale market regulator is the primary line of defense for consumers, and under this market structure, light-handed wholesale market regulation can lead to enormous consumer harm.

As discussed in detail in my written testimony, there was no shortage of effective market monitoring in the California market from the time it started in April 1998 to the present. Both the California Power Exchange and the ISO had their own internal market monitoring units, and the PX and ISO each had independent market monitoring committees overseeing the performance of the markets, and all of these entities, as David Berick discussed, had presented reports starting in the summer of 1998 on the performance of the California market, documenting the exercise of market power.

What allowed the California crisis to occur was the fact that none of these entities had the authority to implement market rule changes or penalty mechanisms to limit the incentive suppliers had to exercise unilateral market power or violate California market rules. Consequently, the California crisis occurred not because of a shortage of observers with radar guns recording the speed of cars on the highway, it occurred because of a lack of traffic cops writing tickets and imposing fines on cars that exceeded the legal speed limit.

Only FERC has the authority to implement market rule changes and make the regulatory interventions necessary to improve market performance. Consequently, it should concentrate on designing proactive protocols for rapid regulatory intervention to correct market design flaws as quickly as possible and order refunds as soon as unjust and unreasonable prices are found. In this regard, I have four recommendations I will briefly outline.

First, FERC must provide a transparent definition of what constitutes unjust and unreasonable prices in the wholesale market. These markets have been in existence in the United States for more than 4 years and FERC has still yet to provide such a definition. This makes the job of market monitor much like that of a snipe hunter at summer camp. The camper is given a burlap bag and a flashlight and sent out into the night to look for a snipe, but no one has ever told him what a snipe looks like. For the exact same reason that no camper has ever caught a snipe, it's impossible for the market monitor to ever find the evidence of unjust and unreasonable prices to bring to FERC's attention because it has never been told by FERC what those are.

This FERC policy creates unnecessary regulatory uncertainty and increases the likelihood of a California crisis in another part of the United States. Setting a transparent ex ante standard for what constitutes unjust and unreasonable prices is substantially less difficult than doing what FERC is currently attempting to do in its refund proceedings.

Moreover, several parties have made detailed submissions to FERC outlining suggested methodologies for such a standard, and given its statutory mandate to protect consumers and the growing evidence that all suppliers possess significant market power under certain conditions, what FERC really must address is whether—essentially, the concept of harm, specifically, what wholesale prices reflect sufficient market power for a long enough period of time over a long enough geographic area to justify being called unjust and unreasonable and, therefore, worthy of regulatory intervention.

My second recommendation is that FERC should also specify in advance what regulatory intervention will occur if this standard is violated with as much clarity as possible. If all market participants are able to construct the index used to determine prices are unjust and unreasonable, then the market will become self-regulating because participants can take unilateral actions to avoid this regulatory intervention, and in this way, there will once again be less regulatory uncertainty and less likelihood of a California crisis.

My third recommendation concerns FERC's current methodology for determining whether prices are unjust and reasonable and refunds are due. Specifically, in both public statements and many of the statements made today, the commissioners have stated that it must find the bad actors and punish them for causing unjust and unreasonable prices. While I think it is important to find market participants that violated market rules and take back their ill-gotten gains, as well as penalize them for their violation of market rules, I think it is important, as emphasized in my testimony, that, essentially, the legal actions of privately-owned firms to serve the interest of their shareholders can result in the exercise of enormous market power.

In short, there is no need for malicious or manipulative behavior by any market participant for wholesale markets to produce unjust and unreasonable prices, and moreover, the Federal Power Act does not specify that prices must be the result of malicious behavior by market participants in order for them to be deemed unjust and unreasonable. It only requires that prices be unjust and unreasonable as determined by FERC and, hence, they must order refunds.

The final recommendation that I would like to make concerns the necessity of comprehensive and accurate data on the physical characteristics of plants, input, prices, and a variety of other characteristics of the wholesale market. This is necessary for effective regulation. And in particular, it is effective for demonstrating essentially the first—it is very necessary for the process of determining what are unjust and unreasonable and wholesale prices, and finally, I think, more important, it is necessary to provide tangible evidence of how well FERC is doing in delivering the economic benefits to consumers that they would not have received under the former vertically integrated utility regime.

So, consequently, particularly during this initial period, FERC should substantially increase and not reduce the amount of data it collects from market participants if it would like to be an effective and credible market monitor.

In conclusion, I would just like to emphasize that I think FERC has made enormous progress over the last year addressing many of these issues, but I also believe that a number of significant challenges remain, as I have discussed above, but I am confident that with Chairman Wood at the helm, FERC will overcome these. Thank you.

Chairman LIEBERMAN. Thanks, Dr. Wolak.

It is significant that both of you have been encouraged by the last year under Chairman Wood's leadership. I have to say that we have been, too, although we think that a lot more has to be done, and I guess you would agree with that, as well.

I was interested, Dr. Wolak, that you view the California crisis not as a market failure but as a regulatory failure, and I do think you are right. It strikes me that what we are all saying here, including the commissioners, is that deregulated markets still require regulation. Perhaps we have to find a new terminology. In other words, when we go from rate setting by a public authority to rate setting by the market, there is still a need for the traffic cop on the beat or on the highway. Do you both agree?

Mr. JOSKOW. Yes, Senator. I think maybe it is a different kind of regulation. It is a function of establishing market rules, market oversight, and identifying problems in the markets and finding remedies for them that is quite different from the process of gathering costs together and setting traditional public utility rates.

And I don't think that is just true of electricity markets. There is no such thing in a market economy like ours as completely unregulated markets. The New York Stock Exchange has market rules. We have a regulator, the CFTC. There are a variety of rules that govern many markets, and especially in the electric power industry, because of its unique characteristics and because it is in a transition from an old system to what we hope is a new system, but very much in transition. It is very important that regulators play a role in monitoring and regulating the essential activities they have to do to ensure that these markets perform well and progress in the directions that we hope they will.

Chairman LIEBERMAN. Dr. Wolak, did you want to add anything?

Mr. WOLAK. Yes. I really think that you hit the nail right on the head and that the way I like to characterize it is that the regulatory process evolved from something that is very lawyer- and accountant-intensive to something that is very, I guess the best way to say it is economist intensive, in the sense that what you are designing is no longer just and reasonable prices through a regulatory mechanism and setting them. You are interested in setting just and reasonable rules, in other words, setting up incentive structures where the privately profit maximizing actions of the market participants result in outcomes that you, as the regulator, perceive as just and reasonable.

And in that sense, it really does require a tremendous shift in how you think about doing your business as a regulator, and I think many of the comments that were presented earlier today, em-

phasize that fact, that it really requires a tremendous change in how FERC thinks about its business.

Chairman LIEBERMAN. I thank you. Let me go back just a bit to the history here, and Dr. Wolak, you were involved as a participant. Your market monitoring committee was providing reports to FERC, raising concerns about the exercise of market power by players in the Western markets going back, I believe, to 1998. There were other participants, including the California Independent System Operator, which, of course, operates the electric grid in California, and the investor-owned utilities like Southern California Edison that also were raising concerns.

But FERC did not seem to respond. When the prices began to spike in 2000, they seemed genuinely to be surprised and they conducted the investigation that I described long ago in my opening statement today and talked about the danger of excess market power being exercised, but didn't find any particular players in the market who were doing so.

As we now know, Mr. Belden, the Enron trader, now has acknowledged participating in fraudulent trading schemes occurring as far back as 1998. The California ISO in 2001 did an analysis of 15 companies, including Enron, showing that they exercised market power excessively during the crisis. But throughout this, FERC never initiated an investigation of the behavior of individual companies and, in fact, didn't start, as Commissioner Wood said, until February of this year.

This just seems to underlie what you were trying to do earlier in your role with the market monitoring committee. I wonder if you can respond to that story, that series of facts that I have described, indicate perhaps some of the information that you gave, the market monitoring committee gave, to FERC during that period and indicate whether you think that in the current reality under Commissioner Wood, that having had the experience we have had, that FERC's reaction would be different.

Mr. WOLAK. Yes. This gets back to my major, what I would argue is my single recommendation, is that you have to define what is unjust and unreasonable prices in order to ever find it. So, effectively, what the market surveillance committee that I chaired did is we said, well, we haven't been given any guidance what the snipe looks like. So what we are going to do is essentially use economic theory and standard economic methods to define what we think it should be and then we are going to tell you that we think that it—and then we are going to go look for it, and then that was effectively what each of the reports did, was said this is what we think the exercise of market power is, this is the extent to which we think it is occurring, and then we presented that information to FERC.

But, as I said, the difficulty was—there was no definition from FERC given as to what would constitute the unjust and unreasonable rates. It was much more of a “we will know it when we see it,” and it took a long time to see it.

Chairman LIEBERMAN. Is that an area that Congress should tread into, or is that really something we should push FERC to do, that definition that you have just talked about?

Mr. WOLAK. I think it is definitely the second one, of certainly pushing them to do. I think they certainly have the capability to do it and I, as I said in my testimony, have been provided with a lot of input. I will freely admit, it is a difficult process, just in the same sense of determining what are prudently incurred costs in a regulatory hearing is a very difficult process.

The same sort of thing is true here, but that is why we have regulators. They make the tough decisions, and I think that is what we need FERC to really do and that will, I think, provide this certainty to market participants to know, look, if things get this out of hand, intervention is coming as sure as the sun will come up, and in that sense, we will have a strong interest to working to solve the problems, rather than what happened in California was it was almost no end to the largess that was available to be taken by essentially market participants, particularly once the State started buying, because the State has the power to tax.

Chairman LIEBERMAN. So that definition has not really been forthcoming yet?

Mr. WOLAK. No, unfortunately.

Chairman LIEBERMAN. And notwithstanding your encouragement, and with the way Commissioner Wood and the Commission has been going, you would say that remains the most significant piece of unfinished business for them?

Mr. WOLAK. Yes. With that sort of metric in place, I think that it becomes—then what you have given is teeth to the just and reasonable rate standard in a wholesale market regime and you have given clarity to it, so that I think it then enables the regulatory process to function in a transparent manner around that.

Mr. JOSKOW. Senator, if I could just add to that, I think it is not that complicated. Frank, I, and others have advocated basically developing a set of market performance indices that the FERC staff would look at on a continuing basis to signal when markets seem to be performing in ways that appear to be inconsistent with competition. That doesn't mean that there is necessarily a problem. It does not mean there are necessarily bad actors. But it becomes a signal for further investigation.

I think, quite frankly, the current effort to run around and try to find evil doers is not the right way to do it. First of all, it is very time consuming. It waits for complaints. I would rather see them focus first on evaluating the performance of the markets in different parts of the country, and when they see what appears to be a performance failure, to then trigger a more detailed investigation of what is going on.

I will just give you an example with natural gas. In the fall and early winter of 2000, natural gas prices delivered to California rose to enormously high levels, levels no one had ever seen before. I have no idea why it happened. I haven't studied it. But I can tell you, if I had been at FERC at that time, we would have done a study, we would have done an investigation then, not now, but then just to understand that was going on and not just to assume that it must be the result of the interplay of supply and demand. It might have been completely innocent, but an indicator like that, when gas prices are ten times normal, should trigger the idea that it requires further exploration.

So I think it requires a change in mindset of a regulatory agency that was used to respond to complaints and used to setting rates based on accounting costs to one that really has to have an ongoing feeling for what is going on in these markets and engaging in an ongoing assessment of how these markets are performing. My hope is that the new Office of Market Oversight and Investigations will, in fact, develop this kind of capability in much the same way as the self-regulating exchanges, like the New York Stock Exchange and the CFTC, have protocols to look for unusual trading behavior, and when they see unusual trading behavior, they will go and they will investigate it. We need that kind of a mindset here.

Chairman LIEBERMAN. Let me just pick up on your last point and ask you if you want to say any more about the Office of Market Oversight and Investigations. As you heard, Mr. Berick said it was a good step and didn't think it was adequately staffed yet, but was concerned also about whether—or let me put it another way—that the creation of the office was not sufficient indication yet to show that FERC understood that effective regulation is not just better rules, but more active enforcement.

Mr. JOSKOW. I have been urging FERC to set up an office like this since 1996, and the models I had were the Antitrust Division of the Justice Department, the Federal Trade Commission, the CFTC. So I am very pleased that they have taken the steps they have to create an office with the kind of staff and the kind of goals they have.

Obviously, as I said, the proof is in the pudding. We haven't seen yet what they are going to do and how they are going to perform, so I think we need to continue to observe how this new office operates and performs. However, and I haven't seen your report, when I heard there were 250 people, my reaction was, that is an awful lot of staff, not the opposite. I think the Antitrust Division, the Economic Policy Office has about 40 professionals and the Federal Trade Commission has about 40, as well. But I think we will just have to evaluate over time whether FERC's market monitoring office has the resources to make this happen.

I am more concerned about institutionalizing this perspective in the agency. I don't think it should be something that just depends on Pat Wood. I mean, President Bush could appoint Pat Wood to some other job, and I think we wouldn't want this new perspective and this new focus to be dependent on one individual. I think we should be looking at whether Pat Wood and the other commissioners are successful in bringing in senior managers and staff who have this new view of what their jobs should be.

Chairman LIEBERMAN. Dr. Wolak.

Mr. WOLAK. Thank you. I just wanted to respond to the issue of resources and the role of the new part of FERC, and that is that I think one of the other lessons from the California crisis was that these markets require day-to-day, on-the-ground monitoring, and I think it is extremely difficult for the Office of Market Oversight and Investigations to really get involved in that.

So what I guess I would say is I am not sure that they really need more resources, but I just think that they need to delegate the responsibilities for undertaking the duties that they are charged with to the ISO market monitoring units and the like. In par-

ticular, there are lots of—it is just many of the FERC orders, particularly during the 2000 period, reflected a misunderstanding of many of the California market rules. This is clearly, I think, explainable by the fact that all these markets are very complex and there is also 3,000 miles between Washington and California.

So that really, I think, the proper way to do it is to allow much more discretion to the monitor at the ISO, and if you are worried about independence, then you can certainly put restrictions on that. But then have the Office of Market Oversight and Investigations handle the big problems and really set the policy for the other monitors, because I think trying to get in, as Commissioner Wood said, there are literally terabytes of data. You have to look through it carefully, and if you don't understand the real details of things, you can really make a mess of it.

So in that sense, I think that the better way to go is the hierarchical structure, where you are essentially delegating most of the responsibility for the, if you like, dirty stuff to the ISO, whereas FERC is setting the policy agenda and really listening to appeals from the ISO.

Chairman LIEBERMAN. Thank you. Interesting.

Mr. JOSKOW. The standard market design rule that has been proposed includes a requirement that each region have an independent market monitor, and I agree with Frank. I think one of the keys here is to find a way for the market monitoring and oversight people at FERC to interact closely with the market monitors in the regions to give the market monitors in the regions substantial discretion on a day-to-day basis and to have a very close working relationship with them.

Frank is probably too modest to say this, but his market surveillance committee, as well as the market surveillance committee of the California Power Exchange, wrote numerous reports identifying problems in the markets long before 2000 and wrote numerous reports and made numerous suggestions during 2000 and 2001 which were largely ignored by FERC. And that is a problem, I think, that really needs to be fixed. If we are going to have these market monitoring units, as I think we should, they have to be able to work in a close, collaborative fashion with the staff at FERC, as well.

Chairman LIEBERMAN. I appreciate your pointing that out, and I took that to be one of the conclusions of our staff report, as well, and thank Dr. Wolak for what he did in that regard.

If I continue this hearing much longer, I will be accused of not wanting to yield the Chairmanship, ever, by just keeping the hearing going, so I will ask this final question. But your testimony has been very substantive. As always, I wish we got you on earlier. But it has affected us and we will circulate the record.

Coming out of the Enron scandal and particularly the crisis in the Western energy markets, California, Oregon, Washington, etc., there has been a lot of second looking at energy market deregulation generally. There are some States that had been on the way to doing deregulation and have now pulled back. We talked about this a bit just a few moments ago, but what is your counsel here? Am I correct that neither of you would say that energy deregulation was a bad idea, but that other kinds of regulation have to stay in effect for it to work? You just can't say, OK, no more rate setting

and walk away. You have got to have the State trooper on the highway, making sure people don't go way over the speed limit.

Mr. JOSKOW. I think the changes that have been initiated to promote wholesale and retail competition in the long run can accrue to the benefit of consumers, but it has to be done right. It requires appropriate industry structures and restructuring. It requires appropriate market rules, and it requires appropriate ongoing regulatory oversight and actions by FERC and the market monitors in the regions.

I think, in a way, the Northeast is going to be a laboratory for this. We are very far along down the path. We share a vision with FERC for what wholesale and retail markets should look like. I don't think it would be unreasonable, if I were the governor of a State like North Carolina or South Carolina or Georgia, to say, before we change our system, which seems to work pretty well, we have low prices, reliable supplies of electricity, why don't you guys show us if you can make it work?

So I think the challenge I feel, both as an academic and as a citizen of New England, is to work with public policy makers and the market participants to demonstrate that these reforms can work to the benefit of consumers, as it has in a number of other countries.

Chairman LIEBERMAN. Thank you. Well said. Dr. Wolak.

Mr. WOLAK. Yes. I would like to say it as we should have demand pull restructuring rather than supply push restructuring, in the sense of rather than FERC going out and saying, you must restructure your market and sort of forcing States kicking and screaming into joining RTOs and the like, I think a better way to go is exactly the way Paul Joskow suggested, is make sure you get the markets that you currently have restructured working very well so that then people look over and they say, I want some of that. That is a market that works. That is delivering low prices to consumers. I would like to join that RTO. I would like to get the benefits that people who are located in that State are getting, rather than the other way, where you are pushing States into it.

Another lesson I think we can learn from California is that if the State infrastructure isn't in place to support a competitive market at the wholesale level, and by that I mean the retail market infrastructure, then disastrous results can occur for the wholesale market, which can impose significant consumer harm. So in that sense, unless you have the States really working to cooperate, it really makes FERC's job much more difficult. So, therefore, certainly given the point that we are at, a far superior, I think, strategy is to make the ones that we have got work very well so that then people in the other States will say, I will make the necessary changes to make it work well in my market, as well.

Chairman LIEBERMAN. Well said. Once again, both of you have contributed very significantly and substantively to the work of the Committee. I thank you very much for your time and for your testimony.

I am going to, without objection, make documents referenced in the staff memo, such as have been designated by staff, part of the public record, as was discussed earlier.

I do want to thank David Berick and the staff for the enormous contribution they made in the report today. I know some of the

questioning took them off the four major cases that they had been on, but I think the substance and constructiveness of the work speaks for itself and I certainly heard Commissioner Wood and the other commissioners welcome the work that was done here, even accept some constructive criticism, and I am very hopeful that it will be part of an ongoing effort by all of us to make our energy markets deregulated as they are now, in that sense, nonetheless function with some remaining oversight and monitoring to the benefit of all concerned, particularly the consumers.

I will leave the record of the hearing open for a couple of weeks, if any Members have additional questions to submit, and if so, we will submit them to the witnesses.

With that, I thank you all and the hearing is adjourned.

[Whereupon, at 2:21 p.m., the Committee was adjourned.]



## A P P E N D I X

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### PREPARED STATEMENT OF SENATOR BUNNING

Thank you, Mr. Chairman.

The Governmental Affairs Committee started off the year holding hearings on Enron's collapse, so I suppose it is fitting that we end the year on the same note.

Today, we look at whether FERC could have done more to detect the corruption and mismanagement at Enron.

Unfortunately, when you look at the Enron scandal, it appears that many people both in the public and private sectors needed to be asking harder questions.

What is so shocking about Enron is that so many of the safeguards we have in place all failed at the same time—both within the government and in the private sector.

In June of this year, GAO issued a report on changes FERC needs to make to be more effective in its oversight of competitive energy markets.

Among other things, the report mentions that FERC needs to make some significant internal structural changes.

It also recommends that FERC hire more employees knowledgeable about these markets as well as improving training of existing employees.

Finally, the report also mentions that FERC needs more legal authority to go after those who engage in anti-competitive or illegal activities.

In his testimony, Chairman Wood listed the actions FERC is taking to address some of these problems. Including working closer with other Federal agencies and creating the new Office of Market Oversight and Investigations.

Similar to the GAO report, Mr. Wood also mentioned that FERC needs Congress to increase its civil and criminal penalty authority.

If you can find a silver lining in Enron's collapse, I suppose it would be that we now have the opportunity to fix and strengthen our system of oversight.

We need to make the necessary changes to ensure there isn't another Enron fiasco.

I would like to thank all of our witnesses who are here today to testify, and I am looking forward to hearing from them.

I especially would like to say "hello" to a fellow Kentuckian, Linda Breathitt.

Thank you.

EMBARGOED FOR PUBLIC RELEASE UNTIL TUESDAY, NOVEMBER 12, 2002

David Berick  
Professional Staff Member, Governmental Affairs Committee  
**Testimony: "Asleep at the Switch: FERC's Oversight of Enron Corporation"**  
Tuesday, November 12, 2002

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**Introduction**

Thank you, Mr. Chairman. What I will describe to you this morning, as briefly as I can, are findings from the Senate Governmental Affairs Committee's majority staff inquiry into the Federal Energy Regulatory Commission's oversight, or lack thereof, of the Enron Corporation. The findings I will highlight can be found in greater detail in the accompanying staff memo being submitted in conjunction with today's hearing.

At your direction, Mr. Chairman, in January 2002, the Committee initiated a broad investigation into the role of the federal government and private sector watchdogs in what was at the time the largest corporate bankruptcy in American history. The purpose of the investigation was to determine whether, over a period of ten years prior to Enron's collapse, federal regulators did their job correctly and took reasonable steps, consistent with their missions and mandates, to identify and if possible prevent the problems that led to Enron's implosion.

In investigating the role of FERC, the federal government's lead energy regulator, the investigation identified four specific areas of concern: Enron's sale and repurchase of certain wind farms; the activities of Enron Online, the electronic trading platform run by the company; transactions conducted between Enron and certain Enron-affiliated companies; and the well-documented California power crisis of 2000.

As you will see, the evidence in all four cases reveals a consistent pattern. In the face of Enron's tireless determination to game the system, FERC displayed a striking lack of determination to scrutinize the company's activities. And this was not simply FERC becoming another victim of Enron's misrepresentations; rather, on a number of occasions, FERC was provided with sufficient and specific information to raise suspicions of improper activities -- or had itself identified potential problems -- but failed to follow through.

In short, the record demonstrates an extraordinary lack of vigilance on FERC's part and a failure to structure the agency to meet the demands of the new, market-based system that the agency itself has championed. While we do not know with certainty whether the disclosure of any of the individual activities I will highlight here today would have prevented Enron's collapse, it seems highly likely that more proactive, aggressive action by FERC would have limited some of the abuses that appear to have occurred, raised larger questions about Enron's trading practices and other business activities, and exposed at least some of the cracks in Enron's foundation earlier. Perhaps scrutiny by a federal agency would have also jolted the Enron Board of Directors and Enron itself into

acting to change direction. At a minimum, we believe it would have alerted investors, analysts, and hopefully other regulators to look more closely at Enron.

#### **Enron's Lobbying Efforts and FERC's Four Failures**

FERC is an independent federal regulatory agency responsible for overseeing America's energy markets. As such, FERC had -- and continues to have -- jurisdiction over Enron Corporation's many energy subsidiaries and activities. There were at least 24 electric, 15 gas pipeline, and 5 oil pipeline subsidiaries or affiliates of Enron subject to FERC regulation. Not surprisingly, then, FERC had thousands of contacts with Enron over the ten-year period examined by Committee staff concerning Enron's FERC-regulated subsidiaries and affiliates.

In addition to these contacts with FERC, our investigation also uncovered evidence of an aggressive public relations and lobbying campaign that Enron undertook in 2000 and 2001 to defend its role in the California power crisis and to seek to influence the composition, policies, and practices of FERC. Through public advertising and private communications with key decision makers in Washington, Enron's campaign sought to change the debate over the California crisis. After all, Enron was heavily invested in the success of the deregulation of energy markets because it represented opportunities for Enron's energy trading and energy services businesses, as well as new market opportunities in the United States and overseas. It was important to Enron, therefore, that

the California crisis not be blamed on deregulation or market systems, in general, or on the market players in a deregulated environment specifically.

Based on a review of the evidence, majority Committee staff has concluded that, among the many Enron-related questions that came before FERC in recent years, four stand out as egregious and cautionary examples of regulatory failure. In each case, despite ample opportunity and available information, FERC failed to question, much less challenge, Enron's behavior. It is likely that this passive and reactive regulatory stance enabled Enron to distort its financial condition, failed to protect energy consumers and the energy industry, and failed to prevent or mitigate the ultimate effects of the company's collapse.

**First, wind farms.** In January 1997, Enron acquired a number of wind farm projects that were considered "qualifying facilities," or "QF"s, under federal law, and were therefore eligible for special rate treatment -- meaning, they were allowed to charge higher rates than those otherwise generally permitted.

Shortly after the acquisition of these wind farms, in August 1997, Enron completed its acquisition of a public utility company located in Oregon -- Portland General Electric (PGE). Under federal law, however, projects that are given special status as qualifying facilities cannot be owned by a public utility or its holding company - - meaning, more than 50 percent owned. Thus, because Enron now owned a public utility company, the wind farm projects it had purchased would no longer be eligible for QF

status. In order to maintain the QF status of the wind farms, Enron found it necessary to divest itself of ownership interests in a number of these projects. In at least four cases, however, it appears that Enron did not truly divest itself of ownership, and in fact effectively retained the risks and benefits of ownership.

FERC has the responsibility to certify that ownership requirements and other pertinent requirements for QF status are met. Critical details of these apparently sham transactions were revealed to FERC. Rather than combing through the financial facts, however, FERC failed to apply adequate scrutiny and wound up approving these transactions.

I will take the events chronologically. In 1997, Enron sold a 50 percent interest in each of three wind farm projects to a special purpose entity named RADR, allegedly set up by Enron Chief Executive Officer Andrew Fastow and his deputy, Michael Kopper. In August, Mr. Kopper pled guilty to wire fraud and conspiracy to commit money laundering based in part on a scheme he and others allegedly devised to enrich themselves and enable Enron to maintain secret control over California wind farms while appearing to maintain eligibility for QF status.

Minutes of a May 1997 meeting of the Finance Committee of Enron's Board of Directors indicate that, although the arrangement was expected to satisfy FERC's requirements for transfer of ownership, it was "not a sale for book purposes" and that Enron therefore planned to continue to recognize revenues from the projects. In addition,

the minutes describe Enron's right to repurchase the projects, noting that Enron would retain a "call option to repurchase the assets in future and sell in 'non-firesale' environment" -- an indication that the company, forced to divest its interests in the wind farms quickly because of its purchase of Portland General, was using the sales to RADR to temporarily "park" the projects until it could obtain what it hoped would be more lucrative financial returns. Financially, the minutes reveal that Enron provided 97 percent of RADR's initial capital by way of a loan from one of its subsidiaries and that Enron intended to indemnify RADR against future tax, environmental, and other liabilities.

The nature of these wind farm transactions is further confirmed by a 2001 PriceWaterhouseCoopers "due diligence" report on another, related Enron transaction, which notes that, because Enron "retained all the risks and rewards associated with the projects" and retained an option to repurchase the shares, the wind farm deal was not treated as a sale and revenue from the projects were accounted for as income from joint ventures.

Information revealed to FERC in Enron's formal applications for QF status should have raised serious questions at FERC as to whether the wind farms' ownership arrangement entitled them to the special rate status. Among other things, Enron's applications stated that the company would loan RADR all the money to purchase its interest in the wind farm projects; that an Enron affiliate would indemnify the owners of RADR for certain tax liabilities; that Enron would retain an option to repurchase RADR's

interest in the projects; that the land for the facilities would be leased from an Enron affiliate; and that the same Enron affiliate would receive fees for providing operation and maintenance service to the facilities.

However, despite Enron offering up all of this information, FERC appears either not to have understood or not to have tried to understand the financial arrangements described to it by Enron, and it seems that this was not out of the ordinary for FERC's review of QFs. According to the agency's staff, QF applications are generally reviewed at the staff level by engineers or others with technical expertise to determine the facility's compliance with technical requirements, but not necessarily by anyone with financial expertise.

A similar lack of meaningful scrutiny repeated itself in 2000 and 2001, when a number of wind farm projects, including the three RADR projects, were re-acquired by Enron, and FERC was once again given the opportunity to provide more than rubber stamp approval. However, in each case, Enron filed a "self-recertification" with FERC informing it of the change in ownership and asserting that the facility -- now majority or entirely owned by a utility holding company -- should maintain its eligibility for QF status. Remember, Mr. Chairman, the special QF rate status is supposed to be granted only when facilities are not controlled by a public utility or its holding company.

Two problems emerged at this point. First of all, as a matter of policy FERC never reviewed the RADR self-certifications, and to this day still never reviews self-certifications, for QF status -- no matter what the applications may say unless an outside party raises an objection. Instead, FERC simply files the form away, as it did in the case of RADR. Another case where Enron took advantage of the weaknesses inherent in this self-certification system occurred in November 1998 when Enron self-certified a new ownership arrangement for another wind farm project known as Cabazon. In this case, Enron self-certified that it had transferred 50% ownership in the project to a non-profit organization, The Nature Conservancy, within the meaning of FERC's QF ownership requirements. In fact, Enron did not actually transfer an ownership interest, only a right to 50% of the net profits -- a condition which did not meet actually meet the FERC ownership test. Indeed, The Nature Conservancy did not consider itself to have any ownership interest in the Cabazon project. However, because this ownership change was the subject of a self-certification, it was not reviewed or contested by FERC.

Second, Enron took advantage of a regulatory black hole between FERC and the Securities and Exchange Commission. Enron told FERC in its self-recertification application that it was eligible to own the wind farms because it had applied to the SEC requesting a special exemption under the Public Utility Holding Company Act, which would permit it to retain QF status for the wind farms. And it did have such an exemption request pending at the SEC. That application remained pending, however, for two and a half years. In fact, the SEC is only now considering its merits.

Meanwhile, from the moment the application was on file at the SEC, for FERC's purposes it was deemed to have been approved. The two agencies never communicated with each other about the substance of the application. Instead, FERC's practice was -- and still is -- to treat a company's "good faith" application to the SEC alone as sufficient for the company to qualify for this exception. Enron got the benefits of the QF status and retains them to this day.

Mr. Chairman, imagine two outfielders, each hoping the other will claim a pop ball, only to let it drop right between them. This is the net result of the regulatory black hole between FERC and the SEC.

**The second area in which FERC failed to adequately scrutinize Enron's activities was Enron Online.**

In 1999, Enron Corporation played a lead role in a fundamental shift in the way natural gas and electric power were traded in America, by creating Enron Online, an Internet-based trading platform for natural gas and electric power. Online energy trading became a significant portion of the energy trading market: in 2001, it was estimated to account for approximately 38 percent of natural gas and 17 percent of electric power marketed in the U.S. Until Enron's bankruptcy, Enron Online was widely acknowledged to be the leading platform for such trading. Enron, in turn, lauded itself for its trading capabilities and rapidly expanded the range of commodities it traded -- from paper to broadband communications capacity.

The public policy implications of this fast-emerging energy trading method interested FERC -- at least up to a point. In May 2001, FERC's General Counsel initiated a staff-level inquiry into the status of electronic trading in the electric power and natural gas markets, in general, and the role played by Enron Online, in particular. FERC staff were asked to evaluate Enron Online's dominant position in electronic trading in the energy industries and to determine whether that position might be exploited to manipulate prices and otherwise contort the energy market. A report discussing these matters was completed on August 16, 2001.

The report found that, unlike some online trading platforms which operate as third-party, "many-to-many" exchanges matching willing buyers and sellers, Enron Online appears to have operated as a proprietary extension of Enron's trading units, including entities regulated by FERC. In other words, in this so-called "one-to-many" exchange, an Enron trader was a party, either as a buyer or seller, to every trade on Enron Online. Therefore, only Enron would know valuable information about the actual volumes and prices transacted on its trading platform -- and, of course, how the prices charged in any particular transaction were set or how they compared to those charged in other, similar transactions.

The report also observed that Enron Online simply served as a trading platform for other Enron subsidiaries, shouldering no financial risk on its own. In other words, the financial risk of all the trades conducted through Enron Online remained with these other

subsidiaries and, since Enron's traders were a party to every trade, this risk was substantial. This also meant the solvency of Enron as a whole was important to the viability of Enron Online and to Enron's trading activity.

With that observation in mind, the report asked whether financial problems at Enron would threaten the energy markets. The report answered the question in two ways. First, it concluded that Enron did not have sufficient market share to disrupt the energy market if it failed. As we describe in our memorandum, this conclusion was based on a cursory analysis of the entire North American energy market rather than a more thorough attempt to scrutinize individual regional markets -- which would have yielded a much more complex and much more troubling picture. Second, the report concluded that, in any event, the chance of Enron failing financially was remote. The report provided little support for this conclusion, and has obviously been disproved over the last year.

Finally, the report found that Enron Online gave a competitive advantage to Enron's own trading units by reducing their transaction costs, giving them wider access to the market, and providing them better market intelligence, but concluded that there was no reason for concern. This conclusion also appeared the result of wishful thinking; there is now evidence, described in a recent FERC staff report, that Enron in fact likely exploited this advantage to manipulate prices, particularly in California and the Western markets.

In short, though the FERC report identified a number of areas that could have and should have raised concerns with federal government's lead energy regulator, it found no reason for concern and no cause for action. Quite simply, FERC's review was too cursory, settled for incomplete answers, drew the wrong conclusions, and the agency ultimately failed to follow up on the warning signs it did raise. These were critical mistakes.

Another very troubling facet of the August 2001 report is that it was not distributed to any of FERC's commissioners prior to, or during, Enron's collapse to inform their decision-making with regard to this event, and it is unclear at what point any of the information contained in the report may have been provided to the Commission. Thus, a report that might have served as a warning wound up being little more than a footnote in the story of Enron's collapse.

Finally, FERC initially did not even bother to address a critical but unresolved question -- namely, to what extent FERC and the Commodity Futures Trading Commission, both of which have some regulatory responsibility for energy trading, had jurisdiction over such electronic trading platforms. This was despite the fact that Enron Online and similar systems were at the time expected to become the dominant way in which both electricity and natural gas were traded. A FERC legal memorandum analyzing FERC's jurisdiction over online trading, including Enron Online, was to have been prepared in August 2001. That memorandum was not completed until July 2002 -- after Chairman Lieberman raised questions about it -- creating another regulatory black

hole, and leaving any thorough scrutiny of Enron Online and other electronic trading platforms to languish.

One final footnote about the 2001 Enron Online inquiry is that it also examined the issue of how pricing information from Enron Online might distort published market price indices, such as those reported by trade publications like *Natural Gas Intelligence* and *Gas Daily*. The FERC staff report noted that such indices were comprised of anecdotal, unconfirmed information and that information provided from a source such as Enron Online could be subject to manipulation. At the time the staff was examining this issue, the Commission was promulgating its order on refunds for the California market, which included a methodology for determining baseline electricity generation costs tied to these published price indices. The concerns expressed by the Enron Online inquiry staff concerning these indices were never communicated to the Commissioners considering the refund issue, nor was other relevant information compiled by the Office of the Chief Accountant concerning electric generation costs in the California market. The significance of these failures is highlighted by the FERC staff's August 2002 report on its ongoing Enron investigation which found that published price indices in the California market were unreliable and may have been distorted or even manipulated by data from Enron Online. The 2002 report recommends that, as a result, the Commission modify its California refund methodology.

**Mr. Chairman, our third area of review was Enron's affiliated transactions.**

Whenever a company conducts transactions among its own affiliates there may be cause for concern about fair dealing. One concern is that where one affiliate has captive ratepayers, a one-sided deal may impose financial burdens on those ratepayers. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.

Based on our review of the evidence, we have concluded that existing regulatory rules and tools, in the hands of a passive FERC, proved inadequate to deter Enron, as the company now appears to have engaged in a number of inappropriate interaffiliate transactions.

Just one example are the loans two of Enron's natural gas pipeline subsidiaries obtained for their parent company in November 2001. As Enron struggled to avoid bankruptcy, the company announced that JP Morgan Chase & Co. and Citigroup, Inc. had committed to loan it a total of \$1 billion. But the loans were actually made to two of Enron's FERC-regulated, interstate pipeline subsidiaries -- Northern Natural Gas Company and Transwestern Pipeline Company -- and were secured by the assets of those pipeline companies. The vast majority of these loan proceeds were subsequently transferred to Enron in the form of unsecured loans from the pipelines to their parent company. After Enron declared bankruptcy a few weeks later, it made no payments on these loans, and the pipeline companies, which did not file for bankruptcy, were left to pay off the entire amount of the obligations to the banks -- a matter of concern because

ordinarily such costs would be passed on to shippers who use the pipelines, and ultimately to natural gas customers.

In this case and others, FERC is now investigating potential wrongdoing concerning Enron's interaffiliate transactions and seeking to strengthen some of the relevant accounting rules. However, it is troubling that the agency failed to address the broader policy question earlier. As key parts of the energy markets have been deregulated under FERC's watch and at FERC's urging, the issue of transactions among a company's affiliates has taken on increased importance. Until Enron's collapse, however, FERC failed to adequately identify such transactions as significant problems that warranted Commission action -- or where it did, as in the case of transactions between marketing affiliates and traditional utilities, FERC's regulations proved inadequate. Thus, this turns out to be another area in which FERC did too little, too late. The agency did not adequately anticipate problems in the market it was instrumental in constructing.

**The final area in which Committee staff reviewed FERC's oversight of Enron Corporation regards the company's role in the California energy crisis.**

As you will recall, severe energy shortages in California began in the spring of 2000, about two years after the state's energy deregulation plan was put into place. The state's investor-owned utilities blamed the crisis on power sellers and marketers who, they said, were unfairly manipulating the system to gin up profits. The power marketers, on the

other hand, claimed that flaws in the actual structure of the new California system were the chief culprit for the crisis.

FERC, which as far back as 1998 had received reports from energy experts in California raising concerns about the exercise of market power, began a staff investigation into the causes of the California crisis in the summer of 2000. The investigation reached what might be considered a curious conclusion: that power sellers had the potential to manipulate the power market, but that there was no evidence to indicate whether an individual company engaged in actual market abuse. The report concluded that identifying individual cases of market abuse would require further investigation.

Despite this initial report clearly articulating the potential for market abuse, it would take a full 15 months -- until February 2002, after Enron had collapsed -- for FERC to order a formal staff investigation into the market behavior of individual companies. Even as FERC was avoiding the question of what individual companies were doing, Enron itself initiated an internal investigation into its own trading practices in California, in October 2000. That investigation would ultimately result in memoranda asking some searching questions about a range of strategies that Enron traders used -- such as the so-called "Get Shorty," "Death Star," "Fat Boy," and "Ricochet" trading strategies -- and discussing the "sanction provisions of the California Independent System Operator ('ISO') tariff." Unfortunately, the company appears to have been more concerned about its own behavior than the government's lead regulator.

As stated earlier, FERC itself would not begin to investigate these practices until more than a year later, after Enron's collapse. In August of 2002, that investigation produced an interim report describing the manipulative trading practices that Enron's traders had allegedly engaged in. Those findings have further prompted three formal FERC investigations into the behavior of individual companies, including Enron, in the crisis.

More details about what FERC may have found had it been more vigilant were revealed last month, when Timothy Belden -- who headed Enron's Western trading desk -- pled guilty to a charge of conspiracy to commit wire fraud, based on allegations that he and others at Enron engaged in trading strategies designed to manipulate energy prices in the California market from 1998 to 2001.

Of course, accountability is important. However, the majority Committee staff believes that the rules and regulations of a federal agency such as FERC cannot effectively deter unreasonable market action if the agency fails to hold market participants accountable in the near term. It should not have taken Enron's collapse to finally trigger FERC's investigation of the role of individual companies in the California energy crisis.

**Conclusion**

In conclusion, Mr. Chairman, all four stories convey the same message: The Federal Energy Regulatory Commission was a poor match for Enron's tireless efforts to subvert the spirit - if not the letter - of the regulatory system. FERC's failure cannot be attributed simply to Enron's aggressive public relations and lobbying campaigns or the deviousness of its methods. In many cases, the Commission had specific and sufficient information that should have raised suspicions about improper behavior on Enron's part. In other cases, FERC recognized potential problems, but through poor management, internal communications disconnects, or sheer lack of will, never followed its suspicions through to their logical ends.

Even after Enron declared bankruptcy, FERC dragged its feet and failed to step into the breach, reinforcing a pattern of performing too little too late.

To be fair, FERC has taken some tentative steps to remedy an unacceptable state of affairs such as creating a new office of market oversight and investigation. But simply rearranging its bureaucracy is not the answer. FERC must work in concert with other regulatory agencies; it must request and be given sufficient resources to monitor the marketplace; and it must be cognizant of what goes on under its own roof. But most importantly, FERC must completely reorient itself to a changed and increasingly complex regulatory environment - an environment that FERC itself has fostered, but failed to adapt to.

Had FERC proven more aggressive on any one of the fronts I have described in my testimony today, it might have unearthed Enron's abuses sooner, perhaps mitigating the company's collapse, protecting consumers from untold hardships, and competitors from Enron's alleged market manipulations. Instead, through a striking lack of vigilance, I think it's fair to say that FERC abdicated its core responsibilities as a federal regulator of the energy markets.

I hope that the information I have presented today will inspire a higher standard in the future.

Thank you. I look forward to your questions.

**SUPPLEMENTAL STATEMENT OF DAVID M. BERICK**  
**December 19, 2002**

At the hearing, Chairman Lieberman suggested that I re-examine documents referred to by Senator Thompson concerning activities by the law firm of Wyatt, Tarrant & Combs on behalf of Enron.

In response to a question from Chairman Lieberman and based on my then recollection of the Wyatt firm's documents that were submitted to the Committee by Enron, I said that the contacts between the law firm and FERC referenced in the documents related to a contractual dispute between Enron and the Tennessee Valley Authority (TVA). Senator Thompson suggested the documents might suggest otherwise.

My subsequent re-examination of the documents indicates that, in addition to hiring it to help resolve a dispute with the TVA, Enron also retained the Wyatt firm to provide "advice with respect to the development of policy at the Department of Energy ('DOE') and the Federal Energy Regulatory Commission ('FERC')." The bulk of the Wyatt firm material produced by Enron involves issues related to TVA, which accounts for the answer I gave at the hearing. There are also some materials that related to other matters, including material that refers to at least two communications between Commissioner Breathitt and Wyatt lawyers in which the California energy crisis appears to have been raised. As to the apparent communications between the firm's lawyers and FERC that are reflected in the Wyatt firm's billing records (including entries for meetings and phone calls between the firm's lawyers and Commissioner Breathitt that were charged to Enron), these records do not indicate the nature or substance of the matters discussed. Consequently, it is not possible to tell from these records the subject to which the communications related.

I also wish to clarify one additional point. Others at the hearing observed that FERC did not regulate TVA and questioned whether there could be any reason for the law firm to communicate with FERC or any FERC Commissioner about a TVA matter. While FERC does not have jurisdiction over TVA itself, FERC does have jurisdiction over interstate wholesale power marketing by Enron, including transactions Enron may have entered into with TVA.<sup>1</sup>

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<sup>1</sup> Indeed, Enron's power marketing subsidiary, EPMI, reported contracts that it had entered into with TVA in the quarterly reports it regularly filed with FERC listing its various power marketing contracts. One example of such a filing is attached.



April 30, 1996

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COMMISSION

The Honorable Lois M. Cashell  
Secretary  
Federal Energy Regulatory Commission  
825 N. Capitol Street, Northwest  
Washington, D.C. 20426

Dear Ms. Cashell:

Pursuant to the Commission's letter-order issued December 2, 1993 in Docket No. ER94-24-000, please find below a summary of activity for Enron Power Marketing, Inc. ("EPMI") for the quarter ending March 31, 1996.

The following agreements were signed:

Consolidated Water Power Company	01/03/96	Evergreen
Oglethorpe Power Corporation	01/03/96	Evergreen
Wisconsin Public Service Corporation	01/09/96	Evergreen
Utility Board of the City of Key West	01/10/96	Evergreen
North Carolina Electric Membership Corporation	01/24/96	Evergreen
Consumers Power Company and The Detroit Edison Company	01/25/96	Evergreen
Lassen Municipal Utility District	02/01/96	Evergreen
Allegheny Power System	02/02/96	Evergreen
Hastings Utilities, City of Hastings	02/07/96	Evergreen
New York State Electric & Gas Corporation	02/07/96	Evergreen
Long Island Lighting Company	02/08/96	Evergreen
The Cleveland Electric Illuminating Company	02/13/96	Evergreen
Interstate Power Company	02/16/96	Evergreen
Bonneville Power Administration	02/21/96	04/01/96-09/30/96
Colorado Springs Utilities (City of Colorado Springs)	02/22/96	Evergreen
Cinergy Services, Inc.	03/01/96	Evergreen
Michigan South Central Power Agency	03/26/96	01/01/97

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The Honorable Lois M. Cashell  
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The following contracts were received after the December 31, 1995 filing was submitted.

American Municipal Power-Ohio, Inc.	02/01/95	Evergreen
The Consolidated Edison Company of New York, Inc.	02/21/95	Evergreen
Duquesne Light Company	02/22/95	Evergreen
Northeast utilities Service Company	03/10/95	Evergreen
Dairyland Power Cooperative	04/24/95	Evergreen
United Power Association	05/17/95	05/01/96-10/31/2000
Catex Vitol Electric, L.L.C.	06/20/95	Evergreen
Central Illinois Light Company	07/01/95	Evergreen
Kentucky Utilities Company	09/29/95	Evergreen
Pennsylvania Power & Light Company	10/09/95	Evergreen
San Diego Gas & Electric	10/16/95	Evergreen
American Electric Power Service Corporation	12/01/95	Evergreen
Tennessee Valley Authority	12/06/95	12/97-06/2006
Vermont Public Power Supply Authority	12/06/95	11/01/98 -10/31/2003
New York Power Pool	12/15/95	Evergreen
Bonneville Power Administration	12/18/95	04/01/96-09/30/98
BYNG Public Works Authority	12/18/95	Evergreen
Kaiser Aluminum & Chemical Corporation	12/22/95	04/01/96-03/31/98
Southern Illinois Power Co-Operative	12/28/95	Evergreen

These agreements set forth the terms and conditions that will govern transactions for wheeling, exchanges, capacity or energy which parties may agree to enter into. At the time of entering into such transactions the parties will establish price, quantity, delivery point(s), term, and the nature of delivery and receipt obligations (e.g., firm or nonfirm). Exchanges are receipts of power or deliveries of power with the agreement to return the power at some point in the future. The effective date represents the date the contract is valid between EPMI and the counterparties.

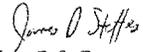
In *Morgan Stanley* and other subsequent marketer cases, the Commission authorized power marketers selling at market-based rates to report changes in status every three years in lieu of filing changes on an ongoing basis. (*Morgan Stanley Capital Group, Inc.*, 69 FERC ¶61, 175 (1994)). EPMI hereby notifies the Commission that it has elected the three-year reporting option relating to changes in status. At the end of the reporting period, EPMI will inform the Commission of any changes in status involving EPMI.

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The attached addenda shows the transactions entered into by EPMI during the quarter ended March 31, 1996. If you have any questions or require any additional information feel free to contact me (713) 853-7673 or Steve Kean (713) 853-1586.

Very truly yours,



James D. Steffes  
Manager, Regulatory Affairs

Attachment

FERC 1ST QUARTER 1996 FILING

Company Name	Transaction Type	Value	Counterparty
Alabama Electric Cooperative, Inc.	Non-Firm Purchase	\$18.00	\$21.00
			14,600 ALCOPFC Int/Face
Alabama Electric Cooperative, Inc.	Non-Firm Sale	\$18.00	\$17.00
			JEA Border
			OPC Border
			SMPP/MPK
			117,700 AEC Border
American Electric Power Service Corporation	Non-Firm Purchase	\$13.30	\$20.00
			OPC Border
			SMPP/MPK
			1,254 AEP - CONSUMERS POWER
			AEP Border
American Municipal Power - Ohio	Firm Purchase	\$20.00	\$24.80
			AEP-APS Border
			AEP-Duke Border
			APS Border
			CINERGY Border
			CHP Border
			COMED Border
			CHL/AEP Border
			DLC Border
			DPL Border
			Duke-AEP Border
			EPSC Border
			EPSC Border
			GE Border
			FWA Border
			VEPC Border
			16,880 AEP Border
			AEP-APS Border
			APS Border
	American Municipal Power - Ohio	Non-Firm Purchase	\$20.00
			19,120 AEP Border
American Municipal Power - Ohio	Firm Sale	\$18.00	\$18.00
			114,400 AEP Border
American Municipal Power - Ohio	Non-Firm Sale	\$18.00	\$20.00
			831 AEP Border

FERC 1ST QUARTER 1998 FILING

Company Name	Transaction Type	Quantity	Price	Market	Product
Avista Power Corporation	Purchase	32,550	\$28.75	Firm	PECO Border
	Sale	40,950	\$29.25	Firm	PECO Border
Avista Power Corporation	Purchase	32,550	\$28.75	Firm	PECO Border
	Sale	40,950	\$29.25	Firm	PECO Border
Alone Electric Power Cooperative, Inc.	Purchase	11,160	\$9.80	Firm	Wattling
	Sale	11,160	\$9.80	Firm	Wattling
Alone Electric Power Cooperative, Inc.	Purchase	352	\$19.00	Non-Firm	PALO VERDE
	Sale	352	\$19.00	Non-Firm	PALO VERDE
Associated Electric Cooperative, Inc.	Purchase	49,497	\$12.85	Non-Firm	AEC Border
	Sale	49,497	\$12.85	Non-Firm	AEC Border
Associated Electric Cooperative, Inc.	Purchase	117,068	\$15.75	Non-Firm	AEC Border
	Sale	117,068	\$15.75	Non-Firm	AEC Border
Associated Power Services, Inc.	Purchase	28,400	\$9.10	Firm	Mid Columbia
	Sale	28,400	\$9.10	Firm	Mid Columbia
Associated Power Services, Inc.	Purchase	10,000	\$9.60	Firm	Mid Columbia
	Sale	10,000	\$9.60	Firm	Mid Columbia
Atlantic City Electric Company	Purchase	90,385	\$2.00	Non-Firm	ACE Border
	Sale	90,385	\$2.00	Non-Firm	ACE Border

FERC 1ST QUARTER 1986 FILING

Company Name	Transaction Type	Value	Category	Item Description
Atlantic City Electric Company	Firm	\$24.80		PERCO System Border
				PJM 500
				PAAL Border
				SREG System Border
Atlantic City Electric Company	Non-Firm	\$37.00		(51,700) ACE Border
				ACE Border
				ACE Border
				PVA 500
Atlantic City Electric Company	Non-Firm	\$17.00		(28,712) ACE Border
				ACE Border
				PJM 500
				PAAL Border
Big Rivers Electric Corporation	Non-Firm	\$12.50		81,397 Big Rivers TVA Border
				BREC-LG&E Border
				KUBREC Interface
				KVA Border
Big Rivers Electric Corporation	Non-Firm	\$12.50		SIGECO Border
				Spec-Brc Interface
				TVA Border
Big Rivers Electric Corporation	Non-Firm	\$12.50		19,251 Big Rivers TVA Border
				BREC-LG&E Border
				KUBREC Interface
				KVA Border
Big Rivers Electric Corporation	Non-Firm	\$12.50		SIGECO Border
				Spec-Brc Interface
				TVA Border
Borough of Zanesville	Firm	\$37.30		(6,842) OE Border
				OE Border
Brow Electric Power Cooperative, Inc.	Non-Firm	\$15.00		(37,800) WPP Border

FERC 1ST QUARTER 1996 FILING

Buyer	Seller	Quantity	Price	Market	Product	Contract
Bying Public Works Peoples Electric Co-Op	60 SWPA Border	124.10	\$24.10	Purchase		
Bying Public Works Peoples Electric Co-Op	228 SWPA Border	\$24.10	\$24.10	Purchase		
Bying Public Works Peoples Electric Co-Op	11,360 SWPA Border	\$17.26	\$17.26	Sale		
Bying Public Works Peoples Electric Co-Op	13,625 SWPA Border	\$17.26	\$17.26	Sale		
Bying Public Works Peoples Electric Co-Op	12,864 C.J.N. Southern Border	\$21.20	\$21.20	Sale		
Bying Public Works Peoples Electric Co-Op	61,492 AEP Border	\$15.26	\$15.26	Purchase		
Bying Public Works Peoples Electric Co-Op	CR, AEP Border					
Bying Public Works Peoples Electric Co-Op	Sante Cooper Border					
Bying Public Works Peoples Electric Co-Op	VEPCO Border					
Bying Public Works Peoples Electric Co-Op	VEPCO CPL Border					
Bying Public Works Peoples Electric Co-Op	7,746 AEP * CONSUMERS POWER	\$15.00	\$15.00	Sale		
Bying Public Works Peoples Electric Co-Op	AEP Border					
Bying Public Works Peoples Electric Co-Op	Duke AEP Border					
Bying Public Works Peoples Electric Co-Op	Duke-CP Border					
Bying Public Works Peoples Electric Co-Op	Sante Cooper Border					
Bying Public Works Peoples Electric Co-Op	TVA Border					
Bying Public Works Peoples Electric Co-Op	VEPCO Border					
Bying Public Works Peoples Electric Co-Op	13,190 C.J.N. Border	\$4.00	\$4.00	Purchase		
Bying Public Works Peoples Electric Co-Op	CSWS Border					
Bying Public Works Peoples Electric Co-Op	East DC 1st CSWS Border					
Bying Public Works Peoples Electric Co-Op	EBLCO BORDER					
Bying Public Works Peoples Electric Co-Op	Energy Border					
Bying Public Works Peoples Electric Co-Op	GRDA Border					
Bying Public Works Peoples Electric Co-Op	Western Farmers					
Bying Public Works Peoples Electric Co-Op	WRI BORDER					
Bying Public Works Peoples Electric Co-Op	11,400 H&P BORDER	\$16.60	\$16.60	Sale		
Bying Public Works Peoples Electric Co-Op	640 CPS Border	\$17.60	\$17.60	Purchase		
Bying Public Works Peoples Electric Co-Op	6,244 CILCO Border	\$40.00	\$40.00	Purchase		
Bying Public Works Peoples Electric Co-Op	CILCO-IP Border					
Bying Public Works Peoples Electric Co-Op	CPS Border					
Bying Public Works Peoples Electric Co-Op	COMED Border					



FERC 1ST QUARTER 1996 FILING

Company Name	Product	Quantity	Price	Total Value	Category	Market
Citizens Services, Inc.	Sale	13.86	\$70.00		Non-Firm	APS Border PJM 500
	Purchase				Firm	6,071 AEP Border CINERGY Border CINERGY-Nipaco CIPS Border DPA Border SIBCO Border
Citizens-Lehman Power	Purchase	18.25	\$19.00		Firm	198,520 AEP-APS Border APS Border APS ICAAR Border COB SN Mid Columbia PALO VERDE
	Sale				Non-Firm	1,206 COB SN PEPCO (Brighton)
Citizens-Lehman Power	Purchase	15.00	\$25.00		Non-Firm	120,600 Mid Columbia Mid Columbia
	Sale				Firm	PALO VERDE PALO VERDE PECO Border PJM 500
Citizens-Lehman Power	Purchase	14.00	\$24.00		Non-Firm	168,000 ACE Border APS Border APS-PJM 500 IP-AEP Border PECO Border
	Sale				Firm	PEPCO (Brighton) PEPCO (Brighton) PEPCO System Border PJM 500 PPAL Border

FERC 1ST QUARTER 1998 FILING

City of Austin	Firm	Purchase	118.76	20,442	CITY OF AUSTIN
City of Austin	Non-Firm	Purchase	113.60	92,287	CITY OF AUSTIN CSWS Border
					LCSA BORDER
					TMPP-Border
					TUCSWS Border
City of Austin	Non-Firm	Sale	117.70	(400)	HLP BORDER
City of Austin	Non-Firm	Exchange/Delivery	N/A	(7,382)	FALO VERDE
City of Austin	Non-Firm	Exchange/Receipt	17.40	10,219	FALO VERDE
City of Galveston	Firm	Sale	117.00	(85,786)	Galveston-FPC Border
City of Galveston	Non-Firm	Sale	121.28	(748)	FPC Border
					Galveston-FPC Border
City of Garland	Non-Firm	Sale	129.00	(400)	TMPP-Border
City of Garland	Firm	Purchase	46.76	4,725	Mass
City of Homestead	Non-Firm	Sale	122.00	(110,869)	FL Border
City of Lakeland	Firm	Sale	117.00	(18,857)	FPC-OLC Border
City of Lakeland	Non-Firm	Sale	117.00	(14,487)	FPC-OLC Border
City of Needles	Firm	Sale	111.16	(1,588)	Mass
City of Pasadena	Firm	Purchase	16.76	7,704	Mass
City of Pasadena	Non-Firm	Purchase	16.76	2,298	Mass
City of Pasadena	Non-Firm	Sale	117.50	(136)	Mass
City of Seattle, City Light Department	Firm	Purchase	15.00	1,330	COB NS
City of Seattle, City Light Department	Non-Firm	Purchase	17.00	4,105	Mid Columbia
					Mid Columbia



FERC 1ST QUARTER 1996 FILING

Company Name	Transaction Type	Value	Counterparty
Colorado River Commission an agency of the State of Nevada	Non-Firm Sale	17.20	60,018 Midway
Colorado Springs Utilities	Firm Sale	110.98	3,008 Midway/FSC
Commonwealth Edison Company	Firm Purchase	111.80	3,874/AEP Border CIPS Border COMED Border Commonwealth/AEP Border
Commonwealth Edison Company	Non-Firm Purchase	49.00	141,319/AEP - CONSUMERS POWER AEP Border CIPS Border COMED Border Commonwealth/AEP Border Instate Power Co. IP Border IP-COMED Border Mid American Border NIPSCO Border WEPSCO Border Wisconsin PEL Border WPSO Border
Commonwealth Edison Company	Firm Sale	116.25	11,840 COMED Border
Commonwealth Edison Company	Non-Firm Sale	116.00	98,453/AEP Border CLCO Border CIPS Border CIPS-COMED Border COMED Border Comcast/NIPSCO Border IP Border
Consolidated Water Power Company	Non-Firm Sale	117.00	6,240 WPSO Border
Dairyland Power Cooperative	Non-Firm Purchase	110.35	306 Wisconsin PAL Border
Dayton Power & Light Company	Firm Purchase	119.42	4,898 OE Border
Dayton Power & Light Company	Non-Firm Purchase	114.30	28,868/AEP - CONSUMERS POWER AEP Border

FERC 1ST QUARTER 1986 FLING

Company Name	Transaction Type	Quantity	Price	Value	Category
Dayton Power & Light Company	Sale	130.00	130.00	130.00	Non-Firm
Dayton Power & Light Company	Sale	115.00	154.00	177.10	Non-Firm
Delmarva Power & Light Company	Sale	130.00	130.00	130.00	Non-Firm
Department of Energy Bonneville Power Administration	Purchase	18.75	418.75	7856.25	Firm
Department of Energy Bonneville Power Administration	Purchase	18.00	114.75	2065.50	Non-Firm
Department of Energy Bonneville Power Administration	Sale	127.00	127.00	127.00	Non-Firm
Department of Water Resources of the State of California	Purchase	48.00	113.75	5460.00	Firm
Department of Water Resources of the State of California	Purchase	2.00	18.00	36.00	Non-Firm
Dept. of Water and Power - City of Los Angeles	Purchase	117.00	42.00	4938.00	Firm
AP Border					
CINERGY Border					
DPL Border					
DE Border					
OE Border					
OE/DPL Border					
IB 4887/AP Border					
CINERGY Border					
DPL Border					
(800)PEPCO/PELGRIT/OTM					
92.856 Aberdeen					
COB 5/N					
Mid Columbia					
PAOLO VERDE					
Shoshone					
TCL BORDER					
4,808 COB NS					
COB 5/N					
Mid Columbia					
Shoshone					
TCL BORDER					
12,100 COB					
COB 5/N					
12,774 COB 5/N					
Summer					
7,857 COB NS					
216 Pass					
PAOLO VERDE					

FERC 1ST QUARTER 1996 FILING

Dept. of Water and Power - City of Los Angeles	Non-Firm	Purchase	112.50	425.00	2,220 Mwhd	PALO VERDE
						Synthetic
Dept. of Water and Power - City of Los Angeles	Non-Firm	Sale	44.00	18.00	1440 COB	
						COB NS
Consent G&T Cooperative, Inc.	Non-Firm	Purchase	811.50	817.00	5,713 Crdtp	
DeStac Energy	Non-Firm	Purchase	610.25	410.25	1,600 HLP-BORDER	
Duke Power Company	Non-Firm	Purchase	815.50	485.00	70,375 AEP Border	AEP-AMRO Border
						Duke-AEP Border
						Duke-CPJ Border
						DUKE-OPC Border
						DUKE-Southern Border
						OPC Border
						Santa Fe Cooper Border
						Southern Interface
Duke Power Company	Non-Firm	Sale	813.80	860.00	(17,010) AEP Border	AEP-Duke Border
						Duke-AEP Border
						DUKE-OPC Border
						OPC Border
						OPC-B1 Level
						Santa Fe Cooper Border
Dupont Power Marketing, Inc.	Non-Firm	Purchase	47.05	47.00	21,000 Mt Columbia	
Dupont Power Marketing, Inc.	Firm	Sale	48.78	47.75	(14,400) Mt Columbia	
Dupont Power Marketing, Inc.	Non-Firm	Sale	46.75	47.75	(7,200) Mt Columbia	
Duguesne Light Company	Non-Firm	Exchange/Receipt	N/A	N/A	71,000 APS Border	APS Border
						APS-ECIS Border
						DCG Border
Duguesne Light Company	Firm	Purchase	824.41	824.41	67,718 APS Border	APS-ECIS Border
						DCG Border

FERC 1ST QUARTER 1996 FILING

Company Name	Transaction Type	Value	Market	Product
Duquesne Light Company	Purchase	\$16.00	128.00	5,303 AEP - CONSUMERS POWER AEP Border
				APS Border
				DLC Border
				DE Border
Duquesne Light Company	Sale	\$11.50	145.00	19,692 AEP - CONSUMERS POWER AEP Border
				AEP-DLC Border
				APS Border
				DLC Border
East Kentucky Power Cooperative, Inc.	Purchase	\$13.25	\$26.50	61,509 AEG Border
				AEP Border
				Big River-TVA Border
				CINERGY Border
				CPIS Border
				EPIC Border
				EPIC-APS Border
				Energy Border
				IE-EPIC Border
				IO-EPIC Border
				LONGMOR
				SMERLARK
				TVA Border
				TVA-MISS
East Kentucky Power Cooperative, Inc.	Sale	\$12.00	\$24.00	13,590 EPC Border
				LG&E-EPIC Border
Electric Challengehouse, Inc.	Purchase	\$8.50	\$16.50	182,480 Mid Columbia
				Mid Columbia
				PALO VERDE
				PALO VERDE
Electric Challengehouse, Inc.	Purchase	\$8.50	\$16.50	4,850 Mid Columbia
				PALO VERDE
Electric Challengehouse, Inc.	Sale	\$7.60	\$28.50	124,800 ACE Border
				ACE-REG Border
				ACE-REG (NEW FREE)
				Mid Columbia
				Mid Columbia
				PALO VERDE

FERC 1ST QUARTER 1996 FILING

Company Name	Entity Type	Transaction Type	Value	Counterparty
Electric Generating, Inc.	Non-Firm	Sale	123.62	PALO VERDE
Empire District Electric Company	Non-Firm	Purchase	118.00	PERGO SOUTHERN BORDER
Empire District Electric Company	Firm	Sale	114.75	PERGO SOUTHERN BORDER
Empire District Electric Company	Non-Firm	Sale	117.75	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Purchase	117.90	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Sale	125.00	PERGO SOUTHERN BORDER
Energy Power Inc.	Non-Firm	Purchase	118.80	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Purchase	10.75	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Sale	10.35	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Purchase	19.00	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Non-Firm	Purchase	18.60	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Sale	15.80	PERGO SOUTHERN BORDER
Florida Power & Light Company	Non-Firm	Purchase	119.00	PERGO SOUTHERN BORDER
Electric Generating, Inc.	Non-Firm	Sale	123.62	PERGO SOUTHERN BORDER
Empire District Electric Company	Non-Firm	Purchase	118.00	PERGO SOUTHERN BORDER
Empire District Electric Company	Firm	Sale	114.75	PERGO SOUTHERN BORDER
Empire District Electric Company	Non-Firm	Sale	117.75	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Purchase	117.90	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Sale	125.00	PERGO SOUTHERN BORDER
Energy Power Inc.	Non-Firm	Purchase	118.80	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Purchase	10.75	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Sale	10.35	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Purchase	19.00	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Non-Firm	Purchase	18.60	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Sale	15.80	PERGO SOUTHERN BORDER
Florida Power & Light Company	Non-Firm	Purchase	119.00	PERGO SOUTHERN BORDER
Electric Generating, Inc.	Non-Firm	Sale	123.62	PERGO SOUTHERN BORDER
Empire District Electric Company	Non-Firm	Purchase	118.00	PERGO SOUTHERN BORDER
Empire District Electric Company	Firm	Sale	114.75	PERGO SOUTHERN BORDER
Empire District Electric Company	Non-Firm	Sale	117.75	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Purchase	117.90	PERGO SOUTHERN BORDER
Energy Electric System	Non-Firm	Sale	125.00	PERGO SOUTHERN BORDER
Energy Power Inc.	Non-Firm	Purchase	118.80	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Purchase	10.75	PERGO SOUTHERN BORDER
Equitable Power Services	Firm	Sale	10.35	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Purchase	19.00	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Non-Firm	Purchase	18.60	PERGO SOUTHERN BORDER
Eugene Water & Electric Board	Firm	Sale	15.80	PERGO SOUTHERN BORDER
Florida Power & Light Company	Non-Firm	Purchase	119.00	PERGO SOUTHERN BORDER

PERC 1ST QUARTER 1998 FILING

Company Name	Transaction Type	Value	Category	Item Description
				FPC Border
				FPC-OUJ Border
				FPL Border
				FPL-OPC Border
				Gainesville-FPC Border
				Gainesville-FPC Border
				KEY WEST-FPL
				Southern Interface
Florida Power & Light Company	Sale	\$14,000	Non-Firm	(\$5,976)/FPL Border
Florida Power Corporation	Purchase	\$80,000	Non-Firm	66,286/ Energy Border
				FPC Border
				FPC-OUJ Border
				FPL Border
				Gainesville-FPC Border
				Southern Interface
				Southern-FPC Border
Florida Power Corporation	Sale	\$18,286	Non-Firm	17,964/ FPC Border
				SEC-FPC Border
Fort Pierce Utilities Authority	Sale	\$20,350	Non-Firm	(\$3,322)/ FPL Border
				FPC Border
General Public Utilities Services Corporation	Purchase	\$24,200	Firm	11,200/ ACE Border
				PS&E System Border
General Public Utilities Services Corporation	Purchase	\$21,000	Non-Firm	243,860/ ACE Border
				GPU System Border
				GPU-PS&E Border
				GPU-PS&E Border
				NYSEG-GPU Border
				PCO Border
				PEPCO System Border
				PJM EOO
				PVAL Border
				PS&E System Border
General Public Utilities Services Corporation	Sale	\$21,000	Firm	111,200/ NYSEG-GPU Border
General Public Utilities Services Corporation	Sale	\$18,000	Non-Firm	(\$49,870)/ ACE Border
				APS- PJM EOO
				GPU System Border

FERC 1ST QUARTER 1996 FILING

Entity	Transaction Type	Value	Counterparty
Grand River Dam Authority	Purchase	115.00	4,981 EDC BORDER
Grand River Dam Authority	Sale	824.00	SVPA Border
Green Mountain Power Corporation	Purchase	137.00	176 VELCO System Border
Hastings Utilities	Purchase	115.00	1,920 NFD-AECI Interface
Heartland Energy	Purchase	925.00	560 PEPCO-REARBOTTOM
Heartland Energy	Sale	925.00	14,160 PSEG System Border
Heartland Energy	Sale	925.00	16,600 GPU PSE&O Border
Heartland Energy	Sale	925.00	PP&L Border
Heartland Energy	Sale	925.00	PSEG System Border
Houston Lighting & Power Company	Purchase	114.00	14,000 HLP BORDER
Houston Lighting & Power Company	Purchase	114.00	27,034 OESB Border
Houston Lighting & Power Company	Purchase	114.00	CSWS Border
Houston Lighting & Power Company	Purchase	114.00	HLP BORDER
Houston Lighting & Power Company	Purchase	114.00	LCRA BORDER
Houston Lighting & Power Company	Purchase	114.00	MAP Border
Houston Lighting & Power Company	Sale	117.50	115,642 HLP BORDER
Houston Lighting & Power Company	Sale	114.50	112,852 HLP BORDER
Illinois Power Company	Purchase	111.50	400 COMED Border
Illinois Power Company	Purchase	111.00	117,955 AEP - CONSUMERS POWER AEP Border
Illinois Power Company	Purchase	111.00	Bo Power-TVA Border
Illinois Power Company	Purchase	111.00	Cherry-AEP Border
Illinois Power Company	Purchase	111.00	CIS Border
Illinois Power Company	Purchase	111.00	COMED Border



FERC 1ST QUARTER 1998 FILING

Company Name	Transaction Type	Value	Counterparty
Interstate Power Company	Purchase	\$10.00	760 Interstate Power Co.
Interstate Power Company	Purchase	\$10.00	18,203 Interstate Power Co.
Interstate Power Company	Sale	\$11.28	(22,135) Interstate Power Co.
Interstate Power Company	Sale	\$11.60	(520) Interstate Power Co.
Jacksonville Electric Authority	Purchase	\$21.00	4,828 PPA Border
Jacksonville Electric Authority	Sale	\$18.00	(121,309) JEA Border
Kaiser Aluminum & Chemical Corp.	Sale	\$20.95	1102,848) Garman
Kansas City Power & Light Company	Purchase	\$12.00	24,000) EDC BORDER
Kansas City Power & Light Company	Sale	\$11.60	(50) KCP&L Border
Kentucky Utilities Company	Purchase	\$17.60	4,384) AEP Border
KN Marketing, Inc.	Purchase	\$11.60	1,600) Craig
Koch Power Services, Inc.	Purchase	\$7.50	217,400) MHz Columbia
Koch Power Services, Inc.	Purchase	\$8.75	4,000) MHz Columbia
Koch Power Services, Inc.	Sale	\$7.00	(17,400) MHz Columbia

FERC 1ST QUARTER 1996 FILING

Company Name	Entity Type	Transaction Type	Value	Counterparty
Each Power Services, Inc.	Non-Firm	Sale	99.85	Mid Columbia PECO Border PJM 500
Lasater Municipal Utility District	Non-Firm	Sale	18.38	COB N/S LASSEN/MD Pencilo Spec Tracy
Louisville Gas & Electric Power Marketing, Inc.	Firm	Purchase	16.85	COB N/S Mid Columbia PALO VERDE
Louisville Gas & Electric Power Marketing, Inc.	Firm	Sale	115.00	Mid Columbia PALO VERDE
Louisiana Electric Power, Inc.	Firm	Purchase	19.06	ACE Border COB N/S Mid Columbia PALO VERDE PECO Border PJM 500 PVAL Border PSE&G System Border
Louisiana Electric Power, Inc.	Non-Firm	Purchase	99.00	COB N/S Mid Columbia PALO VERDE PECO Border PJM 500 PVAL Border PSE&G System Border
Louisiana Electric Power, Inc.	Firm	Sale	124.26	COB N/S Mid Columbia PALO VERDE PECO (Brighton) PECO (Brighton) PJM 500

FERC 1ST QUARTER 1986 FILING

Company Name	Category	Value	Rate	Volume	Location
Louisiana Electric Power Inc.	Non-Firm	111.80	124.50	(1,487)	LAKE BORDER
					Mt Columbia
					PALO VERDE
					PEPCO (Baltimore)
					PPAL Border
Louisiana Gas & Electric Company	Firm	317.88	17.00	7,100	LG&E-ASP Border
Louisiana Gas & Electric Company	Non-Firm	15.90	19.50	16,636	ASP Border
					ASP-AMPO Border
					CINERGY Border
					LG&E System Border
					LG&E-ASP Border
					LG&E-CG&E Border
					TVA Border
					TVA Border
Louisiana Gas & Electric Company	Non-Firm	482.00		(3,448)	Big River-TVA Border
					KU-LG&E Interface
					LG&E-ASP Border
					LG&E-CG&E Border
Lower Colorado River Authority	Non-Firm	121.00	177.50	2,218	CSVS Border
					LCRA BORDER
Lower Colorado River Authority	Non-Firm	417.75	122.75	(60,000)	LCRA BORDER
					380 WPCO Border
Michigan Gas and Electric Company	Non-Firm	111.50	115.00		
Michigan Public Power Company	Firm	111.00	14.50	6,400	ASP - CONSUMERS POWER
Michigan Public Power Company	Non-Firm	11.00	14.50	9,400	ASP - CONSUMERS POWER
Michigan Public Power Company	Firm	114.88	114.88	(84,300)	ASP - CONSUMERS POWER
					ASP Border
MidAmerican Energy Company	Non-Firm	111.00	114.00		MidAmerican Power Co.
Missouri Public Service	Non-Firm	116.00	138.00	50,000	MO-ASC Border
					EEEC BORDER



FERC 1ST QUARTER 1996 FILING

Company	Category	Value	Volume	Unit Price	Market	Product
Northern Indiana Public Service Company	Firm	112.10	112.10			ComEd-Nipisco Border
	Sale					NIPSCO Border
Northern Indiana Public Service Company	Non-Firm	112.00	187.00			NIPSCO Border
	Sale					CONSUMERS POWER
Oglethorpe Power Corporation	Non-Firm	15.09	461.87			AEP Border
	Purchase					CINERGY Border
Oglethorpe Power Corporation	Non-Firm	18.00	160.00			Clearing-Nepaco
	Sale					CIPS Border
Oglethorpe Power Corporation	Non-Firm	14,354.489	14,354.489			COMED Border
	Sale					NIPSCO Border
Oglethorpe Power Corporation	Non-Firm	141,426	141,426			OPC Border
	Exchange/Delivery					OPC Border
Oglethorpe Power Corporation	Non-Firm	4,388	4,388			OPC Border
	Exchange/Receipt					OPC Border
Ohio Edison Company	Firm	122.00	122.00			APS Border
	Purchase					DLC Border
Ohio Edison Company	Non-Firm	119.00	119.00			APS Border
	Purchase					DLC Border
Ohio Edison Company	Firm	130.00	130.00			APS Border
	Sale					DLC Border
Ohio Edison Company	Non-Firm	116,440	116,440			APS Border
	Sale					DLC Border
Ohio Edison Company	Non-Firm	110.00	110.00			APS Border
	Sale					CONSUMERS POWER
Ohio Edison Company	Non-Firm	110.00	110.00			APS Border
	Sale					DLC Border
Ohio Edison Company	Non-Firm	110.00	110.00			APS Border
	Sale					DLC Border

FERC 1ST QUARTER 1996 FILING

Company Name	Transaction Type	Quantity	Value	Category
Oklahoma Gas & Electric Company	Purchase	12.26	135.00	DE Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	DEAFS Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	DEDFL Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	CSNYS Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	GHDA Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	OG&E Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	SWPA Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	WRI BORDER
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	(35)LOG&E Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	B.227/KCP&A Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	KCPK Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Intl American Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	OPFD Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	(15.432)FFC-DUC Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	FPL Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	SEC-FPC Border
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Med
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	COB SR
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	COB NS
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	COB SN
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	LASSERNUD
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Interway/POLE
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	COB NS
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	COB NS
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Med
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Met Columbia
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	PALO VERDE
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Washington
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	77,004/MC Columbia
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	PALO VERDE
Oklahoma Gas & Electric Company	Purchase	16.199	181.00	Washington

FERC 1ST QUARTER 1998 FILING

Company	Entity Type	Transaction	Value	Value	Value	Value
FirstEnergy	Firm	Sale	18.93	19.00	171,733	Md Columbia
FirstEnergy	Firm	Sale	18.93	19.00	171,733	PALO VERDE
FirstEnergy Power Services, Inc.	Firm	Sale	18.76	18.78	110,400	IND Columbia
Paragold Light & Water Commission	Non-Firm	Sale	118.35	118.30	115,192	SWFA Border
PECO Energy Company	Non-Firm	Purchase	115.00	117.50	10,369	PECO (Brighton)
						PECO System Border
						PJM 500
						PPAL Border
						PS&G System Border
PECO Energy Company	Firm	Sale	131.90	137.25	110,080	PECO Border
PECO Energy Company	Non-Firm	Sale	130.00	130.50	185,020	GM System Border
						PECO Border
						PJM 500
						PPAL Border
Pennsylvania Power & Light Company	Firm	Purchase	21.00	21.00	3,200	PPAL Border
Pennsylvania Power & Light Company	Non-Firm	Purchase	19.00	198.50	47,142	ACE Border
						APS Border
						Demand Charge
						PECO Border
						PECO (Brighton)
						PJM 500
						PPAL Border
						PS&G System Border
						PPAL Border
Pennsylvania Power & Light Company	Firm	Sale	119.00	121.00	140,595	PPAL Border
Pennsylvania Power & Light Company	Non-Firm	Sale	141.00	124.00	185,130	APS Border
						PS&G Border
						PPAL Border
						PPAL Border
Pennsylvania Power & Light Company	Non-Firm	Exchange/Delivery	N/A	N/A	175,000	APS Border
						APS EC&H Border
						PPAL Border
Pdbrn, Inc.	Firm	Purchase	130.50	130.50	4,000	PPAL Border

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Company Name	Entity Type	Transaction	Value	Counterparty
Public, Inc.	Firm	Sale	80.00	(81) PPAI Border
Puget River Power Authority	Non-Firm	Purchase	11.00	10,788 AUR Craig
Portland General Electric Company	Firm	Purchase	49.36	101,880 COB N/S COB S/N Mid Columbia PALO VERDE
Portland General Electric Company	Non-Firm	Purchase	14.00	1,160 COB N/S Mid Columbia
Portland General Electric Company	Firm	Sale	17.00	(23,810) COB S/N Mid Columbia
Portland General Electric Company	Non-Firm	Sale	19.00	(20,900) COB S/N Mid Columbia
Portland General Electric Company	Non-Firm	Exchange/Delivery	N/A	(71,860) APS Border ACE Border PS&G System Border
Portland General Electric Company	Firm	Purchase	11.25	151.24 ACE Border
Portland General Electric Company	Non-Firm	Purchase	17.00	38,898 APS 241 500 241 500 ACE Border PS&G System Border
Portland General Electric Company	Non-Firm	Sale	1.600	(2,814) APS Border APS 311 500 ACE Border PS&G System Border
Portland General Electric Company	Non-Firm	Purchase		PERCO-APSEAR Border PERCO-REACHBOTOM VEPC Border
Portland General Electric Company	Non-Firm	Purchase		PERCO-APSEAR Border PERCO-REACHBOTOM VEPC Border
Portland General Electric Company	Non-Firm	Sale		PERCO-APSEAR Border PERCO-REACHBOTOM VEPC Border

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Company Name	Transaction Type	Volume	Price	Value	Location
Public Service Company of Colorado	Purchase	28 Crdg	\$22.80	\$638.40	
Public Service Company of Colorado	Sale	(15,971) Air Crdg	\$12.00	\$191,652.00	
Public Service Company of New Mexico	Purchase	85,120 PALO VERDE	\$13.26	\$1,129,111.20	
Public Service Company of New Mexico	Purchase	67,892 PALO VERDE	\$16.00	\$1,086,272.00	
Public Service Company of New Mexico	Sale	(86,604) PALO VERDE	\$11.10	\$961,304.40	
Public Service Company of New Mexico	Sale	(66,389) Four Corners PALO VERDE	\$12.10	\$803,306.90	
Public Service Electric & Gas Company	Sale	(62,410) GRJ-PSE&G Border	\$22.80	\$1,423,788.00	
Public Utility District #2 of Grant County, Washington	Purchase	45,121 Mid Columbia	\$14.00	\$631,694.00	
Public Utility District No. 1 of Chelan County	Purchase	3,400 Mid Columbia	\$7.00	\$23,800.00	
Public Utility District No. 1 of Chelan County	Purchase	1,894 Mid Columbia	\$7.00	\$13,258.00	
Public Utility District No. 1 of Chelan County	Sale	(440) Mid Columbia	\$22.00	\$9,680.00	
Public Utility District No. 1 of Grays Harbor County	Sale	(5,526) Aberdeen	\$10.00	\$55,260.00	
Public Utility District No. 1 of Grays Harbor County	Sale	(645) Mid Columbia	\$17.62	\$11,362.90	
Puget Sound Power & Light Company	Purchase	48,474 COB MS	\$26.00	\$1,260,324.00	
Puget Sound Power & Light Company	Purchase	TCB BORDER	\$16.00	\$1,792,000.00	
Puget Sound Power & Light Company	Purchase	COB MS	\$17.50	\$1,792,000.00	
Puget Sound Power & Light Company	Purchase	COB SN			



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Entity	Transaction Type	Value	Category	Notes
Santa Cooper (South Carolina Public Service Authority)	Sale	132.00	Non-Firm	OPC Border
		482.00		OPC Border
				OPCB-1 Level
				Santa Cooper Border
				Santa Cooper Border
Santa Electric Cooperative, Inc.	Purchase	116.50	Non-Firm	3.49) FFS Border
		131.24		FFS Border
				SEC-FPC Border
				SEC-FPC Border
Santa Electric Cooperative, Inc.	Sale	119.65	Non-Firm	13.705) IEA Border
		122.00		IEA Border
				EA-SEC Border
				OGI-IEA Border
Southwest Public Utility District # 1	Purchase	14.00	Firm	50) M5 Columbia
Southwest Public Utility District # 1	Sale	17.25	Firm	192.400) M2 Columbia
		113.13		Shohomish
Southwest Public Utility District # 1	Sale	111.50	Non-Firm	110.000) Shohomish
Southern Indiana Gas and Electric Co.	Purchase	119.50	Non-Firm	150) CHERGY Border
Southern Indiana Gas and Electric Co.	Sale	112.84	Non-Firm	1140) SIGECO Border
Southern Indiana Gas and Electric Co.	Purchase	123.00	Non-Firm	BOOKING BORDER
South Mississippi Electric Power Association	Sale	119.00	Non-Firm	119.700) SWEPA/MPL
		150.00		TVA Border
				TVA-MISS
South Mississippi Electric Power Association	Exchange/Receipt	N/A	Non-Firm	5.400) SWEPA/MPL
South California Edison Company	Purchase	112.00	Firm	38.719) MPP
		121.00		PALO VERDE
South California Edison Company	Purchase	112.00	Non-Firm	3.168) Palo Verde
		123.00		PALO VERDE
South California Edison Company	Sale	16.00	Firm	104.507) COB NUS
		117.50		PALO VERDE

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Southern California Edison Company	Non-Firm	Sale	\$7.50	\$10.78	(875)	COB
						COB N/S
Southern Company Services, Inc.	Non-Firm	Purchase	\$13.10	\$50.00	398	Energy Border
						Southern Interface
Southern Company Spoltecs, Inc.	Non-Firm	Sale	\$18.00	\$89.00	(6,567)	Southern Interface
						TVA Border
Southern Energy Marketing, Inc.	Non-Firm	Sale	\$25.25	\$30.00	(20,800)	GPU-PSE&G Border
						PJM 500
Southern Minnesota Municipal Power Agency	Firm	Purchase	\$10.00	\$27.50		PSE&G System Border
						21,386 NSP System(SMMPA)
Southern Minnesota Municipal Power Agency	Firm	Sale	\$16.20	\$18.20	(20,633)	NSP System(SMMPA)
						(748) NSP System(SMMPA)
Southern Minnesota Municipal Power Agency	Non-Firm	Sale	\$13.00	\$40.00		4,480 CSWS Border
						CPS Border
Southern Public Service Company	Non-Firm	Purchase	\$15.75	\$15.75	(87,360)	CPS Border
						CPS Border
Seward Power Cooperative, Inc.	Non-Firm	Sale	\$18.85	\$18.85	(54,600)	COB S/N
						COB S/N
Tecoma Public Utilities	Firm	Sale				TCL BORDER
						TCL BORDER
Tennessee Energy Marketing Company	Firm	Purchase	\$30.50	\$30.50		8,000 PEPCO System Border
						PPAL Border
Tennessee Energy Marketing Company	Firm	Sale	\$25.75	\$25.75	(2,400)	PPAL Border
						PSE&G System Border
Tennessee Valley Authority	Non-Firm	Sale	\$10.00	\$45.00	(26,996)	AEP Border
						Big Rivers-TVA Border
						IP Border
						TVA Border



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Company Name	Transaction Type	Value	Category	Counterparty
Tucson Electric Power Company	Purchase	\$6.25	Non-Firm	Four Corners Mesa
		\$28.00		PALO VERDE San Juan
				Westwing
Utah Electric Company	Purchase	\$12.50	Non-Firm	5,648 CIPS Border
		\$50.00		Columbia Water & Light
				SWPA Border
				TVA Border
University of Missouri	Sale	\$19.30	Non-Firm	(10,480) Columbia Water & Light
Utility Board of the City of Key West	Sale	\$19.00	Non-Firm	(783) FPL Border
		\$25.00		KEY WEST FPL
Virginia Electric and Power Company	Purchase	\$17.60	Non-Firm	73,887 AEP Border
		\$50.00		PS Border
				PEPCO Border
				PEPCO Sun Beam Border
				VEPCO Border
				VEPCO-AEP Border
Virginia Electric and Power Company	Sale	\$17.50	Non-Firm	(71,016) AEP - CONSUMERS POWER
		\$43.00		AEP Border
				CPL AEP Border
				Smixie Cogent Border
				VEPCO Border
				VEPCO-AEP Border
				VEPCO-CPL Border
Vind Gas & Electric LLC	Purchase	\$9.40	Firm	21,016 Mid Columbia
		\$10.00		PALO VERDE
Vind Gas & Electric LLC	Purchase	\$10.76	Non-Firm	1,244 PALO VERDE
Vind Gas & Electric LLC	Sale	\$13.00	Firm	(16,800) PALO VERDE
Walsh Valley Power Association, Inc.	Purchase	\$17.26	Non-Firm	(1,440) AEP Border
		\$21.76		CINERGY Border

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Whish Valley Power Association, Inc.	Non-Firm	Sale	119.50	119.50	(880) CHENERGY Border
West Kootenay Power Ltd.	Firm	Purchase	115.50	115.50	24,960 BC-USA Border
West Kootenay Power Ltd.	Non-Firm	Purchase	113.00	113.00	16,000 West Kootenay
West Kootenay Power Ltd.	Firm	Sale	117.48	117.48	(40,960) BC-USA Border West Kootenay
West Penn Power Company	Non-Firm	Purchase	119.00	128.00	34,420 AEP Border APS Border APS PJM 500 PEPCO (Bingham) PEPCO System Border PJM 500 PJM Border
West Penn Power Company	Non-Firm	Sale	115.00	152.00	(37,730) AEP-APS Border APS Border VEPC Border
Western Area Power Administration-Powells Area Office	Non-Firm	Purchase	65.00	120.00	1,527 Mead
Western Area Power Administration-Sah Lake City	Firm	Purchase	49.75	113.00	4,951 Mead Pinnacle Peak (APS) Westing
Western Area Power Administration-Sah Lake City	Non-Firm	Purchase	16.50	122.50	18,100 Mead Mishawak Pinnacle Peak (APS) Westing
Western Area Power Administration-Sah Lake City	Non-Firm	Sale	111.00	111.00	15 Ault
Western Area Power Administration-Wentown	Non-Firm	Purchase	103.50	143.00	8,006 MID AMERICA Mid America Border APP-ACEI Interface NPP-WALIM Interface WALIM Border
Western Farmers Electric Cooperative	Non-Firm	Purchase	115.00	160.00	19,143 CSVS Border



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Company Name	Entity Type	Transaction Type	Value	Market
Wisconsin Public Power, Inc.	Non-Firm	Sell	437.00	12,412 WEPCCO Border
Wisconsin Public Service Corporation	Non-Firm	Purchase	437.60	2,372 WSPC Border
Wisconsin Public Service Corporation	Non-Firm	Sale	114.00	12,828 WEPCCO Border Wisconsin P&L Border WSPC Border

**Testimony of  
Pat Wood, III  
Chairman, Federal Energy Regulatory Commission  
Before the Committee on Governmental Affairs  
United States Senate  
November 12, 2002**

**I. Introduction and Summary**

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify about the oversight of Enron Corporation by the Federal Energy Regulatory Commission (FERC or the Commission) and the lessons learned from Enron's financial collapse. I became Chairman of the FERC just over a year ago, in September 2001. Since that time, the Commission has moved aggressively to respond to the lessons learned from both the California crisis and the Enron crisis.

The Commission is pursuing a number of regulatory initiatives to establish the market rules and regulatory framework necessary to ensure adequate incentives for much-needed infrastructure, to support the most efficient wholesale competitive marketplace, and to provide adequate market monitoring and market power mitigation to protect customers. In addition, we recently have made organizational changes to address the challenges ahead of us and we are currently in the process of overhauling our regulatory approaches where necessary to assure a competitive marketplace that protects customers against harm of market manipulation and other deceptive practices. We are still learning lessons from the collapse of Enron and we will know more when our ongoing investigations are completed. However, I can assure you that our institutional commitment to remedy and prevent market abuses is now and will continue to be an ongoing one, and that we intend to work with other federal agencies to ensure that we regulate energy industries in a coordinated and effective manner so that customers and investors are fully protected.

My testimony today will first briefly summarize the Commission's regulatory authority and the Enron subsidiaries subject to our authority. I will then describe the significant issues involving Enron actions regulated by the Commission. Finally, I will describe recent initiatives, both generic and in individual cases, that respond to the lessons learned from both the California and Enron crises.

## II. FERC's Regulation of Enron's Subsidiaries

### A. Overview of FERC Jurisdiction

Under the Federal Power Act (FPA), the Commission has jurisdiction over sales for resale of electric energy and transmission service provided by public utilities in interstate commerce. The Commission has interpreted the FPA's definition of public utilities to include energy marketers as well as traditional vertically-integrated electric utilities. The Commission must ensure that the rates, terms and conditions for wholesale sales of energy and transmission services are just, reasonable and not unduly discriminatory or preferential. FERC is also responsible for reviewing proposed mergers, acquisitions and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. The Commission also has jurisdiction under the FPA over licensing of hydroelectric projects and ongoing compliance with Commission licenses.

The FPA does not give the Commission direct jurisdiction over purely financial transactions. The Commission has asserted jurisdiction over such transactions only when they result in physical delivery of the energy which is the subject of the financial contract, or when such transactions or contracts affect or relate to jurisdictional services or rates (*e.g.*, financial contracts affecting firm rights to interstate transmission capacity or the pricing of such capacity).

Under the Public Utility Regulatory Policies Act (PURPA), the Commission determines eligibility for the benefits provided under PURPA to Qualifying Facilities (QFs). The general eligibility requirements for QFs, which are contained in the FPA, include technical and operational criteria as well as ownership criteria.

The Commission also has jurisdiction over transportation and sales for resale of natural gas. However, FERC jurisdiction over sales for resale is limited to domestic gas sold by pipelines, local distribution companies, and their affiliates (including energy marketers). Consistent with Congressional intent, the Commission does not prescribe prices for these commodity sales.

Under these statutory authorizations, FERC's regulatory jurisdiction extends to a number of Enron subsidiaries. However, the Commission does not regulate the parent corporation, Enron Corporation, as it does not engage in activities which are under FERC jurisdiction. Our authority with respect to Enron's subsidiaries is described below.

**B. Energy Marketers****1. Enron's Power Marketing Subsidiaries**

A power marketer generally is an entity that takes title to electric energy and engages in sales of electric energy, but that does not own or control physical generating facilities. To sell wholesale electric energy at market-based rates, public utilities, including power marketers, must file an application with the Commission. The Commission grants the application if the power marketer adequately demonstrates that it and its affiliates lack or have mitigated market power in the relevant markets. FERC requires power marketers to submit quarterly reports of their sales activities and to comply with certain restrictions for the protection of captive customers against affiliate abuse.

The Commission generally waives certain regulations for power marketers with market-based rate authorization. For example, these marketers do not need to submit cost-of-service filings because the rates they charge are market-based. The Commission also exempts power marketers from its accounting requirements, because those requirements are designed to collect the information used in setting cost-based rates. However, as announced last month in the Commission's Final Rule on Accounting and Reporting of Financial Instruments, Comprehensive Income, Derivatives and Hedging Activities, the Commission is considering whether power marketers should continue to receive these waivers.

The Enron-affiliated power marketers regulated by the Commission include: Enron Power Marketing Inc., Enron Sandhill Limited Partnership, Milford Power Limited Partnership, Enron Energy Services, Inc., and Enron Marketing Energy Corporation. It is now clear that at least some of Enron's power marketing activities were inappropriate, and the Commission's ongoing investigation of these activities is discussed below.

**2. Enron OnLine**

Enron's Internet-based trading system, Enron OnLine, was the dominant Internet-based platform for trading both physical energy (electricity and natural gas products) and energy derivatives. Traditional exchanges, like the New York Stock Exchange and NYMEX, determine price by matching the buy and sell orders of many traders in a many-to-many trading format. In contrast, Enron OnLine used a one-to-many trading format, where an Enron affiliate was always on one side of each energy transaction, either as a seller or a buyer. In May 2001, the Commission staff initiated an informal review into Enron OnLine and electronic trading in natural gas and

electric energy markets. The Commission staff's report was completed in August 2001, but never formally presented to the Commissioners. The report recommended that FERC continue to monitor Enron OnLine and electronic trading of natural gas and electric power, but determined that there was no reason for concern about Enron OnLine at that time. At approximately the same time, the Commission staff informally began to analyze whether the Commission could assert jurisdiction over Enron OnLine. While the Commission had asserted jurisdiction over the physical trades made through Enron OnLine, it had not determined whether it could assert jurisdiction over non-physical trades and the trading platform itself. Enron OnLine ceased operations around December 2, 2001, before the Commission staff completed the legal analysis and the full Commission could consider the issue.

### **C. Portland General Electric**

In 1997, the Commission approved Enron's acquisition of Portland General Electric Co. (Portland General), a vertically-integrated utility involved in the generation, purchase, transmission, distribution and sale of electricity, and the operation of licensed hydroelectric projects in Oregon. Portland General's retail rates and practices are under the jurisdiction of the Oregon Public Utility Commission. Portland General also sells energy to wholesale customers in the western United States. The Commission subsequently approved Enron's application to sell Portland General. However, Enron has not yet sold Portland General.

### **D. Gas Pipeline Subsidiaries**

Enron owns or owned all or 50 percent of three major operating gas pipelines: Transwestern Pipeline Company (Transwestern), Northern Natural Gas Company (Northern Natural), and Florida Gas Transmission Company (Florida Gas). Transwestern's system can flow gas from the San Juan, Permian and Anadarko Basins west to the California border and east to Texas intrastate pipeline markets. Northern Natural's system stretches from the Permian Basin to the Great Lakes in the Midwest. Florida Gas delivers natural gas from Texas to Florida.

These pipelines used Enron OnLine to receive bids for use of pipeline capacity. While "advertised" by Enron OnLine, the capacity was sold solely by the pipeline. The pipeline was the buyer's counter-party on these sales. Since the operator of Enron OnLine was not selling pipeline capacity, it was not required to seek prior Commission approval, nor was there any violation of Commission regulations, as long as information requirements regarding capacity availability and confidential shipper (buyer) data were followed. The "sharing" of information between a pipeline and a marketing affiliate (here, potentially through Enron OnLine)

is prohibited under FERC regulations. At this time, the Commission has no evidence that confidential shipper information was improperly shared with Enron marketing affiliates.

In November 2001, the Commission's staff became concerned that unregulated parent companies might be misusing the cash assets of their FERC-regulated energy subsidiaries. FERC staff initiated audits of several regulated companies. On March 1, 2002, the Commission instituted a formal non-public investigation on these issues. During the investigation, staff discovered that Enron had requested that two of its pipeline affiliates at the time, Northern Natural and Transwestern, take out loans totaling \$1 billion. Enron (the parent corporation) took the \$1 billion to hold off a declaration of bankruptcy, but the pipelines remained liable for payment on the loans. Subsequently, in August 2002, the Commission directed Northern Natural and Transwestern to demonstrate why the costs and indebtedness associated with these loans were not imprudently incurred and therefore unrecoverable from ratepayers. In response, Northern Natural and Transwestern executed separate consent agreements, which the Commission approved, whereby they would not include the costs associated with the loan in any future rate proceedings before the Commission.

Also on August 1, 2002, the Commission issued proposed rules for participation by FERC-regulated companies in similar arrangements for pooling cash assets within a corporation, or "cash management programs." The proposed rules include specific documentation requirements and conditions precedent for participation in cash management arrangements. The proposed rules are designed to make such arrangements more transparent and to prevent the abuse of cash management or money pool arrangements that could affect the financial health of regulated entities. The Commission recently held a technical conference on the proposed rules and comments are under consideration.

This past summer, FERC determined that Transwestern had used the Commission's negotiated rate program to improperly charge excessive transportation rates to deliver natural gas into California. On July 17, 2002, FERC ordered Transwestern to return all revenues above its maximum tariff rates collected as part of the affected transactions, plus interest, to all firm shippers on Transwestern's system at the time of the transactions. Further, the Commission prohibited Transwestern for one year from entering into negotiated rate agreements based on index-to-index differentials in natural gas spot market prices. On the same day, the Commission initiated a notice of inquiry to examine whether its negotiated rate program successfully safeguards against the abuse of market power by pipelines. The Commission has received comments on this matter and the comments are under consideration.

**E. Enron's Qualifying Facilities (QFs)**

In 1997, Enron, through its subsidiaries, acquired several windfarms located in California. These facilities had been certified by prior owners as qualifying facilities (QFs) in 1987, 1990 and 1991. QFs are eligible for certain financial benefits and regulatory exemptions under the Public Utility Regulatory Policies Act (PURPA), as implemented by the Commission's regulations, as long as they are no more than 50 percent owned by an electric utility or an electric utility holding company. Such benefits include a mandatory obligation on the part of an electric utility to purchase QF power at the electric utility's avoided cost and exemption of the QF from certain requirements of the FPA, the Public Utility Holding Company Act (PUHCA), and state laws. The other owners of these QFs included electric utilities or electric utility holding companies.

In 1997, Enron proposed to merge with Portland General Electric. This could have caused the QFs to be owned more than 50 percent by electric utilities or electric utility holding companies and, thus, resulted in the loss of QF status for the windfarms. To avoid this result, Enron "sold" and transferred its interest in the QFs to partnerships collectively known as RADR. In the 1997 applications submitted to FERC for recertification of QF status, the RADR applicants represented that the QFs would no longer be owned by Enron and thus still met the QF ownership requirements. Based on the applicants' representations, Commission staff determined that the facts as presented met the criteria for QF status set forth in the Commission regulations, and granted recertification of the windfarms as QFs.

In 2000, Enron filed an application with the SEC for an exemption under certain sections of PUHCA so that it could qualify for unrestricted QF ownership. Enron's QFs then filed notices of self-certification with FERC asserting that Enron had filed an application for PUHCA exemption with the SEC, and thus would again qualify for QF ownership. Under PUHCA, Enron's filing of this application entitled it to the exemption until the SEC determines otherwise, so long as the filing was made in "good faith." Under FERC's rules, this exemption meant that Enron was no longer an electric utility holding company and could own part of these QFs without causing them to lose QF status and the related benefits. Relying on the notices of self-certification it had filed with the Commission, which in turn relied on the application for exemption from PUHCA filed with the SEC, an Enron affiliate "repurchased" the facilities that had been previously "sold" to the RADR partnerships.

Recently, DOJ and SEC filed complaints against two Enron executives, Andrew Fastow and Michael Kopper. The complaints allege, in part, that they devised a scheme to allow Enron to maintain secret control over the QF windfarms

while preserving QF benefits for the windfarms. The alleged Enron control of RADR was far more extensive than had been represented to FERC. Last month, the SEC ordered a hearing on Enron's year-2000 application for exemption under PUHCA. On October 24, 2002, the Commission issued an order initiating an investigation of the QF status of the Enron-affiliated QFs for the period following Enron's 1997 "sale" of those QFs.

To put these facts in perspective, there have been nearly 9,000 filings (either notices of self-certification or applications for Commission certification) from facilities claiming QF status. Most of these filings were self-certifications. Only a small percentage of the filings were *contested* applications for Commission certification. Specifically, there have been fewer than 20 cases of a utility-purchaser alleging that an existing facility no longer was satisfying the criteria for QF status. Moreover, the Enron-affiliated QFs represent the first time there have been allegations that QF filings were fraudulent.

### **III. Price Manipulation by Enron or Others**

In January 2002, in response to allegations that Enron may have used its market position to distort electric and natural gas markets in the West, the Commission initiated a fact-finding investigation into whether any entity, including any affiliate or subsidiary of Enron Corp., had manipulated electric energy or natural gas prices in the West since January 1, 2000. The investigation was formally announced on February 13, 2002. In conducting this investigation, FERC staff has coordinated closely with staff from DOJ, SEC, the Commodities Futures Trading Commission (CFTC), and the Department of Labor.

On August 13, 2002, Commission staff released an initial report of its investigation. The report concludes that published indices of electricity and natural gas prices in or near California during the recent crisis may not be sufficiently reliable to be used in setting refunds for wholesale power buyers in California. Based on this staff finding, the Commission requested comments on whether it should change the method for determining the cost of natural gas in calculating the refunds for power sales in California from October 2000 to June 2001, and if so, what method should be used. The Commission recently received comments on this issue and the comments are currently under consideration.

Also based on the staff report, the Commission initiated formal enforcement proceedings under section 206 of the FPA regarding possible misconduct by three corporate affiliates of Enron (Enron Power Marketing, Inc., Enron Capital and Trade Resources Corporation, and Portland General), and two investor-owned utilities that

did business with Enron (Avista Corporation and El Paso Electric Company). If these investigations conclude that Commission orders or regulations were violated, possible sanctions include loss of market-based rate sales authority.

The Commission staff's investigation continues. Staff, with the assistance of its outside consultants, is conducting a comprehensive investigation of a variety of factors and behaviors that may have influenced electric and natural gas prices in the West during 2000-2001. The Commission staff's final report will include:

- an explanation of Enron OnLine (EOL) operations and the role EOL played in the energy markets;
- an analysis of sales data collected from information requests. Staff will explain the results of the statistical analysis of such data, including findings of how, and to what extent, forward prices directly correlate with spot energy prices;
- an analysis of wash trades in electricity and natural gas markets in the West;
- a discussion of staff's findings on allegations that Williams Co. had attempted to manipulate natural gas markets in the West;
- an analysis of the relationship between physical and financial natural gas and electric products;
- recommended standards and protocols for how to identify and deal with possible physical withholding; and
- further analysis of the extent to which Enron's trading strategies had an effect on other products, such as long-term physical and financial contracts.

The targeted date for completion of the Commission staff's investigation is January/February 2003. As soon as the investigation is complete, a thorough and timely report will be submitted to Congress.

#### **IV. Lessons Learned**

There are two equally important categories of actions the Commission has taken, or is currently taking, to ensure that we avoid the type of crisis that occurred in California and the West, and that resulted from the collapse of Enron. The first category includes generic actions to ensure the right rules are in place to encourage strong competition. The second category includes efforts to monitor markets more vigilantly.

##### **A. FERC Generic Initiatives**

Since I became Chairman a year ago, the Commission has begun or continued work on numerous efforts to improve the design, transparency and oversight of energy markets. These efforts, aimed at ensuring that energy customers receive adequate supplies of energy at reasonable prices, include the following:

- Notice of Proposed Rulemaking (NOPR) on Standard Market Design - On July 31, 2002, the Commission issued proposed rules on market design, including a comprehensive plan for mitigating market power and market manipulation. The proposed rules are intended to provide certainty to all market participants, encourage new infrastructure investment, promote fair competition and prevent a repeat of the mistakes made previously in California.
- Final Rule on Accounting - In October 2002, the Commission issued a final rule directing public utilities, licensees, natural gas companies and oil pipelines to report changes in the fair value of certain investment securities, derivatives and hedging activities. The new rules will enhance the transparency of financial information and facilitate a better understanding of the nature and extent to which derivatives and hedging activities are used by regulated companies and the impact these transactions may have on the companies' financial condition.
- Order No. 2001 – Improving market transparency requires detailed reporting on transactions within the electric energy and natural gas markets. Accordingly, in April 2002, the Commission revised its reporting requirements to enhance public access to information filed by public utilities on their services and sales. The new rules will allow more comprehensive and rigorous monitoring of these activities by the Commission and the public.

- **NOPR on Standards of Conduct** – In September 2001, the Commission proposed to revise its restrictions on the relationships between regulated transmission providers (such as Portland General) and their energy affiliates. The Commission proposed, for example, to broaden the definition of an affiliate to include newer types of affiliates, including those operating trading platforms (*e.g.*, Enron OnLine).
- **NOPR on Regulation of Cash Management Practices** – In August 2002, the Commission proposed requirements for participation in cash management programs in order to prevent the abuse of such programs. Such abuse could occur where cash from Commission-regulated subsidiaries is transferred to an unregulated parent company and essentially no longer belongs to the regulated subsidiary.
- **Comprehensive review of information** – In September 2001, Commission staff began a comprehensive review of the information the Commission needs to carry out its statutory obligation in the current and evolving electric energy and natural gas markets.
- **Notice of Inquiry on Negotiated Rates for Natural Gas Pipelines** - On July 17, 2002, the Commission issued a notice of inquiry seeking comments on its negotiated rate policy. This policy allows a pipeline to negotiate rates above cost-based limits with its customers, so long as the pipeline continues to offer a cost-based recourse rate as a safeguard against any exercise of market power. The Commission has received comments, and the comments are under consideration.

#### **B. FERC Institutional Initiatives**

The Commission's strategic plan, adopted by the full Commission when I became Chairman, encompasses three major areas of activity in overseeing the energy industry, as described below. A copy of the Commission's strategic plan for FY 2002-2007 is attached.

- **Infrastructure** – working with others to anticipate the need for new generation and transmission facilities, determining the rules for cost recovery of new energy infrastructure, encouraging the construction of new infrastructure, and licensing or certificating hydroelectric facilities and natural gas pipelines;

- Market rules – ensuring clear, fair market rules to govern wholesale competition that benefits all participants, and assuring non-discriminatory transmission access in the electric and natural gas industries;
- Market oversight and investigations – understanding markets and remedying market rule violations and abuse of market power.

This third strategic goal reflects the Commission's commitment to ensuring that markets continue to work for customers. To meet this third goal, the Commission created a new Office of Market Oversight and Investigations (OMOI).

### **1. Office of Market Oversight and Investigations**

Following a nation-wide search, in April 2002, my colleagues and I appointed a director to OMOI. He began working to develop the new office's mission and functions, to identify needed workforce skills and experience, and to recruit and hire appropriate talent for the new department. On August 12, 2002, OMOI became a formal, functioning office within the Commission, reporting directly to the Commissioners.

OMOI encompasses two units that function independently but work closely together. The Market Oversight and Assessment unit reviews developments in the market on a real-time and longer-term basis, and spots irregularities. As problems arise and are identified, OMOI's Investigations and Enforcement unit brings swift, decisive and effective enforcement. OMOI serves as an early warning system to alert the Commission when market problems develop, such as the California energy crisis or the collapse of Enron, and allows the Commission to intervene and correct the problems more quickly.

OMOI has begun an aggressive program of outreach to a wide variety of entities including: other federal, state and provincial regulatory agencies, state consumer advocates, industry participants, academic institutions and think tanks, financial institutions (such as ratings agencies), and Market Monitoring Units (MMUs) at Regional Transmission Organizations and Independent System Operators. The purpose of the outreach is to let these entities know that the Commission is developing a clear market oversight capability and to obtain their input for how best to develop that capability. Market monitors presented their evaluations of the ISO regional electricity markets at a Commission Open Meeting in June 2002, and participated in a Commission market monitoring technical conference on October 2, 2002.

In June 2002, the General Accounting Office (GAO) issued a report entitled “Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight.” The report found that the Commission faced key challenges in overseeing energy markets with respect to: (1) changing the Commission’s organizational structure to improve the effectiveness of the Commission’s oversight program; (2) defining and implementing an effective approach to overseeing competitive energy markets; and (3) addressing human capital needs. In addition, the report found that new statutory authority and guidance from Congress would enhance our ability to develop, regulate and oversee competitive energy markets.

I generally agree with the GAO’s conclusions and believe the Commission is moving aggressively to address the challenges. Importantly, we have given the market oversight function the organizational structure, mission and resources it needs. With the establishment of OMOI, the Commission is already implementing a new approach to market oversight. At the heart of the Commission’s efforts to analyze and assess energy markets lies a series of periodic reports to the Commission, including a biweekly Surveillance Report and a semi-annual Seasonal Outlook. In addition, OMOI is receiving appropriate human capital resources. We have budgeted for 110 FTEs in FY 2003 and 120 FTEs in FY 2004. We have also budgeted \$500,000, and \$1 million, respectively in contract dollars to obtain additional expertise.

## **2. Improved Coordination with Market Monitoring Units**

The Commission has instituted measures to ensure market mitigation in the future in all RTO markets. The Commission’s OMOI interfaces with the RTOs’ and ISOs’ market monitoring units (MMUs) and monitors markets to ensure that the market rules are working. The Commission formalized a plan for interaction with the MMUs during a public Commission meeting on June 26, 2002, when market monitors from ISO New England, New York ISO, PJM Interconnection, the California ISO, and the American Electric Power System presented their annual reports on the state of the markets. We have arranged for quarterly meetings of OMOI and the MMUs to discuss market performance and analytical issues. The MMUs will continue to report directly to the Commission, as they did at the June 26, 2002 meeting. Additionally, FERC now has staff stationed on-site at the California ISO, and is organizing regular staff visits to the other ISO and RTO offices.

### **3. Improved Coordination with Other Agencies**

The Commission has worked extensively to improve its coordination with other agencies, building on the relationships established over several years of quarterly meetings between staff of the FERC, Department of Justice and Federal Trade Commission. For example, on the same day that the Commission initiated its investigation into potential market manipulation in the West, Commission staff met with staff from the CFTC to establish the groundwork for cooperation, coordination, and information-sharing. FERC and CFTC staff have jointly deposed or interviewed over 100 individuals in the Western market investigation. The two agencies have also jointly developed and shared discovery responses each has gathered from its respective regulated entities. The Commission has entered into information-sharing agreements with DOJ, SEC and CFTC with respect to the investigation, and these agencies are also coordinated under the Deputy Attorney General for the broader investigatory efforts of the President's Corporate Fraud Task Force. And FERC legal staff has coordinated with the CFTC regarding each agency's respective jurisdiction over energy market activities.

### **V. Congress Should Expand FERC's Penalty Authority**

Congress could create stronger deterrents to anti-competitive behavior, market manipulation, and other violations of the FPA and Natural Gas Act (NGA), by adding or increasing civil and criminal penalty authority under those statutes. Currently, FPA section 316A provides for civil penalties of up to \$10,000 per day for violations of limited sections of the FPA (Sections 211, 212, 213 and 214). These penalties could be broadened to all sections of the FPA and increased significantly. The NGA contains no provision to allow the Commission to impose civil penalties. The NGA should be modified to give FERC this authority. As to criminal penalties, I support increasing the penalty authority under the FPA and the NGA from the current \$5,000 level to \$1 million and increasing the potential prison term from two to five years. For a criminal violation of the Commission's rules or orders under the FPA or NGA, I support increasing the penalty from \$500 per day to \$25,000 per day.

### **VI. Conclusion**

Since I became Chairman just over one year ago, the Commission has launched bold new initiatives that incorporate the lessons learned from the California energy crisis and the collapse of Enron. These initiatives will help to promote efficient competitive markets, while protecting customers and investors from a recurrence of the California and Enron crises. As always, I will be happy to provide further information or answer any questions you may have.

## Strategic Plan FY 2002 - 2007

### Vision

Dependable, affordable energy through sustained competitive markets

### Mission

The Federal Energy Regulatory Commission regulates and oversees energy industries in the economic and environmental interest of the American public.

### Goals and Objectives

#### **Goal 1: Promote a Secure, High-Quality, Environmentally Responsible Infrastructure through Consistent Policies.**

##### **Objective 1.1: Expedite Appropriate Infrastructure Development to Ensure Sufficient Energy Supplies.**

- Identify transmission and pipeline projects with high public interest benefits and facilitate their speedy completion.
- Standardize interconnection of power generation plants of all sizes and technologies.
- Strengthen inter-agency coordination of hydropower licenses and gas pipeline certificates to expedite processing, consistent with due process.

##### **Objective 1.2: Provide Clarity of Cost Recovery to Infrastructure Investors.**

- Establish a timely process to include prudently incurred expansion costs in transmission and pipeline rates.
- Ensure that revenue levels and rate design for regulated company services support long-term competitive markets.
- Welcome balanced innovative rate of return proposals that incent pro-competitive behavior and publicly beneficial projects.

##### **Objective 1.3: Address Landowner and Environmental Concerns.**

- Encourage collaboration among affected parties and address stakeholder concerns before the licensing/certification process.
- Incorporate reasonable environmental conditions into permits, licenses and certificates and ensure compliance with conditions.

##### **Objective 1.4: Promote Measures to Improve the Security and Safety of the Energy Infrastructure.**

- Work with other agencies and parties to identify and address security issues and needs.

- Support industry efforts to improve infrastructure security.
- Ensure strictest adherence to prudent dam safety practices.
- Facilitate prompt recovery of prudently incurred security and safety expenses in jurisdictional rates.

**Goal 2: Foster Nationwide Competitive Energy Markets as a Substitute for Traditional Regulation.**

**Objective 2.1: Advance Competitive Market Institutions Across the Entire Country.**

- Complete firm establishment of regional transmission organizations with clear responsibilities, independence and scope.
- Develop appropriate coordination with states to efficiently oversee regional power markets.
- Encourage balanced, industry-led organizations to develop reliability and business practice standards.
- Firmly establish transmission planning function on a regional basis, with a variety of technology solutions to meet reliability, security and market needs.
- Provide regulatory certainty through clear market rules and case-specific decisions.

**Objective 2.2: Establish Balanced, Self-Enforcing Market Rules.**

- Link market-based rate authority to continued presence of balanced market conditions.
- Rely on international best practices to develop comprehensive market protocols/rules.
- Establish robust programs for customer demand-side participation in energy markets.
- Encourage standardized business rules and practices to maximize market efficiency, ease market entry and reduce transactions costs.

**Goal 3: Protect Customers and Market Participants through Vigilant and Fair Oversight of the Transitioning Energy Markets.**

**Objective 3.1: Promote Understanding of Energy Market Operations and Technologies.**

- Develop and maintain an expert market-operation oversight and investigation capability.
- Keep abreast of industry and market trends and technological innovations to inform and guide market oversight.
- Enhance the Commission's deliberations and public discussion by developing market information and disseminating findings.

**Objective 3.2: Assure Pro-Competitive Market Structure and Operations.**

- Assess market conditions and infrastructure adequacy using objective benchmarks.
- Integrate the Commission's market oversight and the work of market monitoring units.

- Identify and remedy problems with market structure and operations, and periodically review market rules for consistency with long-term market development.
- Ensure that mergers and consolidations are consistent with pro-competitive goals.

**Objective 3.3: Remedy Individual Market Participant Behavior as Needed to Ensure Just and Reasonable Market Outcomes.**

- Investigate market dysfunctions, exercises of market power and rule violations, and remedy problems through Commission authority.
- Use expedited dispute resolution to accelerate processes and minimize customer expense.
- Act swiftly on third-party complaints, using litigation before Administrative Law Judges as needed to determine factual issues.

**Goal 4: Strategically Manage Agency Resources.**

**Objective 4.1: Manage Human Capital to Fulfill the Strategic Plan.**

- Apply workforce planning to help meet the challenges of new Commission roles and changing workforce demographics.
- Get the job done flexibly and efficiently with the right mix of internal workforce and contracted services from the private sector.

**Objective 4.2: Manage Information Technology to Best Serve the Public and Streamline Work Processes.**

- Expedite interactions with customers through secure and efficient e-government initiatives.
- Build effective electronic workload/time-management and case-processing systems to enable getting the work done right and on time.

**Objective 4.3: Clearly Communicate and Build Strong Partnerships with all Stakeholders.**

- Proactively reach out to groups affected by agency actions for advance input.
- Build strong partnerships with all stakeholders, especially with states.

**Objective 4.4: Strategically Manage Financial and Logistical Resources.**

- Integrate budget, business plan, and performance measurement to improve performance and accountability.
- Generate accurate and timely financial information to support operating, budget, and policy decisions.

**STATEMENT OF PROFESSOR PAUL L. JOSKOW<sup>1</sup>  
BEFORE THE COMMITTEE ON GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE**

**November 12, 2002**

Mr. Chairman and Members of the Committee:

Thank you for giving me the opportunity to appear here today to discuss issues associated with the restructuring of U.S. electricity industry and FERC's role in guiding the development of efficient competitive wholesale electricity markets. I last appeared before this Committee on June 13, 2001 as a participant in a hearing that focused on California's electricity crisis, FERC's responses to it, and more generally on the state of restructuring and competition in the electric power industry.<sup>2</sup> I thought that it would be most useful for me to update the comments and observations I made at that time in light of 18 months of additional experience.

A lot has happened in 18 short months. The extraordinarily high wholesale electricity market prices and power supply emergencies that plagued California and the rest of the West during the second half of 2000 and the first several months of 2001 subsided by the summer of 2001 and these extraordinary conditions have not reappeared since then. These changes in market performance followed several actions by federal and state officials that constrained wholesale prices, increased supplies of and reduced the

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<sup>1</sup> Elizabeth and James Killian Professor of Economics at the Massachusetts Institute of Technology (MIT) and Director of the MIT Center for Energy and Environmental Policy Research. The views expressed here are my own and do not necessarily reflect the views of MIT or any other organizations with which I am affiliated. A CV with my educational background, affiliations and a list of my publications can be obtained at <http://econ-www.mit.edu/faculty/pjoskow/index.htm>.

<sup>2</sup> Statement of Paul L. Joskow Before the Committee on Government Affairs of the United States Senate, June 13, 2001 available at <http://econ-www.mit.edu/faculty/pjoskow/files/JOSKOWSENATEFINAL.PDF>.

demand for electricity, along with favorable weather conditions and a significant softening in natural gas prices. However, the impacts of the crisis continue to be felt. Retail electricity prices have increased dramatically (on average) in California to cover the costs of power supplies purchased during the crisis, while its two major utilities have yet to regain investment grade credit ratings and one remains in bankruptcy. The future structure and performance of California's electricity industry remains uncertain.

In October 2001, Enron announced that it had to restate its earnings due to accounting irregularities and within a few short months it was bankrupt. Earnings restatements, additional accounting irregularities, sham round-trip energy transactions, abusive self-dealing arrangements and evidence of efforts to manipulate market prices during the California electricity crisis were subsequently revealed at Enron and other energy trading and merchant generating companies. The financial rating agencies downgraded the credit ratings of many energy firms to "junk" levels in response to new information about the quality of reported earnings, falling profits and profit forecasts, and a new understanding of the true risks associated with energy trading and investments in merchant generating capacity. The share prices for many energy trading and merchant generating companies tumbled and capital markets have largely closed to them. A growing number of companies have withdrawn from energy trading or scaled back their activities, wholesale market liquidity has declined and an enormous amount of new generating capacity that was under construction, development or planned to come on line over the next few years has been cancelled or indefinitely delayed. Investment in transmission infrastructure has continued to stagnate and congestion problems continue to grow.

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In response to these events, public and investor confidence in competitive electricity markets has been shaken, and several states that had planned to introduce restructuring, wholesale and retail competition initiatives have delayed or suspended these programs. Numerous investigations by federal and state agencies have been initiated, indictments and criminal convictions are growing.

The developments in electricity markets and regulation over the last 18 months have inevitably become intertwined with revelations of broader corporate accounting, financial reporting, and related abuses by several large companies, their senior executives, their auditors, and their bankers both within and outside the electricity and gas industries--- Enron, Worldcom, Tyco, etc. These revelations should remind us that certain types of regulatory rules and effective regulatory oversight, as well as clear and accurate disclosure of relevant accounting and financial information, are necessary for market economies to work effectively for consumers and investors. Clearly, the system of checks and balances that we have relied upon to police and mitigate such abuses failed to work effectively in these cases. However, it has been my experience that the vast majority of energy companies play by the rules, file accurate financial reports, have diligent internal and external auditors, have Boards that provide effective oversight, care about their customers and their communities, and run their businesses with high ethical standards. As we learn from recent experience, tighten regulatory rules and oversight, and seek to restore the confidence of the general public and investors it is important to keep this in mind.

What have we learned over the past 18 months about the initiatives to create competitive wholesale and retail electricity market in the United States? My list of important lessons learned is as follows:

- Creating well functioning competitive wholesale and retail electricity markets is a significant technical and institutional challenge. It is easy to do it badly! We still have much to learn about how to make these markets work well and we must expect that there will be a process of (hopefully) continuing improvement. Careful attention to the details of electricity market design, drawing on both U.S. and international experience, and active involvement by federal and state regulators in defining and implementing these details is very important.
- Electricity's unusual attributes also create unusual opportunities to exercise market power and to engage in behavior to raise market prices to supra-competitive levels either unilaterally or through tacit coordination.
- The creation of sound electricity market structures and good market rules can reduce firms' incentives and ability to exercise market power, withhold output, violate market rules, and drive up market prices. It is important that the restructuring process continue to create the necessary market structures and rules to support effective competition and reduce incentives to engage in behavior that harms consumers.
- A well designed market and associated market rules, however, is not enough to ensure that there will be no serious market abuses. An effective, credible and professional market monitoring system must be in place to measure and evaluate market performance, to identify actions necessary to improve market performance where it is poor, to enforce the market rules, and to punish those who violate them. These monitoring and enforcement systems should be insulated as much as is reasonably possible from interest group politics. More public transparency and more public disclosure of market and financial information are necessary in a competitive electricity industry than a regulated electricity industry, just the opposite of the trend that emerged during the recent past. The public, their elected representatives, and investors have lost confidence in the credibility of competitive electricity markets over the last 18 months. Unless the credibility of the markets and market participants is restored, and efforts made to disclose more information and analysis to the marketplace to facilitate the restoration of their credibility, it is unlikely that there will be support for extending electricity restructuring and competition initiatives to additional states.
- At the same time, it is important to guard against unnecessary and ineffective regulatory initiatives that undermine the behavior and performance of well

functioning competitive markets. Hard competition is to be encouraged while unfair competition, unreasonable levels of market power, and misleading or fraudulent presentations of financial and market information are mitigated by effective monitoring and appropriate sanctions. Finding the right balance continues to be an important challenge. I believe that the best approach is (a) to put good market designs and associated market rules in place at the outset, (b) to monitor and enforce compliance with these market rules, (c) to monitor and measure market performance on a continuing basis, (d) to identify sources of poor market performance where it has been found, and (e) to implement mitigation measures in response to poor market performance. Going forward, I would like to see more emphasis on ongoing measurement of market performance and responding quickly to serious performance failures before they do serious damage and less emphasis on micromanagement of individual firm behavior and delayed ex post investigations of behavior after it has run its course and harmed consumers.

- Much more attention needs to be paid to the development of an active demand side in wholesale and retail electricity markets that enables and encourages consumers who can respond to short term swings in market prices to do so. In most markets for goods and services consumers can and do protect themselves from unreasonable prices by buying less. While demand response opportunities for electricity may be less than for many other products, there is some underlying demand elasticity, and allowing it to be revealed in wholesale markets will help to improve market performance.
- The retail competition programs in those states that have adopted them are not working well for residential and small commercial customers. The deficiencies in retail competition programs will have adverse effects on the performance of wholesale markets as well. States need to bite the bullet on retail competition for residential and small commercial customers. They should either do what is necessary to make retail competition work well or abandon the effort and turn to a wholesale competition model in which distribution companies take on the obligation to serve smaller customers with appropriate compensation and incentive regulatory mechanisms in place. A retail procurement/competition framework that is characterized by both short-term contracts and little spot demand response will enhance market power problems and may undermine timely and efficient investment.
- Electricity policy needs to pay more attention to longer-term investment issues. About 100,000 Mw of new generating capacity has been completed in the U.S. in the last two and one-half years, most of it merchant generating capacity. This represents the primary success of the wholesale electric competition initiative to date. Indeed, many regions now find themselves with excess generating capacity and consumers are benefiting from lower wholesale prices that accompany it. However, a large quantity of generating capacity under construction and development has been cancelled or indefinitely delayed in the last 18 months.

The pipeline of generating capacity under construction will soon be empty and it will take years to refill it once projects begin to be planned and built once again. Many of the cancellations and deferrals reflect a natural and healthy response to changing supply and demand conditions. But some of them also reflect the turmoil in the merchant generating sector and uncertainties about future federal and state policies regarding market structure, market rules, market monitoring and mitigation, supply obligations and compensation rules. We must anticipate that significant additional investment in merchant generating capacity will not take place until credit is restored to the sector (on both the supply and purchasing sides), until uncertainties about market structure and market rules are resolved, and until a sound stable framework for encouraging investment is established. This framework must recognize that future investments in generating capacity will involve higher financing costs and more risk management requirements than was the case during the most recent building boom.

- More broadly, we must adopt policies to support the future evolution to an industry structure where merchant generators make most of their money by building and operating power plants cheaply and reliably and selling most of their output under longer term contracts to financial intermediaries and load serving entities. We want to design the markets so that firms earn profits by being the least cost suppliers, rather than by being good at engaging in behavior to increase price spikes in the spot market.
- Well functioning competitive power markets require a more robust transmission systems than we had under with vertically integrated regulated monopolies. Yet transmission investment continues to stagnate as congestion problems increase. In some parts of the country, reliability problems are growing, not because there is inadequate generating capacity in the region, but because there is inadequate transmission capacity to deliver it where it is needed. More transmission congestion increases local market power problems which in turn triggers the need for more regulatory interventions which may simultaneously undermine investment incentives. If we are not successful in adopting policies that stimulate more investment in transmission capacity to support competitive electricity markets we will face very serious electricity reliability and local market power problems in many parts of the U.S. within a few years.
- The absence of a coherent national policy governing electricity sector restructuring, wholesale and retail competition, and effective market monitoring and enforcement, supported by compatible federal legislation, is a serious impediment to achieving good performance for the sector. Wholesale electricity markets naturally span large regions of the country that encompass many states. Decisions made in one state affect electricity prices, supplies, and reliability in other states in the region. The conflicts between policies and perspectives about the costs and benefits of electricity sector restructuring and competition among the states substantially increases the difficulties FERC faces in enforcing its responsibilities under the Federal Power Act. The lack of clear national policy

mandates no doubt reflects the lack of consensus about the merits of industry restructuring and competition and how best to get from here to there. However, at the very least, FERC and the states must have a constructive cooperative working relationship that reflects a common set of performance goals. Moreover, at least in the Northeast, there is a broad commitment to wholesale and retail competition and a reasonable amount of agreement about how to move forward with it. It is important that controversies elsewhere in the country not slow down the efforts by the states, market participants, and ISOs in the Northeast to continue to make constructive reforms.

Let me now turn to a brief assessment of how FERC has responded to the lessons learned over the last 18 months. In my June 13, 2001 testimony I was critical of FERC's responses to the California electricity crisis:

"It should not have taken FERC so long to evaluate the performance of California's markets when they exploded during summer 2000..."

"I was especially disappointed by FERC's response to abundant evidence that market power problems were exacerbating an already bad situation caused by rising natural gas prices, reduced imports of power, higher demand and rising prices for NOx emissions permits."

"There is a very basic problem here. FERC does not appear to have a clear definition of market power, has not identified the empirical indicia it will use to measure the presence and extent of market power, does not routinely collect or analyze the data necessary to draw conclusions about market power, has not defined how much market power is too much market power to satisfy its obligations to ensure that wholesale electricity prices are just and reasonable, and it does not appear to have a well developed set of mitigation measures that it can choose from if it indeed finds that there is a significant market power problem. This is not a prescription for success in the identification of and effective response to serious market power problems."

"By delaying its analysis of the problem, by failing to specify a clear definition of market power, by failing to specify or apply clear numerical criteria for evaluating market performance generally, and by ignoring constructive comprehensive proposals for mitigation, FERC did not in my opinion properly fulfill its responsibilities to respond to the California's market meltdown adequately or in a timely fashion."<sup>3</sup>

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<sup>3</sup> I also indicated that "It is not my intention to place all of the blame on FERC for prolonging or exacerbating the crisis. There is plenty of blame to go around and policy makers have spent too much time looking for parties to blame and too little time fixing the problems. The CPUC's slow reaction to the problems, its failure to increase retail prices, the ensuing utility credit problems, and the legitimate reluctance of suppliers to supply without some assurance of getting paid certainly worsened the underlying

“If FERC is successfully to perform on its obligations it will have to change as well. FERC needs to become an agency with the human resources, organizational structure, administrative procedures and leadership that allows it to play an active constructive role in guiding resolution of wholesale market design issues, to be actively involved in ongoing monitoring of market performance, to develop and effectively apply objective market performance indicia, and to act quickly and cooperatively with the relevant state agencies, Independent System Operators, Regional Transmission Organizations, and market participants to fix serious market performance problems quickly once they have been diagnosed. FERC must also play a more active role in creating new organizational structures and regulatory institutions to govern the nation’s currently balkanized transmission system.”

I believe that FERC has made a lot of progress in the last 18 months under Chairman Patrick Wood’s leadership and has responded positively to the criticisms that I made in mid-2001. While I do not necessarily agree with everything FERC has done or proposes to do, I am generally pleased with the tone that has now been set at the top, the institutions that have been created to monitor electricity and gas markets, and with the electricity market reform initiatives that have been undertaken. The Chairman and the other FERC Commissioners have repeatedly made it clear to market participants that they are committed to creating well functioning competitive wholesale markets and that they will not tolerate efforts to manipulate market prices, violate market rules, engage in fraud, and other market abuses. The FERC Commissioners now appear to recognize that market power, price manipulation and fraud are real potential problems in electricity and gas markets, that serious market aberrations require serious investigation, that if a careful and professional investigation results in evidence of abuse, penalties will be assessed where appropriate, and that FERC must play a central role in responsibly monitoring

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wholesale market problems. The failure of FERC and the CPUC to find a way to work together constructively to find practical solutions in the early Fall of 2000 made the crisis much worse than necessary.”

markets and responding quickly to serious problems in order to restore credibility to wholesale electricity markets and to improve their performance.

In April, 2002 FERC created a new Office of Market Oversight and Investigations. The new Office is to “... help the Commission improve its understanding of energy market operations and ensure vigilant and fair oversight of those areas under Commission jurisdiction. The Office of Market Oversight and Investigations will oversee and assess the operations of the nation's gas, oil pipeline, and electricity markets. Its functions will include understanding energy markets and risk management, measuring market performance, investigating compliance violations, and analyzing market data. The office will be made up of a multi-disciplinary team of economists, engineers, attorneys, auditors, data management specialists, financial analysts, regulatory policy analysts, energy analysts, and support staff.”<sup>4</sup>

I have been arguing for some time that there was the need for an office of this type to be created within FERC. I am very pleased that an office with a professional staff dedicated to measuring market performance, market monitoring and investigation has now been created. There is still much work to be done in defining how market performance will be measured, what criteria will be used for monitoring market behavior, and what mitigation measures will be proposed and how they will be received by the Commission. However, the Office seems to be off to a good start, is reaching out to others with experience with these issues for suggestions for how it can best do its work,<sup>5</sup>

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<sup>4</sup> <http://www.ferc.fed.us/about/offices/offices/omoi/omoi.htm>

<sup>5</sup> I participated in the Technical Conference on market monitoring issues held by FERC Staff on October 2, 2002. <http://www.ferc.fed.us/Electric/RTO/Mrkt-Strct-comments/nopr/RM01-12omoi-09-20-02.pdf>. The Staff received a range of views regarding methods and metrics for measuring market structure, performance and participant behavior.

and improving coordination with market monitoring units in the three ISOs in the Northeast and the California ISO.

The Commission has also launched a number of investigations growing out of the California electricity crisis. In February, 2002 FERC initiated an investigation of gas and electricity markets in the West prior to and during the explosion in electricity and natural gas prices that accompanied the California electricity crisis, largely stimulated by revelations about Enron's behavior.<sup>6</sup> The investigation has been broad, aggressive and has sought help by outside experts to assist with it.<sup>7</sup> It is being coordinated with other agencies, including the Department of Justice, the SEC and the CFTC. An interim Staff report was issued in August 2002 which found evidence of violations by Enron and possibly other market participants of the letter or the spirit of market rules, resulting in higher electricity prices, along with actions aimed at inflating prices and trading volumes for natural gas and electricity reported to and by trade publications.<sup>8</sup> (The efforts to inflate prices reported to trade publications would only have made sense if this behavior in turn led to higher actual prices in spot or forward markets, though the FERC Staff has made no finding yet on these effects.) Indeed, perhaps for the first time, the Staff concluded that certain behavior represented the exercise of market power and not just the result of flawed or inconsistent market rules.<sup>9</sup> A number of other investigations and litigated cases are ongoing, including the California refund cases, the El Paso Pipeline

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<sup>6</sup> <http://www.ferc.fed.us/electric/bulkpower/pa02-2/02-13-02.pdf>.

<sup>7</sup> <http://www.ferc.fed.us/electric/bulkpower/pa02-2/pa02-2.htm>.

<sup>8</sup> <http://www.ferc.fed.us/electric/bulkpower/pa02-2/Initial-Report-PA02-2-000.pdf>.

<sup>9</sup> Staff Report, *ibid.* at page 94; "This behavior (raising prices and the last minute where buyers are unable or incapable of saying no) was not legitimate arbitrage, but was an exercise of market power."

investigation,<sup>10</sup> abusive self-dealing transactions between Enron's regulated and unregulated affiliates.

Ultimately, FERC's effectiveness and credibility as both a market facilitator and a complementary market monitor will depend on its ability to establish rules that increase market and regulatory transparency, to complete ongoing investigations in a way that demonstrates that it will carefully, completely and professionally evaluate the evidence, assess penalties if serious abuses are found, exonerate market participants under investigation if they are not, and complete the investigations as quickly as is reasonably possible.

In Order No. 2001 (April, 2002), FERC established rules that require detailed reporting on transactions within the electric energy and natural gas markets. These new rules should increase market transparency and facilitate more effective monitoring of these markets by FERC and the public.

Finally, on July 31, 2002, FERC issued its Notice of Proposed Rulemaking on Standard Market Design and Structure (SMD).<sup>11</sup> This is a sweeping rulemaking that attempts to deal with many of the problems with wholesale markets that have been identified, including effects to respond to many of the "lessons learned" discussed earlier in my testimony. I recognize that many of the proposals in the SMD are controversial. And while I agree with many of them, I also believe that there are several aspects of the SMD NOPR that need significant improvement and revision. Nevertheless, this is a

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<sup>10</sup> <http://www.ferc.fed.us/electric/bulkpower/RP00-241-006-09-23-02.pdf> .

<sup>11</sup> [http://www.ferc.fed.us/Electric/RTO/Mrkt-Strct-comments/discussion\\_paper.htm](http://www.ferc.fed.us/Electric/RTO/Mrkt-Strct-comments/discussion_paper.htm) .

serious, even courageous effort by FERC to facilitate wholesale market competition and improve market performance. Market monitoring and mitigation proposals are fully integrated into the SMD and the potential for exercising market power and the need to mitigate it has influenced important aspects of the proposals.

FERC has wisely extended the time period for filing comments on the SMD NOPR and has initiated various outreach efforts to better explain certain aspects of the SMD proposals and to receive advice from interested parties about problems with the SMD and potential improvements to its proposals.<sup>12</sup> Because there are wide variations among states and regions in how deeply they have embraced FERC's vision of wholesale and retail electricity competition, and how far they have moved down the restructuring path, it is likely that the SMD's basic principles for wholesale market structure will have to be adapted to better match these regional differences. The alternative appears to be political gridlock and substantial delays. As I have already noted, it would be unfortunate, for example, if the controversies over the SMD, slowed down reforms taking place in the Northeast where most of the states have embraced FERC's vision for wholesale and retail electricity competition and where the better features of the SMD are already being implemented.

Overall, I believe that FERC is doing a much better job today as both a market facilitator and a market monitor than it was doing at the height of the California electricity crisis. The Commission's efforts to facilitate fair competition in wholesale power markets, to improve market performance and to identify and mitigate market abuses deserve your support. One does not have to agree with all of FERC's decisions

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<sup>12</sup> [http://www.ferc.fed.us/Electric/RTO/Mrkt-Strct-comments/discussion\\_paper.htm](http://www.ferc.fed.us/Electric/RTO/Mrkt-Strct-comments/discussion_paper.htm). As of October 20, 2002.

and policy proposals to recognize that this is an agency whose leadership now recognizes that a credible market monitoring and enforcement program is an important part of its job and that it is necessary for facilitating the development of competitive electricity markets that work well. However, institutional cultures can take a long time to change, and only time will tell whether this view at the top has been fully institutionalized within the agency.

Related Papers By Paul Joskow

Paul L. Joskow and Richard Schmalensee, *Markets for Power: An Analysis of Electric Utility Deregulation*, MIT Press, 1983.

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**Statement of**

**Frank A. Wolak**  
**Professor of Economics, Stanford University**  
**Chairman, Market Surveillance Committee, California Independent System Operator**

**Before the**  
**Senate Committee on Governmental Affairs**  
**November 12, 2002**

Chairman Leiberman and Members of the Committee, I am pleased to submit this written statement on the lessons that should be learned about regulating energy markets from the California electricity crisis and the Enron bankruptcy and how these lessons should change way the Federal Energy Regulatory Commission (FERC) carries out its statutory mandate to set just and reasonable wholesale prices for electricity.<sup>1</sup> This issue is particularly timely given the current state of electricity re-structuring in the United States, and the recent Notice of Proposed Rulemaking (NOPR) issued by FERC outlining a standard market design (SMD). It is essential that the right lessons be learned from these two regulatory failures before FERC issues its final order on standard market design. Otherwise, it is very likely that these standard market rules will introduce market design flaws that can enhance the ability of market participants to exercise significant unilateral market power, and therefore increase the likelihood of future regulatory failures like the California electricity crisis and the Enron bankruptcy.

My testimony proceeds as follows. First, I will provide a diagnosis of the causes of the California electricity crisis. This is followed by a discussion of the actions taken at the state and federal level to end this crisis and their impact on the performance of the California electricity market. I then will describe the state and federal actions that ultimately ended the crisis. This is followed by a discussion of what I believe are the major lessons for electricity market design to be learned from the California crisis and the Enron bankruptcy. My testimony concludes with a recommendations for how FERC should change the way it carries out its statutory mandate to set just and reasonable wholesale prices as a result of these lessons learned. In this discussion, I describe

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<sup>1</sup>I am a Professor of Economics at Stanford University. Since April 1, 1998, I have been the Chairman of the Market Surveillance Committee (MSC) for the Independent System Operator (ISO) of California electricity industry. The MSC is an independent committee that monitors the performance of the California market and the California ISO for the Federal Energy Regulatory Commission. A discussion of my academic research and the role of the MSC in the California electricity market is given the end of my testimony. This is followed by a listing of the reports prepared by the MSC that have been submitted to the Federal Energy Regulatory Commission since the start of the California market.

a worst-case scenario for how another California electricity crisis could occur if these recommendations are not followed.

### **Diagnosing the California Electricity Crisis**

At the outset, I would like to emphasize that the California electricity crisis was not a market failure, a but a regulatory failure. As has been shown in recent research that I have carried out with Severin Borenstein and James Bushnell of the University of California, the relationship between the underlying market fundamentals and the level market power exercised in the California electricity market was not appreciably different between the summer of 2000 and the summers of 1998 and 1999.<sup>2</sup> As is becoming increasingly clear as more information becomes publicly available about the behavior of market participants in the California market during the period May 2000 to June 2001, there was never a shortage of generation capacity to serve consumers in California and the rest of the West. Instead, the observed scarcity electricity of during the crisis period was caused by market participants creating an artificial shortage of electricity that would enable them to sell the electricity they did provide at substantially higher prices. A number of independent studies by the California ISO's Department of Market Analysis, the California Public Utilities Commissions and several academic studies using publicly available data have documented this withholding behavior by generation unit owners during the crisis period.<sup>3</sup> This artificial scarcity during the crisis period also allowed suppliers to charge substantially higher prices for any electricity delivered under any forward financial contract with a delivery date in the future less than the time necessary bring a substantial amount of new generating capacity on-line to serve California. Operationally, this meant that any forward financial contract signed during the period January 2001 and May 2001 that delivers any electricity during the period June 2001 to December 2003 would reflect the level of

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<sup>2</sup>Borenstein, Severin, Bushnell, James, and Wolak, Frank. (2002) "Measuring Market Inefficiencies in California's Restructured Wholesale Electricity Market," available from <http://www.stanford.edu/~wolak>.

<sup>3</sup>Joskow, Paul and Kahn, Ed, (2002) "A Quantitative Analysis of Pricing Behavior in California's Wholesale Electricity Market During the Summer of 2000: The Final Word," available at <http://econ-www.mit.edu/faculty/pjoskow>, is the most widely cited study using publicly available data. The ISO's Department of Market Analysis produced a number of reports using confidential data quantifying the extent of withholding behavior among the large California market participants. The California Public Utilities Commission recently released a study of withholding behavior during the period January 2001 to May 2001 by the large California market participants available at <http://www.cpuc.ca.gov/pub/ished/Graphics/19417.PDF>.

market power that suppliers expected (at the time they signed the contract) to exist in the spot electricity market at the delivery date.

Market participants did not need to coordinate their behavior to create this artificial shortage of electricity that allowed them to set extremely high electricity prices during the period May 2000 to June 2001. Because of water availability for hydroelectric production in the Pacific Northwest during the summer of 2000, market participants found this behavior unilaterally profit-maximizing given the actions of other suppliers in the West. Evidence of this significant decline in import availability is that the average hourly quantity of imports into California during the latter part of the summer of 2000 was roughly half the average hourly value of imports during the same time period in 1999, despite average electricity prices in during the latter part of the summer of 2000 more than 5 times higher than average prices during the latter part of the summer of 1999. To understand the importance of import availability to performance of the California market, it is important to recall that, historically, California has obtained roughly one-quarter of its electricity needs from imports.

Owners of fossil-fuel generation facilities serving the California market recognized that higher profits were possible by pursuing a strategy of withholding capacity from the market either by refusing to offer their units to the market, declaring their units unavailable to operate, or by bidding prices vastly in excess of the average variable cost of supplying electricity from their generation units. This withholding behavior by fossil-fuel generation owners during the period May 2000 to June 2001 is documented in the studies referred to earlier in my testimony. Further evidence consistent with this withholding behavior is the unprecedented quantity of generation capacity unavailable to serve California during the period June 2000 to June 2001. For example, during the seven-month period November 1, 2000 to May 31, 2001, the average daily quantity of generation capacity forced or scheduled off-line in California was in excess of 10,000 megawatts (MW).<sup>4</sup> This figure is slightly less than one-quarter of the total amount of generating capacity in California.

The combination of low import availability and extraordinary high levels of generation capacity off-line in California allowed in-state suppliers to bid the capacity they did make available at extremely high prices and still have their bids accepted. Because the vast majority of imports from the Pacific Northwest are from hydroelectric facilities, the quantity of imports of available to

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<sup>4</sup>The California Energy Commission compiles summary statistics on the average daily amount of capacity off-line on a monthly basis at [http://www.energy.ca.gov/electricity/monthly\\_off\\_line.html](http://www.energy.ca.gov/electricity/monthly_off_line.html).

California was not likely to change until water conditions in Pacific Northwest improved. Water levels in Pacific Northwest during the last quarter of 2000 and first quarter of 2001 were extremely low and forecast to be as low or lower during the spring and summer of 2001. Consequently, it was reasonable for suppliers to expect that their withholding strategy would be extremely profitable through, at least, the autumn of 2001, because of forecast low water levels (and import availability) in the Pacific Northwest during this time period.

Further evidence that the California electricity crisis was due to an artificial scarcity of electricity is that all of the blackouts of firm electricity customers occurred during the months of January, March and May of 2001, when the daily peak demand for electricity was no greater than 34,000 MW. However, I would like to stress that the California ISO was able serve demand peaks above 43,000 MW during the summer of 2000 and demand peaks above 41,000 MW during the summer of 2001 without curtailing firm electricity customers. Rolling blackouts during these months, the high-consumption period of the annual demand cycle in California, would be consistent with a true shortage of generating capacity. In contrast, rolling blackouts during January and March, the low-consumption period of the annual demand cycle, and early May, a time of comparatively low demand, casts considerable doubt on the existence of a true scarcity of generating capacity to serve California.

While the above description of events in the California market might give the impression that suppliers engaged in illegal behavior to raise electricity prices during crisis period, I would like to emphasize that explicit coordination among suppliers was not necessary. Clearly, coordinated behavior among California participants would have made it easier to create this artificial scarcity, but, the technology of producing and distributing electricity and how it is priced to final consumers, combined with certain market conditions can result in the unilateral profit-maximizing responses of suppliers to these system conditions setting prices vastly in excess of competitive levels. Specifically, the availability imports to California during the crisis period and the very small quantity of forward contract coverage between California suppliers and the three large load-serving entities (LSEs) in California—Pacific Gas and Electric (PG&E), Southern California Edison (SCE) and San Diego Gas and Electric (SDG&E)—combined with the unilateral profit-maximizing actions of these suppliers to raise average energy prices over the period May 2000 to June 2001 to more than five times average prices over the period April 1, 1998 (the start of the California wholesale market) until April 30, 2000.

**Fundamental Enabler of Supplier Market Power in California**

I will now describe the primary factor that allowed suppliers serving the California market to raise prices vastly in excess of competitive levels during the period May 2000 to June 2001. Different from any other wholesale electricity market operating in the US or any other country in the world, when California sold off approximately 18,000 MW of fossil-fuel generation capacity owned by PG&E, SCE, and SDG&E to Duke, Dynegy, Reliant, AES, and Mirant, the five new entrants to the California market, it was done without an accompanying provision that the new owners agree to sell back to these three firms at fixed-price a large fraction of the expected annual output from these units in long-term contract with a duration of at least 5 years. These mandatory buy-back forward contracts sold along with the generation units are typically called “vesting contracts.” A vesting contract on a 500 MW unit might require the new owner to sell an average of 400 MWh each hour back to the load-serving entity that sold the generation asset at a price set by the regulator (before the asset is sold) for a period of at least 5 years. There are number modifications to this basic vesting contract structure, but the crucial feature of these forward contracts is that they obligates the new owner to sell fixed quantity of energy each year at a fixed price to the (LSE) affiliate of the former owner.

This forward contract sets up an extremely powerful incentive for the new owner to produce at least the contract quantity from its unit each hour of the day. The new owner must purchase any energy necessary to meet its forward contract obligations that it does not supply from its own units at the spot market price and sell it at the previously agreed upon fixed price. Consequently, the supplier only has an incentive to bid to raise the market price if it is assured that it will produce at least its forward contract obligations from its own units. However, this supplier cannot be assured of producing its forward contract obligation unless its bids for this quantity of energy are low enough to be accepted by the ISO. If each supplier knows that other suppliers have vesting contracts and are eager to supply at least their forward contract obligations from their own units, then all suppliers will have strong incentives to bid very close to their marginal cost of production for their forward contract obligation. This aggressive bidding brought about by the desire of suppliers to cover their forward contract positions will set market prices very close to competitive levels in all but the highest demand periods when at least one supplier is confident that it will be needed by the ISO to produce more energy than its forward contract quantity regardless of how high it bids.

In contrast, if suppliers have little or no forward contract obligations, their incentive to bid substantially in excess of the marginal cost supplying electricity from their units can be much greater. That is because they will earn the market-clearing price on all of electricity they produce. Because these suppliers have no forward contract obligations to meet, they are net suppliers of electricity with the first MWh of electricity they produce. To understand this dramatic change in the incentive to raise prices caused by having no forward contract obligations, consider the 500 MW unit described earlier. Suppose this supplier actually produces 450 MWh of energy. In a world with vesting contracts, if it manages to raise market prices by \$1/MWh, this will increase its revenues by the difference of 450 MWh (the amount energy it actually produces) and 400 MWh (the amount of its forward contract obligation), times \$1/MWh or \$50. In contrast, in a world with no forward contract obligation, if this firm manages to increase the market price by \$1/MWh is earns an additional \$450 in revenues, because it is paid this price for all of its sales. In this simple example, the lack of any forward contract obligation for the suppliers has resulted in a 9 times greater incentive to raise market prices by \$1/MWh, than would be case if the firm had the forward contract obligation to supply 400 MWh. Extending this example to the case of suppliers that own a portfolio of generation units, one can immediately see the tremendous increase in the incentive bid in excess of marginal costs during certain system conditions caused by the lack of vesting contracts. The five new entrants to the California market had very limited forward contract commitments to the three large load serving entities in California.<sup>5</sup> Consequently, any increase in the market price could be earned on virtually all of the energy produced by these suppliers.

This same incentive for suppliers to raise spot prices in the eastern ISO is limited to extreme demand conditions, because all of the large load-serving entities in these markets either own sufficient generation capacity to meet virtually all of their final demand obligations or have vesting contracts with the new owners of their units for substantial fraction of the expected output of these units. Consequently, the exercise of significant market power only occurs during very high demand conditions.<sup>6</sup> Although it is difficult to get precise estimates of extend that final demand is covered

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<sup>5</sup>The California Power Exchange ran a "block forwards" long-term financial contract market, and some of the California LSEs had purchased a limited amount of long-term financial contract coverage from this market.

<sup>6</sup>James Bushnell and Celeste Saravia. "An Empirical Assessment of the Competitiveness of the New England Electricity Market" (May 2002, available from <http://www.ucei.berkeley.edu/ucei/PDF/csemwp101.pdf>) shows that significant market power exists during high demand conditions in the New England and PJM electricity markets.

by forward contracts, estimates for the PJM, New York and New England Markets suggest that more than 90 percent of annual demand is covered by forward financial obligations either in the form of generation ownership or forward financial contracts . In California during the period May 2000 to June 2001, this figure was close to 40%, which is the approximate average percentage of the total demand of the three large investor-owned utilities that could be met from their own generation units. As noted above, the five new entrants—Duke, Dynegy, Reliant, AES and Mirant—had very limited forward contract obligations to supply to these three large LSEs.

The very limited forward contract obligations to the three LSEs by the five new fossil-fuel capacity entrants combined with low import availability during the second half of 2000 created an environment where the unilateral profit-maximizing bidding behavior of these suppliers resulted in prices vastly in excess of competitive levels. If California had forward contract coverage for final demand at the same levels relative to annual demand as is the case in the eastern ISOs, I do not believe that California suppliers would have found it unilaterally profit-maximizing to withhold capacity to create the artificial scarcity that allowed them to raise market prices dramatically. Moreover, even if they had been able to raise market prices, California consumers would have only had to pay these extremely high prices for less than 10 percent of their consumption rather than for close to 60 percent of their consumption.

The lack of forward contract obligations to final load in California created an additional harm to California relative to other states in the west that used the spot market for less than 5% percent of their electricity needs. The substantially larger spot market share in California meant that the same \$/MWh electricity price increase resulted in wholesale energy payments increases in California that were more than 10 to 12 times higher than the wholesale energy payments increases in the rest of the western US.

**Regulatory Dispute that Led to California Crisis**

The California electricity crisis was the direct result of the conflict between the Federal Energy Regulatory Commission and the state of California over the appropriate regulatory response to the extremely high wholesale electricity prices in California during the summer and autumn of 2000. The state of California argued that wholesale electricity prices during the summer and autumn of 2000 were unjust and unreasonable and it was therefore illegal under the Federal Power Act of 1935 for California consumers to pay these wholesale prices. However, not until it issued a preliminary order on November 1, 2000 did FERC first state that wholesale prices in California were unjust and unreasonable and reflected the exercise of significant market power by suppliers to the California market. Although FERC reached this conclusion almost four months after California, the ultimate conflict between the FERC and state of California does not appear to be over whether wholesale prices in California during the summer and autumn of 2000 were illegal under the Federal Power Act. Instead, the ultimate regulatory conflict that led to the California crisis appears to be over the appropriate remedy for these unjust and unreasonable prices.

To understand the statutory mandate that FERC operates under that allows this regulatory failure to occur, it is useful to review the provisions of the Federal Power Act that require FERC to set “just and reasonable” wholesale electricity prices and to describe how FERC has managed to introduce wholesale electricity markets in spite of its statutory mandate to set just and reasonable wholesale prices. The accepted legal standard for just and reasonable wholesale prices are those that recover production costs, including a “fair” rate of return on the capital invested by the firm. Moreover, if the FERC finds that wholesale electricity prices are unjust and unreasonable, the Federal Power Act gives it considerable authority to take the actions necessary to set just and reasonable prices. Finally, the Federal Power Act requires that FERC order refunds for any payments by consumers for prices in excess just and reasonable levels.

Approximately ten years ago FERC embarked on an explicit policy to promote wholesale electricity markets throughout the US. The price a generation unit owner receives from selling into a wholesale electricity market is would be determined by the willingness of all generation unit owners to supply electricity, rather than an administrative process that uses the firm’s production costs and a rate of return on capital invested to determine the price it is paid. The just and reasonable price standard for wholesale electricity prices required by the Federal Power Act presented a significant legal and regulatory challenge for FERC because markets can set prices

substantially in excess of the production costs for sustained periods of time. This occurs because one or more firms operating in the market have market power--the ability to raise market prices through their unilateral action and profit from this price increase.

Because of the very large potential harm from the exercise of unilateral market power by firms in a competitive electricity market, FERC has determined that unless a firm can prove that it does not possess market power it is not eligible to receive market-based prices. An implication of FERC's logic for granting market-based rate authority is that only if all firms participating in a market possess no market power will the price set by the market satisfy the just and reasonable standard of the Federal Power Act. Specifically, before it allows any market participant to receive a market price rather than a cost-based regulated price, FERC requires each participant to demonstrate that it does not have market power. My previous testimony submitted to this committee on June 13, 2001 describes FERC's process for determining whether a firm is can sell at market-based prices.<sup>7</sup>

As should be clear from the events in California from June 2000 to June 2001, the process FERC uses to determine whether a firm is eligible to receive market-based prices is fatally flawed. First, the dichotomy implicit in the FERC process that a firm either possesses market power or does not possess market power is factually false. Depending on conditions in the transmission in network and the operating decisions of all market participants, almost any firm can possess substantial market power in the sense of being able to impact significantly the market price through its unilateral actions. Second, it also extremely difficult, if not impossible, to determine on a prospective basis the frequency that a firm possesses substantial market power given the tremendous uncertainty about system conditions and the incentives they create for the behavior of other firms in the market. Finally, the methodology used by the FERC to make a determination of whether a firm has the ability to exercise market power uses analytical techniques that have long been acknowledged by the economics profession as grossly inadequate. My June 13, 2001 testimony describes these shortcomings in detail.

Because FERC granted market-based price authority to all sellers in the California market using a flawed and outdated methodology without any accompanying regulatory safeguards, it is not

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<sup>7</sup>Wolak, F.A. "Written Testimony On Role of Federal Energy Regulatory Commission in Functioning of California Electricity Market," June 13, 2001 (available from <http://www.stanford.edu/~wolak>).

surprising that a sustained period of the exercise of significant market power and unjust and unreasonable wholesale prices occurred because of the substantial dependence of California's three large LSEs on the spot market. However, FERC's remedies implemented in its December 15, 2000 order are more difficult to understand. Despite filings by a large number of parties arguing that these remedies (also proposed in the November 15, 2000 preliminary order) would be ineffective at best and most likely harmful to market, FERC still implemented their proposed remedies largely without modification. For example, the Market Surveillance Committee of the California ISO that I chair wrote in its December 1, 2000 comments, "The MSC concludes in its analysis that the Proposed Order's remedies are likely to be ineffective to constrain market power and, in fact, could exacerbate California's supply shortfalls, and thereby, increase wholesale energy prices."<sup>8</sup> Unfortunately, this is precisely what happened following the implementation of these remedies in January of 2001. The California Power Exchange went bankrupt, PG&E declared bankruptcy, SCE came close to declaring bankruptcy, and rolling blackouts of firm load occurred in January, March and May of 2001.

As noted in the December 1, 2000 MSC report, FERC's soft price cap policy contained in its December 15, 2000 final order amounted to no price cap on wholesale electricity prices, because all suppliers had to do was to cost-justify their bids in excess of the \$150/MWh soft price cap, something they found increasingly easy to do over time because FERC only did a very limited review of the prudence of these cost justifications. Rather than remedying the unjust and unreasonable prices of the summer and autumn of 2000, the December 15, 2000 remedies produced wholesale prices from January 1, 2001 to the end of June 2001 that were substantially higher than average wholesale prices during any preceding or following six-month period, along with the rolling blackouts and bankruptcies and near-bankruptcies described above.

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<sup>8</sup>Wolak, Frank A., Nordhaus, Robert, and Shapiro, Carl, "Analysis of Order Proposing Remedies for California Wholesale Electric Markets (Issued November 1, 2000)," December 1, 2000 (available from <http://www.stanford.edu/~wolak>).

**Solution to California Electricity Crisis**

I now address the question of the solution to California electricity crisis. As described above, the lack of vesting contracts between California suppliers and the three large LSEs created strong incentives for suppliers to withhold capacity from the market in order to increase spot prices. By this logic, if enough California suppliers had a substantial amount of their capacity committed in long-term contracts to California LSEs, the incentive California suppliers had to withhold capacity from the market would be substantially reduced and the accompanying very high average spot prices created by this artificial scarcity would be largely eliminated. For this reason, the December 1, 2000 report of the Market Surveillance Committee proposed a joint/federal state regulatory mechanism to implement what amounted to ex-post vesting contracts between California's LSEs and suppliers to the California market at fixed prices set by the FERC. However, this regulated forward contract remedy was rejected by FERC in its December 15, 2000 order. Consequently, if the state of California wished purchase the quantity and mix of forward contracts necessary to commit suppliers to the California market during the summer 2001 and following two years, it would have to pay prices that reflected the market power that suppliers expected to exist in the spot market in California over the coming two years. Suppliers would not voluntarily sell their output in a forward contracts that covered this time period at prices below what they expected to receive in the spot market.

Thus, the only way for California to lower the price it had to pay for a forward contract was to increase the duration of the contract or the fraction of energy purchased in the later years of contract. By committing to purchase more power from existing suppliers at prices above the level of spot prices likely to exist in California more than two years into the future, California could obtain a lower overall forward contract price. However, this was simply a case of paying for the market power that was likely to exist in the California spot market during the period June 2001 to May 2003 on the installment plan rather only during this two-year time period.

During the late winter and early spring of 2001, the state of California implemented this solution, by signing approximately \$45 billion in forward contracts with durations averaging approximately ten years. These forward contracts committed a significant amount electricity to the California market during the summer of 2001 and even more in the summer of 2002 and beyond. While a few of the forward contracts signed during the winter of 2001 began making deliveries in late March and the beginning April and May of 2001, a substantial fraction these contracts began

delivering power to California during June 1, 2001. The vast majority of the remaining contracts delivering power during summer of 2001, began July 1, 2001 and August 1, 2001.

FERC Price mitigation plan described in its June 19, 2001 order was implemented June 20, 2001. This plan established a west-wide price cap and required power marketers to bid as price takers in the California market. However, all sellers other than power marketers were still allowed the opportunity to cost-justify and be paid as-bid for their electricity at prices above this west-wide price cap.

To assess the relative impact on spot market outcomes of this price mitigation plan relative to the forward contracts purchased by the state of California, it is important to bear in mind the following facts. First, the FERC price mitigation plan only applied to sales in the California ISO real-time market. During this time period less than 5% of the energy consumed in California was paid the ISO real-time price. The vast majority of sales during the summer of 2001 were made through the long-term forward contracts signed during the winter of 2001 and medium-term commitments to supply power negotiated by the California Department of Water Resources. Second, according to the California ISO's Department of Market Analysis, average prices for incremental energy were slightly below \$70/MWh during July of 2001 and less than \$50/MWh for the remaining months of 2001. Throughout this entire time period the west-wide price cap was slightly above \$91/MWh. Third, according to the July 25, 2001 Market Analysis Report of the ISO's Department of Market Analysis, the extent to which real-time prices exceeded the competitive benchmark price during the period June 1, 2001 to June 19, 2001 was substantially smaller than it was any previous month during 2001<sup>9</sup>. The result is consistent with the forward contracts beginning delivery on June 1, 2001 providing incentives for more competitive spot market behavior. Finally, it is important to note that demand during each month of 2001 was approximately 5% percent less than demand during the same month of 2000, because of significant conservation efforts by California consumers. All of these facts suggest that the June 19, 2001 price mitigation plan was not a binding constraint on real-time prices during the vast majority of hours of the second half of 2001.

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<sup>9</sup>Sheffrin, Anjali, "Market Analysis Report," July 25, 2001 (available from <http://www.caiso.com/docs/2001/07/26/200107260820387855.pdf>)

Monthly average real-time incremental energy prices from January 1, 2002 to September 30, 2002, the end of price mitigation period, averaged between \$50/MWh and \$60/MWh, which provides evidence that this price mitigation plan was not the binding constraint on prices for the vast majority of hours of the first nine months of 2002 as well. Average prices for near-term energy during the period July 1, 2001 to September 30, 2002 were significantly lower than average incremental real-time energy prices over this same time period. This result provides evidence that the long-term contracts signed during the winter of 2001 caused suppliers to exhibit more competitive behavior in the near-term energy market during this time period. More recent analyses of market outcomes by the Department of Analysis of the California ISO that accounts for the impact of the forward contract obligations of the large suppliers finds additional evidence consistent with the view that these forward contract obligation increased the competitiveness of the near-term and real-time electricity markets during the period July 2001 to September 2002.

Although I believe that the FERC July 19, 2001 price mitigation order, at most, had a very limited impact on the competitiveness of the medium-term and real-time spot markets for electricity in California relative to the impact of forward contracts signed by the state of California during the winter of 2001, the greater willingness of FERC to support the actions of the California ISO operators following the June 19, 2001 order significantly benefitted the reliability of the California ISO transmission network. Following the implementation of the June 19, 2001 order, FERC was much more willing to take tangible actions in support of the ISO's efforts to make suppliers comply with FERC's must offer requirement as well as a number of other provisions of the ISO tariff. I believe that these actions convinced California market participants that FERC was now taking a far more active role in regulating the California market and that this more active presence in California benefitted system reliability and market performance.

#### **Lessons Learned from the California Electricity Crisis**

Several lessons from the California electricity crisis follow directly from the diagnosis of the causes and solution to the California electricity crisis given in the previous section of this testimony. The most important lesson is that any re-structuring process should begin with a large fraction of final demand covered by long-term forward contracts. Only a very small fraction of total demand should be purchased from the medium-term and real-time markets, particularly given the way that retail electricity is priced to final consumers throughout the US. To the extent that the wholesale

market in a geographic region is highly dependent on imports and highly dependent on hydroelectric power, the fraction of total demand that should be left to the medium-term and real-time market is even smaller. For this reason, the forward contract coverage of final load at the start of the market in California should have been even greater than what exists in any of the markets in the eastern US because none of them are as dependent on imports and hydroelectric energy as California.

The second lesson is that state and federal regulators must coordinate their regulatory efforts to protect consumers. Because FERC disregarded much of the input from California regulators and policymakers and other independent monitoring entities intimately acquainted with the performance of the California market during autumn of 2000 in formulating its December 15, 2000 order implementing remedies for the California market, this order had many unintended consequences that only made matters worse, rather than remedying the extreme market power exercised in the spot electricity market in California. This outcome underscores an important component of this lesson this is particularly relevant for states that have not yet re-structured. State regulators cannot protect consumers from market power in the wholesale market without the cooperation of the FERC because it is the only regulatory body charged with setting just and reasonable wholesale electricity prices. To provide the necessary assurance to states that another regulatory crisis between FERC and state regulators will not occur at some future date, it may be necessary for FERC to implement a formal mechanism that guarantees that it will fulfill its statutory mandate to set just and reasonable wholesale prices in the most timely manner possible should market outcomes that reflect significant market power arise in any wholesale electricity market that it regulates. I am extremely skeptical that the national political process will allow further re-structuring of the electricity supply industry unless FERC is able to provide a greater degree of assurance to state regulators that it will provide the same or a superior level protection to consumers relative to what they received in the former vertically integrated utility regime. The tremendous resistance to FERC's standard market design NOPR expressed by politicians and policymakers in the majority of US states appears to be due in large part to the perception that FERC cannot or will not provide this level of protection to electricity consumers.

An important corollary to the necessity of coordinating federal and state regulatory policies, is that a successful wholesale market design must take into account the existing retail market design. Federal wholesale market policies must be coordinated with state-level retail market policies. The details of state-level retail market policies can have potentially enormous unintended consequences

for wholesale market performance. For example, designing a wholesale market assuming the existence of active participation in the wholesale market by final consumers, when virtually all retail markets in the US does not support such participation, will not create a workably competitive wholesale market. Consequently, a national policy for a standard wholesale market design should at least recognize that certain conditions in the retail market are necessary to support a workably competitive wholesale market. For example, one retail market pre-condition for FERC approval of a wholesale market design would be that all customers above some peak demand level, say 200 KW, have hourly meters at their facility and face a default price equal to the hourly spot price of electricity at their location. FERC may also wish to consider pre-conditions on the retail infrastructure to support participation by small business and residential customers in wholesale market, but some pre-conditions on the retail infra-structure for large, sophisticated electricity consumers is essential.

A third lesson from the California crisis is that FERC cannot set ex ante criteria for a supplier meet in order it to be allowed to receive market-based prices without an ex post criteria for assessing whether the subsequent market prices are just and reasonable. As discussed above, it is impossible determine with certainty on an ex ante basis whether a supplier owning a portfolio of generation units has the ability to exercise significant market power. Consequently, I see no way for FERC to avoid devising a transparent methodology for determining what constitutes a just and reasonable price in a wholesale market regime. Despite over four years experience with wholesale markets in the US, FERC is still unwilling to define what constitutes unjust and unreasonable prices. This FERC policy creates unnecessary regulatory uncertainty and increases the likelihood of another California electricity crisis, where there is a disagreement between FERC and state regulators over the extent to which wholesale prices are unjust and unreasonable and the appropriate regulatory remedies for these prices.

If one is willing to acknowledge that suppliers attempt to exploit all of the unilateral market power that they possess and that conditions in the transmission network and the production and consumption decisions of other market participants determine whether a firm possess substantial market power, then it follows that a supplier cannot be immunized against the ability to exercise market power on an ex ante basis. By this logic, the issue is no longer whether any supplier possesses market power, but whether the unilateral actions of all market participants exercising all available market power results in prices that impose significant harm to consumers. In other words,

do wholesale prices reflect the exercise of a substantial amount of market power for a sustained enough period of time to impose sufficient harm to consumers to justify regulatory intervention? This is the fundamental question that FERC must answer in order to provide a transparent definition of what constitutes unjust and unreasonable prices in a wholesale market regime. Specifically, FERC should be required to define the extent of market power exercised, the geographic market over which it is exercised and the time interval over which it exercised that results in unjust and unreasonable wholesale prices worthy of regulatory intervention. A transparent definition of unjust and unreasonable prices in a wholesale market regime that can be applied to any wholesale market considerably simplifies the process of regulating wholesale markets. If this transparent standard (that can be computed by all market participants) for prices is exceeded then regulatory intervention should automatically occur.

This perspective on just and reasonable wholesale market prices suggests a potential logical inconsistency in FERC's current approach to enforcing the just and reasonable price provision of the Federal Power Act. Specifically, in both public statements and its orders, FERC has stated that it is important to find the bad actors and punish them for causing unjust and unreasonable prices. While it is important to find market participants that violated market rules and take back their ill-gotten gains as well as penalize them for any market rule violations or illegal behavior, these statements by FERC seem to suggest that bad behavior on the part of a market participant is necessary for unjust and unreasonable prices worthy of refunds to occur. However, as emphasized in the above discussion and my June 13, 2001 testimony, the unilateral actions of all privately-owned market participants to serve their fiduciary responsibility to their shareholders and the unilateral actions of all publicly-owned market participants to serve the interests of their captive customers can result market outcomes that reflect the exercise of enormous market power. In short, there is no need for any malicious behavior by any market participant for a wholesale electricity market to produce unjust and unreasonable prices. Moreover, the Federal Power Act does not specify that prices must be the result of malicious behavior by a market participant in order for them to be deemed unjust and unreasonable. The Federal Power Act only requires that if FERC determines that prices are unjust and unreasonable, regardless of the cause, then it must take actions to set just and reasonable prices and it must order refunds for any payments in excess of just and reasonable levels.

The Federal Power Act does not say that these refunds must be paid only by firms that violated market rules or engaged in illegal behavior. This is the fundamental logical inconsistency that FERC faces in attempting to introduce wholesale markets without an explicit statutory mandate to do so. Firms can be required to refund wholesale market revenues despite the fact that no market participant engaged in any illegal behavior or violated any market rule, because their unilateral profit-maximizing actions jointly resulted in unjust and unreasonable market prices. This means that the legal actions of market participants in compliance with the market rules can result in market prices that are illegal and worthy of refunds. I believe the best way for FERC to deal with this problem is once again to set a transparent standard for what constitutes unjust and unreasonable prices in a wholesale market regime and set a pre-specified regulatory intervention that will occur if this standard is violated. This will minimize the potential for future FERC versus state regulatory conflict that can create another California electricity crisis.

#### **Recommended Changes in FERC's Regulatory Oversight of Wholesale Market**

A final lesson from California crisis is that FERC must regulate, rather than simply monitor wholesale electricity markets. As should be clear from the previous sections and the description of the earning warning signs of the exercise of market power in the California market discussed in my June 13, 2001 testimony, there was no shortage of effective market monitoring in California from the start of the market in April 1, 1998 to the present time. The Department of Market Analysis of the California ISO, the Market Monitoring Committee of the California Power Exchange, the Market Surveillance Committee of the California ISO, as well as a number of state agencies all documented the exercise of market power in California. However, none of these entities had the authority to implement any market rule changes or penalty mechanisms to limit the incentives firms had to exercise market power or violate California ISO market rules. Only FERC has the authority to implement market rules changes and make regulatory interventions to improve market performance. Rather than focusing its attention of monitoring market performance, FERC should instead concentrate on designing pro-active protocols for rapid regulatory intervention to correct market design flaws as quickly as possible and order refunds as soon as unjust and unreasonable prices are found.

What allowed the California crisis to exist was not a shortage of observers with radar guns recording the speed of cars on the highway. It was the lack of traffic cops writing tickets and imposing fines on cars that exceeded the posted speed limit.

On the topic of the necessity of FERC regulating rather than simply monitoring wholesale market, I would like to use FERC's soft price cap policy during the period January 2001 through June 2001 to illustrate this point. As discussed above, the soft cap policy stated that if a generator could cost-justify a bid in excess of the \$150/MWh soft price cap, then it could be paid as bid for its energy if it was needed to meet demand. However, regulation that simply says a firm must justify their costs in order to be reimbursed, can amount to no regulation at all. The recent revelations that energy traders in California misreported transactions prices during the crisis period suggests that it would be easy for an electricity supplier to obtain an invoice for its natural gas input fuel purchase at prices in excess of the actual cost to its energy trading affiliate. Consequently, without a rigorous prudence review of how input costs are actually incurred and disallowances for imprudently incurred costs, there is little limit on the prices that firms might be able to cost-justify. In fact, during the period January 1, 2001 to June 30, 2001, electricity suppliers often cost-justified and were paid as-bid prices substantially in excess of \$300/MWh under the guise of the FERC soft-cap policy. For this reason, anytime FERC caps the bids that a firm might submit based on its costs of production, it must perform a prudence review of these costs and be prepared to disallow any cost that cannot be adequately justified.

A final point related to the importance of FERC regulating rather than simply monitoring is the necessity of very accurate data on physical characteristics of plants, input fuel prices, other input prices and many other aspects of the operation of the wholesale market to carry out this task. For example, in order to perform a satisfactory review of the prudence of costs a firm would like to recover, FERC must have the best available data on these variables. Moreover, in order to compute the best possible estimate of what constitutes a just and reasonable wholesale market price FERC will need, at a minimum, the best available information on the operating characteristics of generation units, input fuel prices, the physical state of the transmission network. Finally, in order to provide tangible evidence on how well it is doing in delivering economic benefits (in the form of lower prices) to consumers that they would not have received in the former vertically integrated utility regime, FERC will need to be able to determine what prices would be under the former vertically integrated utility regime. This will require the same information. Consequently, particularly during the initial transition to a wholesale market regime, FERC should substantially increase, and certainly not reduce, the amount of data that it collects from market participants if it would like to be an effective and credible regulator.

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

December 20, 2002

The Honorable Joseph I. Lieberman  
Chairman  
Committee on Governmental Affairs  
United States Senate  
Washington, D.C. 20510-6260

Dear Mr. Chairman:

I appreciate the opportunity to testify before your Committee at its November 12, 2002 hearing about the oversight of the Enron Corporation by the Federal Energy Regulatory Commission (FERC or the Commission) and the lessons learned from Enron's financial collapse.

Thank you for your letter of November 26, 2002, enclosing questions from you and Senators Fred Thompson and Carl Levin, for the record of your Committee's November 12 hearing. My answers to those questions are enclosed.

**Please note that the Commission requests CONFIDENTIAL TREATMENT for the response to Senator Levin's Question No. 8. That response is attached in the Confidential Non-Public Appendix to this letter. If you need additional information, please do not hesitate to let me know.**

Best regards,  
  
Pat Wood, III  
Chairman

Enclosure

**CHAIRMAN WOOD'S RESPONSES TO QUESTIONS  
SUBMITTED BY SENATORS**

**Senator Lieberman**

**Question 1:** In our February 15, 2002 letter to you, the Committee requested, among other things, a list of all communications between Enron and the Commission (including all Commissioners, officers or employees of FERC) from January 1, 1992 to December 2, 2001. You responded to this request on March 4, 2002 and supplemented this response on March 20, 2002. Since then, questions have been raised about the completeness of these responses.

- a. Please indicate whether the information provided in FERC's submission of March 4, 2002 and March 20, 2002 is a complete and accurate record of your communications with Enron and its representatives during that time period. If not, please list any communications (as that term is defined in the Committee's February 15, 2002 letter) that you had with Enron or its representatives from January 1, 1992 through December 2, 2001 that were not included in the Commission's earlier submissions to the Committee.

**Answer:** To the best of our knowledge, the information provided in FERC's submissions of March 4, 2002, as supplemented on March 21, April 24, and May 8, 2002, contains a complete and accurate record of communications between FERC employees and Enron and its representatives during that time period. To the best of our knowledge, those submissions plus the supplement submitted by Chairman Pat Wood to Special Counsel Gary Brown on October 18, 2002 contain a complete and accurate record of communications between the three current members of the Commission (Chairman Wood, Commissioner William L. Massey, and Commissioner Nora Mead Brownell) and Enron and its representatives. A copy of the October 18, 2002 response is attached to this answer. (As Question No. 1(c) recognizes, former Commissioner Breathitt supplemented her responses directly to Mr. Brown. Accordingly, we have sent her a copy of the November 26, 2002, letter, so that she may have the opportunity to respond to the Committee directly.)

- b. Is there anything to which you testified at the hearing with respect to your communications with Enron and its representatives that you wish to supplement?

**Answer:** Chairman Wood, Commissioner Massey, and Commissioner Brownell (the three current members of the Commission) believe that their testimony as given at the November 12, 2002 hearing is complete; for that reason, they do not wish to supplement it.

- c. On October 11, 2002, Minority Committee counsel wrote to FERC asking that the Commissioners review their answers to the Committee's February 15, 2002 request for all communications between FERC and Enron and its representatives and amend or supplement them as necessary. (Neither the Chairman nor Committee Counsel received a copy of this letter.) You responded to this request by letter to Minority Committee counsel dated October 18, 2002. In your letter, you amended your answer about your communications with Enron and reported that Commissioner Breathitt would forward an amended answer under separate cover. Commissioner Breathitt did so, supplementing her original answer by letter to Minority Committee counsel dated October 30, 2002. You did not copy your response and that of Commissioner Breathitt to Minority counsel's October 11, 2002 letter to the Committee, nor was the information therein otherwise provided as a supplemental response to the Committee's February 15, 2002 request. Given that these letters contained information responsive to the Committee's February 15, 2002 request and indicated that FERC's March 4 and March 20 responses to the Committee were incomplete, why did you not supplement those responses to the Committee?

**Answer:** We did not send a separate copy of the October 18, 2002 response to the Committee as a whole because we did not anticipate that the response might not be added by Committee staff to the record shared by the entire Committee. (Former Commissioner Breathitt was apparently under the same impression.) On many past occasions, we responded to inquiries from Mr. David Berick, Professional Staff Member, Governmental Affairs Committee, by sending materials directly to him, without sending additional copies to other Committee members. Hearing nothing to the contrary, we believed that this was a sufficient means of conveying information to the full Committee, and believed that the same would be the case with respect to the response to Mr. Brown. We apologize for any inconvenience this may have caused the Committee.

**Question 2:** On September 17, 2001, Senator Feinstein and Senator Lieberman wrote to Chairman Wood in conjunction with a General Accounting Office review of communications between former FERC Chairman Curt Hébert and Enron Chairman Kenneth Lay asking "... that the Commission review its ethics and record-keeping regulations and procedures, including maintenance of telephone logs and other measures, to ensure that communications between

Commissioners and the regulated community are conducted in a manner that leaves no question in the public's mind about the objectivity and independence of the Commission." In a letter dated October 11, 2001, you responded to the September 17, 2001 letter and stated that "(w)e have reviewed our procedures in this regard and based on that review, I conclude that no changes to FERC's existing rules or relevant statutes are necessary at this time."

As GAO discovered in its investigation of the Hébert/Lay communications, Chairman Hébert did not keep a phone log of his conversations, thus making it difficult to ascertain information. In her October 30, 2002 response to minority counsel, as well as in her testimony before the Committee, Commissioner Breathitt also noted that neither she nor her office keep telephone logs, and consequently her ability to respond to the minority request was limited. More generally, in response to the Committee's February 15, 2002 request for all communications between FERC and Enron and its representatives, FERC indicated that official records of such communications, including communications involving Commissioners, are not maintained by FERC; furthermore, some former FERC Commissioners, in their individual responses, indicated that they did not maintain phone logs or similar records of meetings and other communications and/or that they no longer possessed such records. The net result is that FERC apparently has been unable to provide the Committee with a complete picture of contacts Enron had with the Commissioners.

Do you continue to believe that no changes are needed in FERC's existing rules or relevant statutes with regard to "the maintenance of telephone logs and other measures?"

**Answer:** Yes. Maintaining telephone logs would impose an unwarranted recordkeeping burden and would be a wasteful use of employees' time and government resources.

In this regard, FERC's existing rules and practices concerning the creation and maintenance of agency records are consistent with the letter and spirit of the relevant rules and guidelines in current law. Thus, for example, neither the General Records Schedule (GRS) issued by the Archivist of the United States and applicable to FERC and most other Federal agencies, nor the National Archives and Records Administration guide, "Documenting Your Public Service," contemplates the creation or maintenance of telephone logs. In fact, GRS 23.5(b) provides that telephone logs as records documenting routine activities containing no substantive information may be destroyed or deleted when no longer needed for convenience of reference.

In addition, the integrity of the Commission's decisionmaking process is in large part protected by its *ex parte* rule, which applies to communications, including telephone conversations, between Commissioners (as well as other FERC employees) and members of the public. In a contested on-the-record proceeding, that rule found at 18 C.F.R. § 385.2201 prohibits any off-the-record communication relevant to the merits of the proceeding between Commission decisional employees and any person outside the Commission. In the event that such a prohibited communication occurs, the Commission employee who makes or receives such a communication is obligated to place the communication (or, if oral, a summary of its substance) in the public file associated with, but not part of, the decisional record of the proceeding. Public notices of *ex parte* communications are issued by the Commission and published regularly in the Federal Register. The Commission employee is also obligated to warn the outside person that knowingly making an *ex parte* communication may lead to sanctions under 18 C.F.R. § 385.2201(i), including dismissal of the person's claim in the affected proceeding, or suspension of the person's privilege to appear before the Commission. Accordingly, while Commissioners may or may not maintain telephone or meeting logs, the public interest in the integrity of Commission decisions is protected by the *ex parte* rule.

**Question 3:** In light of the weaknesses (including a lack of searching, or in some cases any, scrutiny) inherent in both FERC's review of applications for qualifying facility (QF) status and its self-certification process for QF's, what steps does FERC intend to take to ensure that facilities claiming eligibility for QF status do, in fact, meet the requirements of Public Utility Regulatory Policy Act (PURPA) for QF eligibility such as facility ownership?

**Answer:** The Commission staff intends to conduct periodic, random audits of the veracity of representations made concerning the ownership and control of QFs in filings that claim eligibility of QF status. These audits would include not only filings that have expressly requested Commission determinations of QF eligibility, but also QF self-certification filings. Among other things, such audits will examine whether representations made in QF filings concerning transfers of ownership have in fact occurred, and if so, whether the level of utility ownership and control over the QF after the transfers is as claimed in the most recent QF filing and is also in accordance with Commission regulations and enabling statutes.

Additionally, Commission staff intends to meet with staff of the Securities and Exchange Commission (SEC) to discuss what constitutes a "good faith" filing before the SEC concerning whether an entity is entitled to certain QF exemptions that are claimed under sections 3(a)(3) or 3(a)(5) of PUHCA. Enron QF affiliates had represented that they had made such "good faith" filings with the SEC in order to obtain Commission determinations of QF status. There is a pending proceeding at the Commission, Docket

No. EL03-19-000, in which the Commission will have an opportunity to consider its reliance upon "good faith" filings at the SEC.

Finally, the rates paid to QFs are not set by this Commission and, instead, generally are set by state regulatory authorities. As directed by Congress, the Commission's regulations require electric utilities to purchase electricity from and sell electricity to QFs. QFs are eligible for certain financial benefits and regulatory exemptions under PURPA, as implemented by the Commission's regulations. These benefits include a mandatory obligation on the part of the electric utility to purchase QF power at the electric utility's avoided cost. 18 C.F.R. §§ 292.301-292.308. These "avoided cost" rates are set by the state regulatory authority for all utilities except those which are "non-regulated."

**Question 4:** As discussed in the November 12 hearing, as well as in Committee staff's accompanying memorandum, less than 10% of FERC's employees measured in terms of full time equivalents – FTE's – (the equivalent of one person working full time) are allocated to the new Office of Market Oversight and Investigation (OMOI). According to FERC's 2003 budget 250 FTE's, including OMOI, are engaged in monitoring and enforcement activities, even broadly-defined; these activities thus account for less than 20% of FERC's total personnel and less than 15% of its budget.

Please explain why you believe this level of commitment to market oversight and enforcement is adequate, particularly in light of: 1) the fact that there are currently a number of investigations relevant to the energy industry ongoing not only at FERC (including the investigation of the California and Western markets) but also at other federal agencies (for example, the CFTC and SEC) and at the state level (for instance, the California Attorney General's investigation of energy company activities during the 2000-2001 energy crisis) which may well uncover information that requires additional or expanded FERC investigations; and 2) the need for an effective enforcement program to ensure compliance with market rules when markets are deregulated.

**Answer:** While the numbers you cite may be lower than the percentages for other federal agencies, please remember that a significant part of this Commission's resources is committed to regulatory efforts unrelated to markets. Specifically, this Commission also is responsible for licensing and, in some respects, continuing operational oversight of hydroelectric dams and natural gas pipelines in interstate commerce. As I testified orally, these infrastructure responsibilities dominate the agency's resource allocation and account for 53 percent of our program and support employees. The substantial resources needed for this non-market oversight make simple ratios of FTEs an inappropriate basis for

comparing the market oversight efforts of this Commission and other federal agencies.

Fifty-seven percent of the rest of our employees handle the market oversight function at FERC, which is a total of 335 program and support employees. As described below, the current level of effort the Commission is expending on market oversight and enforcement is appropriate. It demonstrates our commitment to market oversight and leverages our resources effectively. If experience indicates that we should commit additional resources to market oversight, I will take all steps within my control to do so.

**The Commission has made an unprecedented commitment to market oversight and enforcement.** In the Strategic Plan that we issued in the fall of 2001, we made market monitoring one of three central goals for the Commission going forward, coequal in importance with our traditional work on infrastructure and tariffs and rates. In 2002, we established a new office – the Office of Market Oversight and Investigations – devoted solely to overseeing markets, investigating problems and enforcing market rules. As you note, this Office will be operating with 120 staff by summer 2003, which reflects the significant commitment we are making to oversight. In addition, we are working to make all of the Commission’s technical offices more attuned to market oversight and investigation issues. Thus, we expect that staff will examine all tariff filings, for example, from a perspective of what effects they have on energy markets and on ongoing market monitoring efforts. Most importantly, we have demonstrated a sustained commitment from the Commissioners themselves that this function must work and work well. This is evident in the ongoing attention that both my colleagues and I are giving to the key issues involved. And it is this commitment that ultimately matters most.

**The Commission is leveraging its market monitoring resources.** Each developed electric market around the country has a market monitoring unit (MMU) that has direct access to everything that happens within the ISO or RTO. In aggregate, these MMUs cover the Northeast, Midwest and California, and employ about 65 people today. These numbers will increase as existing MMUs increase staffing and new MMUs come on line. We are forging a partnership with these MMUs so that together they and we will form a single, seamless market monitoring presence around the country. On December 3 and 4, 2002, we held a workshop with the MMUs to lay the foundation of that partnership. We are pleased that representatives of many regions not currently in fully-fledged ISOs or RTOs joined our workshop.

**Senator Fred Thompson**

**Question 1:** Do you consider FERC to have been the lead agency with respect to overseeing the kinds of activities that led to Enron's collapse? Was FERC's oversight responsibility over Enron activities such that your agency really could have prevented Enron's collapse?

**Answer:** I do not consider FERC to have been the lead agency with respect to oversight of Enron or the activities that led to its collapse. Many of the Enron activities which have been investigated fall under the specific jurisdiction of the CFTC, the SEC, and the DOJ, and not under the jurisdiction of the FERC. At the same time, FERC has been vigilant in acting swiftly in those limited areas that do fall under our jurisdiction, such as the recent investigations into (and subsequent settlements concerning) loans made by Enron-affiliated interstate natural gas pipelines with Enron. In working closely and cooperatively with our sister agencies, any information we have found that may relate to others' ongoing investigations has been turned over promptly. In recent months, FERC has also taken steps to improve transparency in energy markets through better reporting requirements, and has devoted considerable resources to the new office of Market Oversight and Investigation, which should help to prevent such occurrences in the future. Finally, while FERC's statutory mandate requires it to balance responsibility between ensuring just and reasonable rates with a financially healthy energy industry, our primary duty is to our nation's energy customers, and not to individual companies.

**Question 2:** As to the issues surrounding the so called "wind farm transactions," please explain how the Commission addressed these issues in an order initiating an investigation of the qualifying facility (QF) status of the Enron-affiliated QFs for the period following Enron's 1997 "sale" of those QFs?

**Answer:** On October 24, 2002, the Commission instituted a proceeding in Docket No. EL03-17-000 into the QF status of the three Enron-affiliated facilities which were recertified in 1997. Investigation of Certain Enron-Affiliated QFs, 101 FERC ¶ 61,076 (2002). The Commission noted:

It has come to the attention of the Commission that in criminal and civil proceedings in the United States District Court for the Southern District of Texas, the United States of America through its Department of Justice, and the United States Securities and Exchange Commission (SEC), have alleged that in 1997 Enron improperly retained QF benefits for these facilities by fraudulently transferring its ownership in the QFs to partnerships indirectly controlled by Enron. [101 FERC ¶ 61,076 P 1.]

The Commission set for hearing:

whether Zond Windsystems, Victory Garden, and Sky River have failed to conform with the representations presented in their 1997 applications for re-certification, *i.e.*, whether the Enron affiliates actually transferred their ownership interests in the facilities, and thus whether those certifications can be relied on. We are also setting for hearing the issue of whether each facility actually satisfied the Commission's ownership requirements for QF status following Enron's merger with Portland General. [101 FERC ¶ 61,076 P 16.]

The Commission's order sets for hearing the issue of the facilities' QF status. However, other issues concerning the windfarms, *e.g.*, issues concerning possible criminal conduct by Enron's chief financial officer, are being addressed in criminal proceedings brought by the Department of Justice and by the Securities and Exchange Commission in Federal court in Texas.

In addition, the Commission issued an order on December 19, 2002, addressing a request by Southern California Edison Company (SoCal Edison) that the Commission issue a declaratory order revoking the QF status of five Enron-affiliated generating facilities for failing to comply with the Commission's ownership criteria for QF status. *Southern California Edison Company v. Enron Generating Facilities, et al.*, 101 FERC ¶ 61, 313 (2002). The Commission set for hearing SoCal Edison's allegations that the five facilities did not in fact satisfy the statutory and regulatory requirements for QF status from 1997 onward. In addition, the Commission consolidated this proceeding with the on-going hearing instituted in Docket No. EL03-17-000.

**Question 3:** You said in your testimony that there have been about 9000 applications for QF status. What safeguards are in place to ensure that the applicants qualify for this status?

**Answer:** A facility which seeks QF status by self certification must serve a copy of the self-certification on both the state regulatory authority where the facility is located and the utility with which it expects to interconnect, transmit or sell energy to or purchase energy from. Applications for Commission certification must contain the name of the utility or utilities to which the facility expects to interconnect, transmit or sell electric energy, or from which the facility expects to purchase power. Applications for Commission certification are noticed in the Federal Register. An electric utility is not required to purchase from a facility of 500 kW or more until 90 days after the facility notifies the utility that it is a QF or 90 days after the facility has applied for Commission certification. This 90-day period gives utilities the opportunity to contest the QF status of a facility. The Commission relies largely on the monetary self-interest of utilities that are obligated by law to purchase from QFs to monitor the QF status of the facilities. The Commission's experience has been that utilities generally do not want to pay avoided cost

rates for power from a facility which is not entitled to QF status and that utilities, at times in conjunction with state regulatory authorities, have set up programs to require data from QFs and monitor the QF status of the facilities from which they purchase power. Utilities, state regulatory authorities or others may oppose a facility's QF status by challenging an application for Commission certification or filing a petition for declaratory order. Governmental entities, including state commissions, do not have to pay a fee to file a petition for declaratory order. Further, for good cause shown, other groups may seek a waiver of the filing fee.

Out of the nearly 9,000 filings with the Commission from facilities claiming QF status (either notices of self-certification or applications for Commission certification), only a small percentage of the filings were *contested* applications for Commission certification. There have been fewer than 20 cases of a utility-purchaser alleging that an existing facility no longer was satisfying the criteria for QF status. Moreover, the Enron-affiliated QFs represent the first time there have been allegations that QF filings were fraudulent.

**Question 4:** Looking at the Enron/RADR transactions, what administrative, staffing or other oversight requirements would have been in order for FERC to have been able to pierce the fraudulent applications they submitted?

**Answer:** The 1997 Enron applications were uncontested applications, *i.e.*, neither Southern California Edison (the utility which purchased from these facilities) nor any other party intervened in opposition to the 1997 requests for recertification. Because the applications were uncontested, the Commission accepted the representations made in the applications as true. A procedure to investigate every unchallenged allegation made in an application to the Commission would require many times the resources currently employed by the Commission and would not appear to be an appropriate use of government resources, since others such as electric utilities have a monetary incentive to monitor such filings. However, in this case, it is far from clear that closer scrutiny would have uncovered Enron's financial manipulations. Even Enron's own financial auditors reviewed materials relating to the Enron/RADR transactions, and did not find fault with the transactions at the time they were undertaken.

**Question 5:** Were there any energy crises issues – any close calls – last summer?

**Answer:** The closest call last summer occurred in Connecticut. On April 26, 2002, ISO-New England announced that southwestern Connecticut was expected to experience critical power supply reliability problems during summer peaks due to inadequate transmission facilities in the area, especially if there were a loss of any significant transmission or generation resources. (There is currently a state-imposed moratorium on new energy infrastructure construction). Six days later, on May 2, 2002, Devon Power

LLC (a subsidiary of NRG Energy, Inc.) made a filing with ISO-New England to deactivate three of its plants (total of 230MW) in southwestern Connecticut on August 1, 2002. Devon Power (NRG) indicated that it would not have to deactivate its units if it could enter into an RMR (reliability must run) contract with ISO-NE that would provide adequate and fair compensation for reliability.

The Commission directed its Enforcement staff to inquire into this situation. The Commission sought to make sure that NRG was not exercising market power to increase its revenues in this transmission-constrained area. After numerous meetings of NRG, ISO-NE and staff, under the auspices of a FERC staff mediator, the parties reached an agreement on an RMR contract for the three Devon units. ISO-NE then filed the RMR contract with the Commission on August 16, 2002 (effective Aug. 1), and agreed to begin negotiations on RMR contracts for other units owned by NRG in Connecticut. Thus, outages in southwest Connecticut were averted through the 2002 summer cooling season.

However, reliability in that area is still at risk for summer 2003 unless infrastructure and/or demand responsiveness is increased in the area. Reliability risks remain for southwest Connecticut, especially if NRG, which is considering a bankruptcy filing, is unable to secure contracts to provide for maintenance and operation of nine other generators in NRG's Connecticut fleets. Staff mediators from OMOI are currently meeting with the participants, including load-serving entities of Connecticut, to negotiate RMR contracts for NRG's units. Absent some success in these efforts, there is a risk of electrical shortages in southwest Connecticut in the summer of 2003.

**Question 6:** The Majority Staff Memo criticizes FERC for not acting sooner to address trading and marketing abuses in the California and Western energy markets. That was then and this is now. It seems that the Commission is moving pro-actively and aggressively to investigate the allegations of abuses. Are you convinced that the Commission will uncover any significant wrongdoing that occurred in these markets?

**Answer:** Yes. The Staff investigation in Docket No. PA02-2-000 is devoted to investigating price manipulation in Western energy markets for the years 2000-2001. That investigation, formalized on February 13, 2001, has already issued one report, in August 2002, and a second report will be issued February/March 2003. Among other things, in the August 2002 report, Staff recommended to the Commission that several hearings be held to investigate preliminary evidence that several companies, including several Enron affiliates, had engaged in improper conduct, including affiliate abuse. Those proceedings are currently in litigation.

The Staff in Docket No. PA02-2-000 is continuing its investigation of possible manipulation of price indices published by the trade press, including deliberate

misreporting of transactional data by traders; wash trading; and strategic outages (physical withholding to reduce available capacity). We anticipate that, among other things, the Staff report will suggest means by which the Commission could regulate the reporting of transactional data by power marketers subject to the Commission's jurisdiction; prevent strategic outages; regulate wash trades; and prevent other means by which prices can be manipulated.

In addition, even before the Commission initiated the investigation in Docket No. PA02-2-000, the Commission's November 15, 2000, report on California bulk power markets laid a solid foundation for addressing such systemic problems in Western markets as over-reliance on spot markets.

Finally, on December 5, 2002, El Paso Electric Company (El Paso) announced that it had reached a settlement with FERC trial staff, in Docket No. EL02-113-000, in which it was charged with helping Enron Corp. manipulate Western electricity markets during 2000-2001. Under the settlement, El Paso agreed to refund \$14 million and give up its right to sell power at market-based rates for the next two years. El Paso has not admitted any wrongdoing.

**Question 7:** Does the fact that you are having to operate at FY 2002 funding levels six weeks into the new fiscal year (and perhaps into next year) hamper your efforts to make progress in marketing and investigation efforts?

**Answer:** Operating at FY 2002 funding levels going into FY 2003 has affected our progress in marketing and investigation efforts as follows:

- Delayed our ability to augment market oversight and investigation resources by 50 FTEs
- Delayed approximately \$1M in information technology and contractor support to enhance market oversight and investigation functions

We hope that these funding issues will be resolved soon.

**Senator Carl Levin**

**Question 1:** Current law provides special rates and other benefits to qualifying small power production facilities under 16 U.S.C. 796 (17)(c) (hereinafter “QF facilities”).

- a. Approximately how many QF facilities now exist?

**Answer:** Since 1980, over 7000 facilities have filed with the FERC claiming to meet the regulations for QF status that are set out in PURPA. Of the 7000 facilities which claim QF status, many were never built while others have gone out of business or have converted to some other type of facility which may or may not meet the requirements of PURPA.

- b. Approximately how many QF facilities have equity interests held by multiple parties?

**Answer:** The Commission does not keep records of this information.

- c. Approximately how many QF facilities are owned in part, either directly or indirectly, by any electric utility company, electric utility holding company, or an affiliate of an electric utility holding company (hereinafter “electric utility”)?

**Answer:** For the period from 1980-1995, approximately four percent of QFs were owned in part, either directly or indirectly, by an electric utility. The Commission does not have statistics on this since 1995.

- d. Approximately how many QF facilities are owned in part by a special purpose entity (SPE) that was established by an electric utility.

**Answer:** The Commission does not keep records of this information. The reason for this is twofold. First, in enacting PURPA, Congress sought to remove the substantial burdens of pervasive federal and state regulation from entities that received QF status. One of these burdens was the obligation to keep detailed records. See FERC v. Mississippi, 456 U.S. 742, 750-51 (1982) (citing legislative history of PURPA). Second, the Commission’s interest in reviewing ownership issues associated with QF applications is to determine the overall utility ownership of the QF, and not the specific organization of ownership. If an SPE is utility-owned, then the ownership interest of the SPE is considered to be utility ownership. Section 292.206 of the Commission’s regulations provides that, except under limited circumstances:

If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.

The limited exceptions to this requirement are being addressed in two pending proceedings at the Commission (Docket Nos. EL03-17-000 and EL03-19-000), the former of which was initiated by the Commission. Utilities are required to disclose in their QF applications the extent to which they are owned, directly or indirectly, by an electric utility. The SPE form of ownership would be covered under this reporting requirement. Commission certification that an entity is a QF is only valid to the extent that the facility is owned in the manner described in the QF application.

- e. Approximately how many QF facilities are owned in part by an SPE whose equity ownership interest in the facility was largely provided, financed, or guaranteed by an electric utility?

**Answer:** Please see response to Question No. 1d. above.

- f. Approximately how many QF facilities are owned in part, either directly or indirectly, by a director, officer or employee of an electric utility or by a family member closely related to such director, officer or employee?
- g. Please describe the characteristics and nature of existing QF facility owners, including whether any particular companies dominate ownership of these facilities, the most common types of owners, and the relative percentage of owners that are electric utilities, corporations, partnerships, trusts, or individuals.

**Answer:** The Commission does not keep records of any of the information sought in parts (f) and (g). Neither PURPA, the FPA, nor the Commission's implementing regulations require that such information be provided by QF applicants, or collected by the Commission.

**Question 2:** If FERC determined that a company which had owned a QF facility sold 100 percent of the equity interest in that facility to an SPE that was established and financed primarily by an electric utility, would the facility likely continue to qualify for QF status under FERC regulations? What if the SPE was owned or controlled by a senior officer or employee of an electric utility?

**Answer:** The issues raised in this question are being addressed in a pending

proceeding. On October 24, 2002, the Commission instituted a proceeding in Docket No. EL03-17-000 into the QF status of the three Enron/RADR facilities which were recertified in 1997. Investigation of Certain Enron-Affiliated QFs, 101 FERC ¶ 61,076 (2002). I cannot prejudge the issues in this pending proceeding. However, below, I have outlined the applicable Commission law and precedent on this issue.

In Subpart B of the Commission's PURPA regulations, implementing the sections of PURPA that modified the Federal Power Act (FPA), the Commission set forth criteria and procedures for becoming a QF. 18 C.F.R. §§ 292.201-292.211 (2002). One of the criteria for being a QF relates to ownership of the QF. Sections 3(17)(C) and (18)(B) of the FPA, 16 U.S.C. §§ 796(17)(C)(ii) and (18)(B)(ii)(1994), provide that a QF must be:

owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

The Commission's regulation implementing this statutory requirement states that:

(a) General Rule. A cogeneration facility or small power production facility may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

(b) Ownership test. For purposes of this section, a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.

18 C.F.R. § 292.206(a) and (b) (2002).

The Commission has summarized its ownership requirements for QF status as follows:

The Commission's regulation thus equates "ownership interest" with "equity interest," but does not define the term "equity interest." This definitional issue has been most problematic in cases involving partnerships as opposed to corporations. This is because the stated percentage of partnership

interests in partnership agreements does not always correspond with specific provisions in the partnership agreements concerning control of and/or division of benefits from the partnership assets. The Commission has therefore looked to the entitlement to profits, losses, and surplus after return of initial capital contribution, as well as the share of control of the venture, to help it in determining whether the division of equity interests in a partnership complies with the statutory and regulatory ownership requirements for QF status.

Indeck North American Power Fund, L.P., 85 FERC ¶ 61,239 at 62,001-02 (1998)(footnote omitted), order noting withdrawal of reh'g and denying motion to vacate, 86 FERC ¶ 61,123 (1999). See also Vineland Cogeneration Limited Partnership, 99 FERC ¶ 61,304 (2002) (approving QF recertification of a facility following a merger); Coso Energy Developers, et al., 85 FERC ¶ 61,355 (1998) (denying QF recertification following a merger); Coso Energy Developers, et al., 86 FERC ¶ 61,209 (1999) (approving QF recertification following merger).

In the late 1980s, the Commission considered revising its QF regulations in a rulemaking in Docket No. RM88-17-000. At that time, some electric utilities (including, e.g., Southern California Edison Company) argued that electric utility subsidiaries should be allowed to own 100 percent of a QF. However, as noted in the preceding paragraphs, the Commission's general policy has been to allow no more than 50 percent electric utility ownership of QFs.

**Question 3:** At the hearing, Chairman Wood indicated that FERC would undertake a review of existing filings to determine whether any QF facilities are operating under the same or similar ownership arrangements used by Enron with respect to its wind farms. Please describe how FERC plans to conduct this review, approximately how many QF facilities will be examined, and projected key dates for completion of the review. Given the evidence that has emerged over the last year regarding how Enron and other companies have abused SPEs by concealing their control over or financial contributions to the relevant SPE, please describe how FERC plans to identify and evaluate the nature and extent of any links that may exist among the QF facility, an SPE with an equity ownership interest in that facility and any electric utility.

**Answer:** As indicated in our response to Question 3 to Senator Lieberman, Commission staff will conduct periodic, random audits of the veracity of representations made concerning the ownership and control of QFs in filings that claim eligibility of QF status. This may be accomplished through a combination of periodic searches of publicly available information sources (e.g., the internet, SEC filings), data requests that are issued

to QF applicants at the time QF authorization is being sought, and the periodic issuance of letters compelling the provision of ownership information from QFs and/or their owners. However, with regard to the latter method of auditing, please note that no more than ten such letters may be issued at one time without the Commission first having obtained clearance from the Office of Management and Budget. Through these three means, the Commission would expect to randomly survey approximately 50 QFs over the next year. These examinations of ownership would attempt to determine ownership and control over the surveyed QFs, including ownership by Special Purpose Entities.

**Question 4:** [Omitted]

**Question 5:** At the hearing, FERC indicated that it currently relies to a large extent on third parties to file complaints about QF facilities that may be in violation of FERC's QF ownership rules. Are there any plans for FERC to publish Federal Register notices to alert consumer advocates to facilities claiming QF status or to changes in the ownership of these facilities: Are there any plans to eliminate the \$16,000 fee for complaints against QF facilities?

**Answer:** There are no plans to do so yet. While the Enron problems have raised questions about certain aspects of government oversight of corporations, there is no indication that a change in FERC's notice procedures or fees for QF matters would have made any difference in detecting or preventing the type of behavior engaged in by Enron's QFs. If future developments indicate to me that a change in these procedures would be useful in preventing abuse of QF rights, I will certainly work in support of such changes.

As background information, I would note that there are two procedural ways a facility may be certified as a QF. A facility may self-certify or a facility may seek Commission certification. Facilities filing notices of self-certification are required to serve a copy of the notice on each electric utility with which it expects to interconnect, transmit or sell electric energy to or purchase power from and on the state regulatory authority in each state where each affected utility is located. 18 C.F.R. § 292.207(a)(1)(ii). Notices of applications for Commission certification are published in the Federal Register. 18 C.F.R. § 292.207(b)(4).

The applicable fee for a proceeding seeking revocation of the QF status of a facility is the fee for a declaratory order. See Hydro Investors, Inc. v. Trafalgar Power, Inc., 94 FERC ¶ 61,207 (2001), reh'g denied, 95 FERC ¶ 61,120 (2001). Waiver of the fee is available to petitioners suffering severe economic hardship. 18 C.F.R. § 381.106. In addition, states municipalities and anyone who is engaged in the official business of the Federal Government are exempt from the filing fees. 18 C.F.R. § 381.108.

**Question 6:** FERC's staff conducted two examinations of the electronic trading operation known as Enron Online (EOL). The first staff report was issued in August 2001, and the second a year later in August 2002. The first report concluded "there is no reason for concern about EOL at this time." The second report found significant evidence of price manipulation and deceptive practices by Enron. How do you explain the differences between the two staff reports?

**Answer:** The first staff report (August 2001) relied almost exclusively on Commission staff's direct observation of trading floor activities by Enron traders, presentations by Enron management, and informal conversations with non-Enron traders. In retrospect, it is clear that Enron failed to present Staff with a complete and accurate picture of how EOL operated.

With the commencement of the investigation in Docket No. PA02-2-000, the Commission empowered Staff to conduct extensive discovery of Enron. Staff acted aggressively to seize control of Enron's databases, including those applications Enron used on EOL and the databases where records of EOL transactions were kept. With the assistance of its outside forensic database experts, Staff now has an accurate picture of how EOL operated and how Enron used EOL's particular operating characteristics to assist it in wrongdoing, which was discussed in the August 2001 report. Enron's earlier misrepresentations to Staff have now been detected and examined in detail.

**Question 7:** The August 2002 FERC staff report includes a detailed analysis of the natural gas trades made on Enron Online for next-day delivery into California over the course of a single day, January 31, 2001. The report found that out of a total of 227 trades on that day, 174 – or more than two-thirds of the trades – involved Enron and a single counter party. Most of these trades took place during the last hour of trading, with the two parties buying huge amounts of natural gas from each other in numerous transactions. The report determined that the trades took place at "higher prices" than other trades that day and resulted in a steep price increase over the last hour of trading. The report described this trading as "difficult to rationalize as a normal or standard business practice" and noted that "only Enron and possibly the counter party could have known that so much of the trading was going on between themselves, because parties looking at EOL's screens could only see the bid and ask prices; they could not know who the counter party was on any particular trade." The report also indicates that Enron Online's price data was routinely used to prepare published reports on natural gas prices, which meant that the EOL price data was not just affecting Enron trades, but also contributing to higher natural gas prices industrywide. The FERC staff report concluded that Enron had "significant

ability and incentive to manipulate the price data published by the reporting firms."

- a. What is the identity of the counter party in the 174 trades analyzed in the 2002 report?

**Answer:** The identity of this firm has been kept confidential by the Commission to avoid compromising its on-going investigation of the firm's possible misconduct. The activities of this firm, including but not limited to the trades discussed in the initial report, are under active investigation and will be discussed in Staff's final report in Docket No. PA02-2-000. To avoid compromising the ongoing investigation, we request that the disclosure of the identity of the firm in question be deferred at least until issuance of the final report in Docket No. PA02-2-000.

- b. (i) Is it FERC's position that it currently has jurisdiction to monitor and investigate electronic trading systems like Enron Online which affect U.S. energy markets?

**Answer:** Electronic trading systems may involve trading of electric energy and/or natural gas products. We believe the Commission generally has jurisdiction to monitor and investigate electronic trading systems which may affect matters under our jurisdiction. However, that is a separate question from whether the Commission has jurisdiction to regulate electronic trading systems. The latter question will turn on a case-specific inquiry into whether the owner or operator of the trading system is a "public utility" under the Federal Power Act or a "natural gas company" under the Natural Gas Act.

- b. (ii) Does FERC's jurisdiction arise in part from its statutory obligation to ensure just and reasonable rates?

**Answer:** The Commission's basic jurisdiction under Part II of the FPA is determined by FPA section 201, as discussed in the preceding answer, and not by its duty to ensure just and reasonable rates under sections 205 and 206 of the FPA.

- c. Would you agree that the 2002 FERC staff analysis of Enron Online has established beyond dispute that electronic trading can affect U.S. energy prices and utility rates?

**Answer:** The investigation in Docket No. PA02-2000 has produced evidence that electronic trading platforms are important trading mediums which can affect energy prices and utility rates. However, price manipulation does not take place solely on electronic trading platforms; it can potentially occur through such means as telephones

and non-electronic organized trading exchanges. The Commission's Standard Market Design rulemaking would help to prevent abusive trading practices by standardizing trading in some respects; such standardization also would facilitate Commission oversight.

- d. Given the importance of electronic trading in U.S. energy markets today, is it fair to say that FERC cannot ensure just and reasonable rates without monitoring and overseeing the key electronic trading systems that affect U.S. energy markets?

**Answer:** The Commission is still evaluating the role of electronic trading systems and the appropriate regulatory response to such systems. As we obtain additional information, we will continue to evaluate the need for further regulatory monitoring and oversight, within the statutory framework devised by Congress for FERC and other Federal agencies.

**Question 8:** Please list the key electronic systems that currently affect U.S. energy markets. Has FERC initiated a detailed examination of any of these electronic trading systems since Enron's collapse in December 2001? If so, please identify them. In addition, please indicate whether FERC has conducted or plans to undertake a detailed examination of UBSWenergy.com or the Intercontinental Exchange.

**Answer:** [Please see Confidential Non-Public Appendix].

**Question 9:** FERC uses certain information, like large trader reports, to monitor designated exchanges such as NYMEX. Does FERC have any plans to require electronic trading systems like UBSWenergy.com or ICE to begin filing similar information with FERC, so that FERC can monitor their trading? If not, how will FERC monitor existing electronic platform trading in the energy markets to detect and prevent roundtrip and other suspect transactions that may be improperly increasing energy prices or utility rates?

**Answer:** FERC does not monitor NYMEX directly. NYMEX is regulated by CFTC, and NYMEX is a self-regulated organization (SRO) where its members filed trading reports, etc., with the SRO having the primary responsibility to catch any violations or manipulations. CFTC has oversight and audit authority over the SRO, along with enforcement of laws over wrongdoing. CFTC also has access to confidential individual transaction data, which it monitors and analyzes for aberrant behavior. CFTC publishes on its website aggregate reports such as the commitment of trader reports which include concentration ratio and other useful monitoring metrics at the aggregate level. CFTC compiles the large trader reports mentioned in the question, but these reports are not

publicly available as they contain sensitive competitive information.

At this time, ICE has qualified as an exempt commercial market under the Commodity Futures Modernization Act (CFMA) of 2000, and therefore has less data filing requirements than NYMEX. Therefore, there is limited available data on which useful metrics can be developed to identify aberrant market behavior other than price which is published and sold by ICE as a separate service. Reliance on ICE's self-reporting and self-regulation is the only option except when there are reported allegations of wrongdoing and an investigation is opened by FERC or CFTC. As ICE begins to "clear" physical transactions and its clearing members take title before netting and delivery to the matched party, there may be cause to deem these clearing members as FERC jurisdictional marketers and subject to FERC requirements for reporting, etc. Concurrently, FERC is exploring cooperation with CFTC to define and obtain market data for more effective monitoring. As FERC moves towards completion of its comprehensive data requirements project in 2003, it will have a comprehensive list of data it can have ready access to, its planned metrics, and how it proposes to use these metrics for oversight and monitoring. FERC will also have defined data gaps, and options for obtaining these data to better monitor the markets, including revised rules, clarifying reporting requirements, or even new legislation requiring more disclosure and transparency to match the greater market freedom.

**Question 10:** Electronic trading is not confined to offers and bids on short term contracts for next-day deliveries of energy, but also energy derivatives, forward contracts and futures.

- a. Does FERC need to examine all aspects of this trading activity to fully understand energy markets and evaluate whether particular prices are just and reasonable?

**Answer:** A comprehensive overview of these activities would be useful to fully understand energy markets but may not be needed to ensure that particular prices are just and reasonable.

- b. Is FERC's existing statutory authority sufficient to permit it to monitor and investigate the whole range of energy trading activity that takes place on electronic trading systems, or is it FERC's position that it is precluded from examining certain types of trading? If it is FERC's position that it is precluded from examining certain types of electronic trading, please identify those categories of trading and explain why FERC is unable to examine them.

**Answer:** As discussed in the response to Question 7b., the Commission generally has authority to monitor and investigate activities affecting jurisdictional sales. However,

this is a separate question from whether we have authority to **regulate** such activities. With respect to the latter, the Commission, as a general matter, must make a case-specific inquiry.

**Question 11:** Please provide any recommendations you may have for clarifying or strengthening FERC's statutory authority to ensure that FERC has clear jurisdiction to monitor, obtain routine information regarding, and investigate all aspects of electronic trading systems, including all types of trading activity, that may bear on energy prices and utility rates.

**Answer:** I do not have any recommendations for statutory changes at this time. As the Commission continues to learn about the activities of electronic trading systems such as Enron Online and other newer entities, through its investigation in Docket No. PA02-2-000 and other means, I will certainly seek any additional authority that I believe the Commission may need to ensure adequate oversight of energy markets.

ATTACHMENT TO ANSWER NO. 1  
OF SENATOR LIEBERMAN'S  
FOLLOW-UP QUESTIONS  
TO THE NOVEMBER 12, 2002  
COMMITTEE HEARING

Response to Question No. 3 in February 15, 2002 Letter  
From Senators Lieberman and Thompson

Redline Version

Name	Office	Division	(a)	I. Who Initiated the meeting	II. List all that were present at the meeting	III. What was the subject matter(s) of the meeting	IV. Give the date	IV. Date range	V. Was any action taken by the Comm. in response to meeting	VI. Other Comments
Wood, Pat III	Office of the Chair Commissioner Langdon	Office of the Chair	Yes	Ms. Ellen Gay Baker	Possibly another Enron Employee	Courtesy Visit or pre-filing Meeting	1992		None	From 1/1/92 to 2/5/93, employed at FERC as Legal Advisor to Commissioner Jerry Langdon. I don't maintain 1992 records but it's possible that I met with Ms. Baker or another Enron employee in 1992 but no specific recollection.
Wood, Pat III	Office of the Chair Commissioner Langdon	Office of the Chair	Yes	Ellen Gay Baker	None	My departure from FERC.	1/28/1993		No	From 1/1/92 to 2/5/93, employed at the FERC as Legal Advisor to Commissioner Jerry Langdon.
Wood, Pat III	Office of the Chair	Office of the Chair	Yes	Jerry Halverson	Jerry Halverson, Stan Horton, Mark Frevort and Sean Steve Kean	Pipeline Security	9/20/2001		No	Thank you note received from Frevort on 9/26/01.
Wood, Pat III	Office of the Chair	Office of the Chair	Yes	Eugene Lockhart, Pres & CEO New Power Co.	Cynthia Sandherr and Kathleen Magruder	Issues facing retail energy service providers and ERCOT	9/24/2001		No	

Name	Office	Division	(a)	I. Who initiated the meeting	II. List all that were present at the meeting	III. What was the subject matter(s) of the meeting	IV. Give the date	IV. Date range	V. Was any action taken by the Comm. in response to meeting	VI. Other Comments
Wood, Pat III	Office of the Chair	Office of the Chair	Yes	Kenneth Lay	Pat Wood	It appears to have been a call to inform me of proposed merger with Dynegy.	11/8/2001		No	Mr. Lay phoned me but he did not reach me.
Wood, Pat III	Office of the Chair	Office of the Chair	Yes	Ken Lay	Enron Policy Conference. A broad spectrum of people attended the conference.	US Energy Policy at the Crossroads		October 3 & 4, 2001	No	Participated at a speaker dinner on 10/3 and made a presentation at the conference on 10/4/2001.
Wood, Pat III	Office of the Chair	Office of the Chair	Yes	Stan Horton	Enron Global Services	General business update	4/18/2002		No	

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**LINDA K. BREATHITT**

December 27, 2002

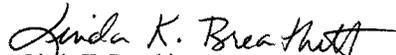
Honorable Joseph I. Lieberman, Chairman  
United States Senate  
Committee on Governmental Affairs  
340 Dirksen Senate Office Building  
Washington, D.C. 20510

Via Fax (202.228.3792) and Federal Express

Dear Senator Lieberman:

Thank you for your letter of November 26, 2002 regarding additional questions related to my testimony before the Committee on November 12, 2002. My response to your questions is attached to this letter. With regard to the additional questions submitted for the record by Senator Carl Levin, I have no additional comments to submit, and I would adopt the responses submitted by Chairman Pat Wood.

Sincerely,

  
Linda K. Breathitt

Enclosures:

- a) Response to Questions;
- b) October 30, 2002 Letter to Minority Counsel;
- c) New York Times Article, Nov. 13, 2002.

**QUESTIONS SUBMITTED FOR THE RECORD  
FROM CHAIRMAN JOSEPH I. LIEBERMAN  
TO THE HONORABLE LINDA K. BREATHITT, FORMER COMMISSIONER  
FEDERAL ENERGY REGULATORY COMMISSION  
November 12, 2002**

1. In our February 15, 2002 letter to Chairman Wood, the Committee requested, among other things, a list of all communications between Enron and the Commission (including all Commissioners, officers or employees of FERC) from January 1, 1992 to December 2, 2001. You responded to this request on March 4, 2002 and supplemented this response on March 20, 2002. Since then, questions have been raised about the completeness of these responses.

a. Please indicate whether the information provided in FERC's submission of March 4, 2002 and March 20, 2002 is a complete and accurate description of your communications with Enron and its representatives during that time period. If not, please list any communications (as that term is defined in the Committee's February 15, 2002 letter) that you had with Enron or its representatives from January 1, 1992 through December 2, 2001 that were not included in the Commission's earlier submissions to the Committee.

**RESPONSE:** To the best of my knowledge, FERC's prior submissions to the Committee, along with my letter of October 30, 2002 to the Committee's Minority Counsel Gary M. Brown (copy attached), contain a complete and accurate record of my communications with Enron and its representatives during the relevant time period. Please see the additional comments set forth below in further explanation.

b. Is there anything to which you testified at the hearing with respect to your communications with Enron and its representatives that you wish to supplement?

**RESPONSE:**

At the hearing on November 12, I was provided by Senator Fred Thompson (for the first time) with a copy of a two page document that purported to show a total of 46 instances of communication (between May, 2000 and December, 2001) between me and Enron or its representatives. From Senator Thompson's questions at the hearing, it appears that this document was reconstructed primarily from the law firm billing records of Charles Bone, an attorney with the firm of Wyatt, Tarrant & Combs who represented Enron. (Breathitt Testimony, 11/12/02, p. 107).

As I stated in my letter of October 30, 2002 to the Committee's Minority Counsel, I attended numerous conferences, seminars and speaking engagements in which I had incidental contact with Enron, as well as other regulated entities. I also stated that I cannot provide specific information on telephone calls, since no logs were kept by me personally or by my office.

**LINDA K. BREATHITT  
RESPONSE TO QUESTIONS FROM SEN. LIEBERMAN  
DECEMBER 27, 2002  
PAGE 2**

Of the 46 contacts set forth in the Thompson document, 26 are telephone calls involving Mr. Bone. The others are listed as "courtesy meetings", two luncheon meetings, four dinner meetings, one breakfast meeting, an approved attendance at an inaugural brunch, a speaking engagement at an INGAA Board meeting in Houston; attendance at a political event for U.S. Rep. Ford, and a public speaking engagement at a Conference hosted by Enron. Some of these "contacts" were most likely routine phone calls involving logistics or scheduling of the meetings that I previously disclosed. Others most likely involved purely social or political matters that were unrelated to anything involving Enron. Mr. Bone had no prior energy background, and therefore the technical and highly arcane issues within FERC's jurisdiction were foreign to him.

I have known Mr. Bone for a number of years, prior to my appointment to FERC, and prior to his engagement as a lawyer for Enron. My acquaintance with him has been social and political, and has never influenced any action I have taken in my official capacity. After Mr. Bone was hired by Enron, he was persistent in his efforts to set up meetings with Enron officials reflected in my prior disclosures. I treated these requests by Mr. Bone in the same manner as I did similar requests from anyone else.

The Thompson document appears to rely on Mr. Bone's billing records with regard to his contacts with me. This reliance leads to subjective judgments about how to characterize those contacts. For example, Sen. Thompson's document purports to show breakfast and lunch meetings with me on December 4, 2000. On that date, I attended and was a luncheon speaker at a financial conference in New York that was attended by over 200 people (a few of whom, including Mr. Bone, represented Enron). Likewise, the Thompson document purports to show that I participated in a number of conference calls, two of which were with individuals I do not know (Mr. Delainey and Harold Ford Sr.). The balance of the 46 entries reflect the contacts I previously disclosed, along with the incidental contacts at public or social functions and phone calls (several of which were totally unrelated to Enron) that were referred to in my October 30, 2001 letter to the Committee's Minority Counsel, and the one personal trip I made to Nashville (Breathitt Testimony, p. 108).

In a news article following my November 12, 2002 testimony, it was reported that "Mr. Thompson also emphasized that he was not asserting that Ms. Breathitt had done anything improper, only that he was trying to show how easy it was to draw negative inferences in such situations." ("Senator Releases Document's on Gore Aide's Enron Ties", *The New York Times*, Nov. 13, 2002, copy attached). While it may be "easy to draw negative inferences", I believe any fair reading of the record establishes that such negative inferences are unwarranted.

**LINDA K. BREATHITT  
RESPONSE TO QUESTIONS FROM SEN. LIEBERMAN  
DECEMBER 27, 2002  
PAGE 3**

As I testified, Enron was aggressive in promoting its views on energy policy. (Breathitt Testimony, 11/12/02, p. 119). I was one of the Commissioners who was least receptive to Enron's philosophy of deregulation. (Id. p. 114). It is not surprising that Enron would engage a social and political friend of mine in an effort to gain introductions and opportunities to meet with a Commissioner who was viewed as being unreceptive to their point of view. Enron, throughout my tenure at FERC, had advocated establishing an open access regime that included mandatory regional transmission organizations (RTO's), FERC authority over bundled sales in interstate commerce, and new mandatory interconnection and pricing rules. I did not support these positions advocated by Enron. I listened, however, to their point of view with the same fairness and respect that I accorded any member of the public or regulated entity that sought to share their views with me.

With respect to the California energy crisis, my testimony (at pages 109-110) addresses some of FERC's numerous responses to this pressing issue. Beginning with the December 15, 2000 Order, FERC issued several important Orders addressing this crisis. These Orders imposed mandatory price controls, imposed a "must offer" provision addressing supply, closed down the Power Exchange, imposed penalties for underscheduling, allowed the incumbent utilities to self supply, extended price caps in the entire West, and prohibited megawatt laundering. I wholeheartedly supported all of these important measures adopted by FERC to address the crisis, as well as other technical measures to mitigate the high prices and address the dysfunctional market in California.

Finally, I would like to address Sen. Thompson's remarks, commenting on the fact that my Father was associated with Wyatt, Tarrant & Combs, the same law firm as Mr. Bone. In 1992, after his retirement, my Father joined the law firm's Lexington, Kentucky office, as "counsel", on a fixed salary that was totally unrelated to Mr. Bone in the firm's Nashville office, or Enron. My Father has had a long career of public service. He has had absolutely no involvement in my activities at FERC or the activities of Mr. Bone, or the firm, on behalf of Enron. As Senator Thompson conceded, "He is a distinguished public servant." (Id., p. 111).

I would like the public record to reflect that throughout my tenure at FERC, I endeavored to serve the public by fairly and impartially discharging the duties that were entrusted to me. I was privileged to serve at an agency that is staffed by dedicated public servants, and to serve with other Commissioners who, despite philosophical disagreements, always did their best to administer a complex regulatory system in the public interest. The Committee's task in examining the ways that the regulatory process worked, or failed to work, is extremely important. I hope my responses here will help the Committee to stay focused on that important task.

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

OFFICE OF THE COMMISSIONER

October 30, 2002

Mr. Gary M. Brown, Special Counsel  
U.S. Senate Committee on Governmental Affairs  
Washington, DC 20510-6250

Dear Mr. Brown:

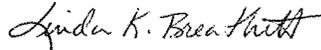
This responds to your invitation to supplement my responses to the February 15, 2002 letter from Senators Lieberman and Thompson set forth in your letter of October 11, 2002 to Don Chamblee.

After conducting another review of my calendar, I have found one additional meeting that involved Enron or an Enron affiliate during the relevant time period. The meeting occurred on June 7, 2000. It was attended by representatives of Puget Sound Energy, Avista, Portland General Electric (an Enron affiliate) Sierra Pacific Resources and MT Power. The subject matter most likely involved the development of RTO West.

As to other communications, I have had opportunities for incidental contact with representatives of numerous entities regulated by the FERC, including Enron and its affiliates, in contexts such as conferences, seminars and speaking engagements. Further, during the relevant time period I had telephone communications with representatives of Enron and its affiliates. However, because neither my office or I keep telephone logs, I cannot provide specific information such as dates and the number of additional contacts. They likely involved the same kinds of discussions reflected in my prior responses, i.e., transmission access, RTO development and tariff reform for a single transmission tariff.

My prior responses to Senators Lieberman and Thompson, as supplemented by this letter, reflect my best recollection of contacts I have had with employees of Enron and its affiliates. If I can further assist the committee in this matter, please do not hesitate to contact me.

Sincerely,



Linda K. Breathitt  
Commissioner

The New York Times

## Business

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## Senator Releases Documents on Gore Aide's Enron Ties

By RICHARD A. OPPEL Jr.

**W**ASHINGTON, Nov. 12 — In a parting shot at Democrats today, Senator Fred D. Thompson released documents detailing how one of Al Gore's top presidential campaign officials, Johnny Hayes, was paid to do consulting work for Enron during the 2000 campaign. Mr. Hayes was hired to help the company resolve a costly dispute with a federal agency and also to lobby federal energy regulators.

Mr. Hayes, who was Mr. Gore's national finance chairman in the 2000 campaign, was paid \$100,000 by a prominent law firm, Wyatt, Tarrant & Combs, that had been hired to resolve a dispute between Enron and the Tennessee Valley Authority, according to the managing partner at the firm. The dispute was settled late in 2000 after Enron agreed to pay more than \$200 million.

The firm had also been hired by Enron to obtain "better communication" with a commissioner at the Federal Energy Regulatory Commission, Linda Breathitt, whose father was a lawyer at the firm, according to documents written by a former partner at the firm that were also released by Mr. Thompson, a Tennessee Republican who is retiring this year.

Enron had close relations with President Bush and other top Republicans, and the documents illustrate how the company strove during the 2000 elections to play both sides of the fence by fostering close links to senior Democratic party officials. Enron had long been a major financial backer of Mr. Bush, a relationship Democrats have used to try to damage the Bush administration.

But Enron, apparently concerned two years ago that Mr. Gore might win the election, set out on an aggressive tack to also cultivate people close to him and other Democratic officials. Mr. Hayes, who did not return a phone call seeking comment today, also worked for Enron after Mr. Gore was defeated.

Mr. Thompson released the documents during a Senate Governmental Affairs Committee hearing today in part because he said he was concerned that Democrats on the panel were trying to paint Republican appointees to the energy commission in an unfair light.

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"Selective indignation is not going to work," Mr. Thompson said. The panel's chairman, until next year, is Senator Joseph I. Lieberman, Democrat of Connecticut, who is seen as a possible presidential candidate in 2004. Mr. Lieberman denied any effort to "get Republicans and protect the Democrats."

Details of Mr. Hayes's work for Enron have been reported by The Chattanooga Times Free Press.

In an interview this afternoon, the managing partner at Wyatt, Tarrant & Combs, Kevin Hable, confirmed that the firm paid Mr. Hayes \$100,000 in March 2001 for work Mr. Hayes performed the year before on behalf of Enron.

Mr. Hable said that lawyers on the executive committee of the law firm were not told that Mr. Hayes had been retained to do the work until January 2001. The only person at the firm who knew about the deal with Mr. Hayes before that date, he said, was Charles W. Bone, who he said had sought to arrange a \$325,000 payment to Mr. Hayes. The executive committee, Mr. Hable added, also did not know Mr. Bone was lobbying the energy commission until 2001. Mr. Bone, who left the law firm late last year, did not return a phone call seeking comment.

At the hearing today, Mr. Thompson noted that Ms. Breathitt's father, Edward T. Breathitt, the former governor of Kentucky, had been a lawyer at the Wyatt law firm at the same time that Mr. Bone and Mr. Hayes were in contact with Ms. Breathitt.

Under questioning by Mr. Thompson at the hearing, Ms. Breathitt, a Democrat appointed to the energy commission by President Bill Clinton in 1997, testified that her contacts with Enron officials were proper. Her father, she said, was paid by the Wyatt firm only a fixed salary that did not increase based on new business. Mr. Breathitt has since retired from the firm.

Ms. Breathitt added that many of the positions she had taken at the commission were adverse to Enron. "I have been the most reticent, least philosophically attuned to where Enron was going, in my opinion," Ms. Breathitt said.

The energy commission chairman, Patrick Wood III, who was appointed by Mr. Bush last year, said after the hearing that he believed that the harsh questioning of Ms. Breathitt had been unfair.

For his part, Mr. Thompson also emphasized that he was not asserting that Ms. Breathitt had done anything improper, only that he was trying to show how easy it was to draw negative inferences in such situations.

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FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

OFFICE OF THE COMMISSIONER

December 20, 2002

The Honorable Joseph I. Lieberman  
Chairman  
Committee on Governmental Affairs  
United States Senate  
Washington, D.C. 20510-6260

Dear Mr. Chairman:

Thank you for your letter of November 26, 2002, enclosing questions from you and Senator Carl Levin. I am providing my answers, set out below, for the record of your Committee's November 12 hearing.

**Senator Joseph Lieberman**

**Question 1:** In our February 15, 2002 letter to Chairman Wood, the Committee requested, among other things, a list of all communications between Enron and the Commission (including all Commissioners, officers or employees of FERC) from January 1, 1992 to December 2, 2001. You responded to this request on March 4, 2002 and supplemented this response on March 20, 2002. Since then, questions have been raised about the completeness of these responses.

- a. Please indicate whether the information provided in FERC's submissions of March 4, 2002 and March 20, 2002 is a complete and accurate record of your communications with Enron and its representatives during that time period. If not, please list any communications (as that term is defined in the Committee's February 15, 2002 letter) that you had with Enron or its representatives from January 1, 1992 through December 2, 2001 that were not included in the Commission's earlier submissions to the Committee.
- b. Is there anything to which you testified at the hearing with respect to your communications with Enron and its representatives that you wish to supplement?

**Answer:** Thank you for the opportunity to supplement my responses to your previous inquiries. To the best of my knowledge, the information provided in FERC's submissions of March 4, 2002 and March 20, 2002 accurately reflects my communications with Enron and its representatives during that time period.

**Question 2:** As discussed at the November 12 hearing, as well as in Committee staff's accompanying memorandum, less than 10% of FERC's employees measured in terms of full equivalents - FTE's - (the equivalent of one person working full time) are allocated to the new Office of Market Oversight and Investigation (OMOI). According to FERC's FY2003 budget 250 FTE's, including OMOI, are engaged in monitoring and enforcement activities, even broadly-defined; these activities thus account for less than 20% of FERC's total personnel and less than 15% of its budget. Do you believe this level of commitment to market oversight and enforcement is adequate in light of: 1) the fact that there are currently a number of investigations relevant to the energy industry ongoing not only at FERC (including the investigation of the California and Western markets) but also at other federal agencies (for example, the CFTC and SEC) and at the state level (for instance, the California Attorney General's investigation of energy company activities during the 2000-01 energy crisis) which may well uncover information that requires additional or expanded FERC investigations; and 2) the need for an effective enforcement program to ensure compliance with market rules when markets are deregulated?

**Answer:** I believe that the Commission has made the necessary level of commitment to market oversight and enforcement, but that commitment is not measured solely by the FTEs allocated to OMOI. Let me explain why I am satisfied that the Commission has allocated sufficient resources to these critical efforts. It starts at the top. For the first time, the Commission has made market oversight one of its three central goals, along with the traditional work on infrastructure and tariffs and rates, which is reflected in our Strategic Plan that we issued in the fall of 2001. The inclusion of market oversight as a central goal in the Strategic Plan represents a new way of doing business and, in fact, a huge cultural change at the Commission.

We have taken a number of steps to accomplish this goal. First, we established a lead organization whose lone priority is market oversight and enforcement, the Office of Market Oversight and Investigations (OMOI). OMOI became operational in 2002 and will be fully staffed with 120 FTEs by summer 2003. Second, we also began transforming our existing processes and resources. The organizations whose primary mission is traditional infrastructure and tariffs and rates are becoming more attuned to market oversight and investigation issues. Third, our resource allocation is not static. We are using FTEs from a number of organizations (Office of Litigation, Office of General

Counsel, Office of Markets, Tariffs and Rates and Office and the Office of the Executive Director) in major investigations. Furthermore, we are conducting a Closed Door session after each Commission meeting to, among other things, focus our monitoring and investigative efforts and resources and ensure full involvement of the Commissioners. Fourth, to the extent our expertise needs to be supplemented by special skill sets, we have not hesitated to contract with outside consultants, as we have done in the West Wide investigation. Fifth, we have increased our cooperative efforts with the other federal agencies such as the CFTC, SEC and DOJ. Finally, we are leveraging our market oversight resources. Each developed electric market around the country has a market monitoring unit (MMU) that has direct access to markets within the ISO or RTO. We are forging a fundamental partnership with these MMUs so that together we will form a single, seamless market monitoring presence around the country.

I believe the Commission has made an unprecedented commitment to market oversight and enforcement and the current level of effort the Commission is expending on market oversight and enforcement is appropriate. It demonstrates our commitment to market oversight and leverages our resources effectively. If experience indicates that we should commit additional resources to market oversight, I will not hesitate to reallocate resources where we can or seek additional resources from Congress if we must. It is, of course, critically important that we get the market structures and the rules in place as we are doing in the RTO dockets in SMD proposal rulemaking.

**Senator Carl Levin**

Senator Levin propounded a number of questions to the Commissioners generally seeking data regarding QFs and raising a number of legal issues. I have read the responses of Chairman Wood on behalf of the Commission. I agree with the responses and, therefore, adopt those responses as my own. So as not to unnecessarily burden the record, I have not replicated those response here. I would be more than happy to respond to any specific inquiry that Senator Levin would have for me.

Sincerely,



Nora Mead Brownell  
Commissioner

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426

OFFICE OF THE COMMISSIONER

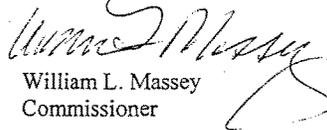
December 20, 2002

The Honorable Joseph I. Lieberman  
Chairman  
Committee on Governmental Affairs  
United States Senate  
Washington, DC 20510-6260

Dear Mr. Chairman:

Thank you for your letter of November 26, 2002, enclosing questions from you and Senators Fred Thompson and Carl Levin, for the record of your Committee's November 12 hearing. My answers to those questions are enclosed.

Sincerely,

  
William L. Massey  
Commissioner

Enclosure

**COMMISSIONER MASSEY'S RESPONSES TO QUESTIONS  
SUBMITTED BY SENATORS**

**Senator Lieberman**

**Question 1:** In our February 15, 2002 letter to you, the Committee requested, among other things, a list of all communications between Enron and the Commission (including all Commissioners, officers or employees of FERC) from January 1, 1992 to December 2, 2001. You responded to this request on March 4, 2002 and supplemented this response on March 20, 2002. Since then, questions have been raised about the completeness of these responses.

- a. Please indicate whether the information provided in FERC's submission of March 4, 2002 and March 20, 2002 is a complete and accurate record of your communications with Enron and its representatives during that time period. If not, please list any communications (as that term is defined in the Committee's February 15, 2002 letter) that you had with Enron or its representatives from January 1, 1992 through December 2, 2001 that were not included in the Commission's earlier submissions to the Committee.

**Answer:** To the best of my knowledge and recollection, the information provided is a complete and accurate record of communications between me and Enron and its representatives during that time period.

- b. Is there anything to which you testified at the hearing with respect to your communications with Enron and its representatives that you wish to supplement?

**Answer:** I do not wish to supplement my testimony.

**Question 2:** As discussed in the November 12 hearing, as well as in Committee staff's accompanying memorandum, less than 10% of FERC's employees measured in terms of full time equivalents – FTE's – (the equivalent of one person working full time) are allocated to the new Office of Market Oversight and Investigation (OMOI). According to FERC's 2003 budget 250 FTE's, including OMOI, are engaged in monitoring and enforcement activities, even broadly-defined; these activities thus account for less than 20% of FERC's total personnel and less than 15% of its budget. Do you believe this level of commitment to market oversight and enforcement is adequate in light of 1) the fact that there are currently a number of investigations relevant to the energy industry ongoing not only at FERC

(including the investigation of the California and Western markets) but also at other federal agencies (for example, the CFTC and SEC) and at the state level (for instance, the California Attorney General's investigation of energy company activities during the 2000-2001 energy crisis) which may well uncover information that requires additional or expanded FERC investigations; and 2) the need for an effective enforcement program to ensure compliance with market rules when markets are deregulated?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to question No. 4 submitted by Senator Lieberman. I will continue to urge that the Commission's resources are appropriately focused on vigorous investigations and oversight. Under Chairman Wood's leadership, the Commission's commitment to market oversight and enforcement has increased rather dramatically. I have reached no conclusion about whether additional resources will be necessary. It is my hope that standardization of market structures and rules, vigorous market monitoring units within each RTO and the more effective *ex ante* mitigation tools we have proposed in our Standard Market Design rulemaking will allow a more efficient utilization of the Commission's oversight and enforcement resources.

**Senator Carl Levin**

**Question 1:** Current law provides special rates and other benefits to qualifying small power production facilities under 16 U.S.C. 796 (17)(c) (hereinafter "QF facilities").

- a. Approximately how many QF facilities now exist?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- b. Approximately how many QF facilities have equity interests held by multiple parties?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- c. Approximately how many QF facilities are owned in part, either directly or indirectly, by any electric utility company, electric utility holding company, or an affiliate of an electric utility holding company (hereinafter "electric utility")?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- d. Approximately how many QF facilities are owned in part by a special purpose entity (SPE) that was established by an electric utility.

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- e. Approximately how many QF facilities are owned in part by an SPE whose equity ownership interest in the facility was largely provided, financed, or guaranteed by an electric utility?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- f. Approximately how many QF facilities are owned in part, either directly or indirectly, by a director, officer or employee of an electric utility or by a family member closely related to such director, officer or employee?
- g. Please describe the characteristics and nature of existing QF facility owners, including whether any particular companies dominate ownership of these facilities, the most common types of owners, and the relative percentage of owners that are electric utilities, corporations, partnerships, trusts, or individuals.

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 2:** If FERC determined that a company which had owned a QF facility sold 100 percent of the equity interest in that facility to an SPE that was established and financed primarily by an electric utility, would the facility likely continue to qualify for QF status under FERC regulations? What if the SPE was owned or controlled by a senior officer or employee of an electric utility?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 3:** At the hearing, Chairman Wood indicated that FERC would undertake a

review of existing filings to determine whether any QF facilities are operating under the same or similar ownership arrangements used by Enron with respect to its wind farms. Please describe how FERC plans to conduct this review, approximately how many QF facilities will be examined, and projected key dates for completion of the review. Given the evidence that has emerged over the last year regarding how Enron and other companies have abused SPEs by concealing their control over or financial contributions to the relevant SPE, please describe how FERC plans to identify and evaluate the nature and extent of any links that may exist among the QF facility, an SPE with an equity ownership interest in that facility and any electric utility.

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 4:** [Omitted]

**Question 5:** At the hearing, FERC indicated that it currently relies to a large extent on third parties to file complaints about QF facilities that may be in violation of FERC's QF ownership rules. Are there any plans for FERC to publish Federal Register notices to alert consumer advocates to facilities claiming QF status or to changes in the ownership of these facilities: Are there any plans to eliminate the \$16,000 fee for complaints against QF facilities?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 6:** FERC's staff conducted two examinations of the electronic trading operation known as Enron Online (EOL). The first staff report was issued in August 2001, and the second a year later in August 2002. The first report concluded "there is no reason for concern about EOL at this time." The second report found significant evidence of price manipulation and deceptive practices by Enron. How do you explain the differences between the two staff reports?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 7:** The August 2002 FERC staff report includes a detailed analysis of the natural gas trades made on Enron Online for next-day delivery into California over the course of a single day, January 31, 2001. The report

found that out of a total of 227 trades on that day, 174 – or more than two-thirds of the trades – involved Enron and a single counter party. Most of these trades took place during the last hour of trading, with the two parties buying huge amounts of natural gas from each other in numerous transactions. The report determined that the trades took place at "higher prices" than other trades that day and resulted in a steep price increase over the last hour of trading. The report described this trading as "difficult to rationalize as a normal or standard business practice" and noted that "only Enron and possibly the counter party could have known that so much of the trading was going on between themselves, because parties looking at EOL's screens could only see the bid and ask prices; they could not know who the counter party was on any particular trade." The report also indicates that Enron Online's price data was routinely used to prepare published reports on natural gas prices, which meant that the EOL price data was not just affecting Enron trades, but also contributing to higher natural gas prices industrywide. The FERC staff report concluded that Enron had "significant ability and incentive to manipulate the price data published by the reporting firms."

- a. What is the identity of the counter party in the 174 trades analyzed in the 2002 report?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- b. (i) Is it FERC's position that it currently has jurisdiction to monitor and investigate electronic trading systems like Enron Online which affect U.S. energy markets?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- b. (ii) Does FERC's jurisdiction arise in part from its statutory obligation to ensure just and reasonable rates?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to the question.

- c. Would you agree that the 2002 FERC staff analysis of Enron Online has established beyond dispute that electronic trading can affect U.S. energy prices and utility rates?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

- d. Given the importance of electronic trading in U.S. energy markets today, is it fair to say that FERC cannot ensure just and reasonable rates without monitoring and overseeing the key electronic trading systems that affect U.S. energy markets?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question. I believe that FERC cannot ensure just and reasonable rates without monitoring and overseeing by some appropriate federal agency, whether FERC or the CFTC, of key electronic trading systems that affect U.S. energy markets.

**Question 8:** Please list the key electronic systems that currently affect U.S. energy markets. Has FERC initiated a detailed examination of any of these electronic trading systems since Enron's collapse in December 2001? If so, please identify them. In addition, please indicate whether FERC has conducted or plans to undertake a detailed examination of UBSWenergy.com or the Intercontinental Exchange.

**Answer:** [Please see Confidential Non-Public Appendix to Chairman Wood's responses.]

**Question 9:** FERC uses certain information, like large trader reports, to monitor designated exchanges such as NYMEX. Does FERC have any plans to require electronic trading systems like UBSWenergy.com or ICE to begin filing similar information with FERC, so that FERC can monitor their trading? If not, how will FERC monitor existing electronic platform trading in the energy markets to detect and prevent roundtrip and other suspect transactions that may be improperly increasing energy prices or utility rates?

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question.

**Question 10:** Electronic trading is not confined to offers and bids on short term contracts for next-day deliveries of energy, but also energy derivatives, forward contracts and futures.

- a. Does FERC need to examine all aspects of this trading activity to fully understand energy markets and evaluate whether particular prices are just

and reasonable?

**Answer:** Yes.

- b. Is FERC's existing statutory authority sufficient to permit it to monitor and investigate the whole range of energy trading activity that takes place on electronic trading systems, or is it FERC's position that it is precluded from examining certain types of trading? If it is FERC's position that it is precluded from examining certain types of electronic trading, please identify those categories of trading and explain why FERC is unable to examine them.

**Answer:** I hereby incorporate by reference, and adopt as my own, Chairman Wood's answer to this question. The FERC or other appropriate agency such as the CFTC should have full authority to regulate such activities.

**Question 11:** Please provide any recommendations you may have for clarifying or strengthening FERC's statutory authority to ensure that FERC has clear jurisdiction to monitor, obtain routine information regarding, and investigate all aspects of electronic trading systems, including all types of trading activity, that may bear on energy prices and utility rates.

**Answer:** The FERC would have full authority if the Federal Power Act were amended to define an electronic trading system as a "public utility."



**STAFF MEMORANDUM**

**To:** Committee on Governmental Affairs  
Members and Staff

**From:** Majority Staff

**Date:** November 12, 2002

**Subject:** Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron Corp.

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## INTRODUCTION

On December 2, 2001, Enron, then ranked as the nation's seventh largest company, filed for federal bankruptcy protection amid allegations of far reaching financial and other fraud. Enron's collapse left thousands of employees without jobs and with severely diminished retirement savings and erased billions of dollars of shareholder value. Perhaps most significantly, it triggered a crisis of investor confidence in U.S. financial markets – and a concomitant crisis in ratepayer and investor confidence in the energy markets. Enron's meltdown has had effects that have reverberated through the energy sector as well as other parts of the U.S. economy, and its consequences continue to be felt today.

In January 2002, the Senate Committee on Governmental Affairs undertook an investigation into the collapse of Enron. Specifically, the Committee examined a variety of public and private entities that had responsibility for overseeing or monitoring aspects of Enron's activities and protecting the public against the type of calamities that resulted. The charge was to seek to determine if these watchdogs did their jobs correctly and whether they could have done anything to prevent, or at least detect earlier, the problems that led to Enron's failure. Among the entities looked at closely by the Committee has been the Federal Energy Regulatory Commission (FERC), the government's primary energy regulator. Although Enron, at the end, was involved in an assortment of far-flung activities, at its core, Enron was an energy company, and many of its activities were subject to direct or indirect oversight by FERC.

The Committee initiated its investigation through letters sent to the FERC Chairman on February 15 and March 27, 2002, requesting information about FERC's dealings with Enron and its affiliates over the last ten years, information which FERC provided to the Committee. The Committee also made follow-up requests to FERC for further information concerning investigations, inquiries, and audits involving Enron subsidiaries and affiliates. In addition, Committee staff had a number of interviews and discussions with FERC staff, officials of other federal agencies, and non-Enron utility company employees concerning the specific matters discussed in this memo. Committee staff also reviewed thousands of documents and e-mail records from Enron and affiliated companies provided to the Committee and to its Permanent Subcommittee on Investigations in response to subpoenas to Enron.

What Committee staff for the majority found was an agency that was no match for a determined Enron and that has yet to prove that it is up to the challenge of proactively overseeing changing markets. On a number of occasions, FERC was provided with sufficient information to raise suspicions of improper activities – or had itself identified potential problems – in areas where it had regulatory responsibilities over Enron, but failed to understand the significance of the information or its implications. Over and over again, FERC displayed a striking lack of thoroughness and determination with respect to key aspects of Enron's activities – an approach seemingly embedded in its regulatory philosophy, regulations, and practices. In short, the record demonstrates a shocking absence of regulatory vigilance on FERC's part and a failure to structure the agency to meet the demands of the new, market-based system that the agency itself

has championed. In the end, this investigation reveals that FERC did not fulfill its role to protect the consumer against abuses that can result if a market-based system is not adequately patrolled by those charged with doing so.

This memorandum will discuss four specific areas in which FERC failed to conduct effective oversight of Enron's activities. The first involves certain wind farms owned by Enron. In an effort to preserve these wind farms' eligibility as so-called "qualifying facilities" eligible for certain economic and regulatory benefits, Enron purported to transfer 50% ownership interests in these wind farms to third parties. At least some of the transactions, however, appear to have been sham sales. Enron, as required under FERC regulations, provided written notice to FERC of each of these sales (as well as subsequent repurchases), along with certain telling details; in some instances Enron in fact sought FERC's affirmative approval of the transactions. Nonetheless, FERC failed to make any effective inquiry – or in some cases, any inquiry at all – into these transactions, enabling Enron to receive substantial benefits for its wind farms to which it may not have been entitled.

Second, the memo will look at an investigation that FERC staff conducted in May 2001 into the operations of Enron Online, Enron's electronic trading platform used to buy and sell electricity and natural gas. The inquiry included questions about the competitive advantage that this trading operation gave Enron traders and whether that advantage could lead to abusive practices in the market; in connection with this inquiry, FERC staff also looked at questions concerning Enron's financial viability. FERC staff asked some of the right questions about Enron's electronic trading activities and finances, but ultimately settled for incomplete, unconvincing, or incorrect answers to those questions. Equally troubling, FERC failed to follow up on some of the most serious concerns raised in the course of its inquiry – concerns that have since been borne out. A critical legal memorandum regarding the basic question of whether FERC had jurisdiction over such trading platforms as Enron Online – which were expected to become the dominant way to trade both electricity and natural gas – was started but left to languish until Chairman Lieberman raised questions about it in a May 15, 2002 letter to FERC Chairman Wood. All this occurred at a time when Enron internal documents uncovered during the Committee's investigation show that the company placed a high priority on maintaining the unregulated status of Enron Online.

Third, the memo will examine questionable transactions between Enron and its FERC-regulated affiliated companies. In particular, shortly before Enron declared bankruptcy, it borrowed approximately \$1 billion through two of its pipeline subsidiaries, securing the loans with the pipelines' assets. When Enron went bankrupt, the pipeline companies – and potentially their ratepayers – were left to repay the loans. In addition, there is evidence suggesting that Enron may have used its public utility affiliate, Portland General Electric (PGE), to engage in the questionable export and reimportation of electricity from California during the Western energy crisis of 2000-2001 and disguised these prohibited interaffiliate transactions. Although FERC has now opened investigations into both matters, before Enron's collapse it had been unprepared and unwilling to act against suspect interaffiliate transactions either because the Commission's

rules were inadequate or because it was not able to effectively monitor whether companies were complying with the rules.

The fourth area involves the abusive trading practices that, according to recently released documents, Enron traders engaged in during the California energy crisis. FERC waited nearly two years after the first allegations of market abuse by individual companies arose before launching a formal inquiry into the potentially abusive actions of individual companies. This was despite the fact that FERC was provided with information raising concerns about the exercise of market power in California as early as 1998. Not until February 2002 did FERC pursue evidence that suggested that companies like Enron were manipulating the market. This failure to look at the behavior of individual companies came while Enron, deeply concerned about the effect the Western energy crisis could have on the course of deregulation and on its business, engaged in an extensive public relations and lobbying campaign to influence FERC's actions in the California market.

In addition to examining these areas of failed oversight, the memo will look at the efforts the Commission has undertaken recently to more effectively oversee the contemporary energy markets. Committee staff has serious concerns about whether, as currently constructed, such efforts are likely to result in the proactive, aggressive agency that is needed to protect consumers.

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While we do not know with certainty whether the disclosure of any of the individual activities to be highlighted at the hearing would have prevented Enron's collapse, it seems highly likely that more vigilant, aggressive action by FERC would have limited some of the abuses that appear to have occurred, raised larger questions about Enron's trading practices and other business activities, and unearthed at least some of the cracks in Enron's foundation earlier. Perhaps scrutiny by a federal agency would have jolted the Enron Board of Directors and Enron itself into acting to change direction. At a minimum, we believe it would have alerted investors, analysts, and hopefully other regulators to look more closely at Enron.

#### **I. FERC: BACKGROUND**

FERC is an independent, five-member regulatory commission within the Department of Energy. It was created in 1977 as a successor to the Federal Power Commission, which had been established in 1935 by the Federal Power Act. FERC regulates the interstate transmission and wholesale sale of electricity and natural gas, while state and local governments regulate retail sales and intrastate transmission. FERC also licenses hydroelectric projects and regulates the transmission of oil by interstate pipelines.

Over the past 25 years, FERC has overseen a fundamental change in the energy industry from a set of highly regulated monopolies to a system increasingly based on market competition.

The regulatory framework as it has evolved and is administered by FERC in three areas that constituted a substantial portion of Enron's energy business – electricity, natural gas, and oil – is, very briefly, as follows:

A. Electricity

The federal regulatory scheme for electric utilities is set forth in the Public Utility Holding Company Act<sup>1</sup> (PUHCA) and the Federal Power Act<sup>2</sup> (FPA). Both laws were passed in the mid-1930's in response to corporate abuse by utility holding companies. Holding companies were taking advantage of the fact that they owned utilities in multiple states to engage in interstate, intra-company transactions that could not be controlled by state public utility commissions. The Securities and Exchange Commission (SEC) was given authority to regulate matters relating to utilities' corporate structures under PUHCA, including the ability to restrict ownership of multiple utility companies by a single holding company.<sup>3</sup> Under the FPA, FERC's predecessor agency – the Federal Power Commission – was given the authority to regulate the rates that could be charged for electricity sold by one utility to another. The FPA required that these wholesale electric rates be “just and reasonable” and nondiscriminatory; rates that are not just and reasonable or are discriminatory are unlawful.<sup>4</sup> This statutory standard remains in place today. State utility commissions continue to regulate retail rates charged to consumers within their states.

The electricity industry in the U.S. has historically been characterized by vertically integrated utility companies that owned and controlled generation, transmission and distribution systems necessary to serve their own customers. These systems were primarily regulated by state commissions which approved construction of the facilities necessary to provide electric service and consumer rates to recover the cost of those facilities. Generally, sales of power between utilities were overseen by FERC. The situation began to change with the passage of the Public Utility Regulatory Policy Act<sup>5</sup> (PURPA) in 1979 and the Energy Policy Act<sup>6</sup> (EPA) in 1992. PURPA created a new category of independent generation facilities known as “qualifying facilities” or “QFs,” which were allowed to sell electricity to electric utility companies. (QFs include cogeneration facilities (*i.e.*, facilities that simultaneously produce two forms of useful

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<sup>1</sup> 15 U.S.C. § 79 *et seq.*

<sup>2</sup> 16 U.S.C. § 791a *et seq.*

<sup>3</sup> *See* 15 U.S.C. § 79k(b)(1).

<sup>4</sup> 16 U.S.C. §§ 824d(a) and (b); *see also* 16 U.S.C. § 813.

<sup>5</sup> 16 U.S.C. § 2601.

<sup>6</sup> 42 U.S.C. § 13201.

energy, such as electric power and steam) and small power production facilities that use biomass, waste, or renewable resources, including wind, solar and water, to produce electric power). In an effort to develop this new, independent generation industry, utility companies were required to purchase electricity from these QFs at preferential rates in lieu of using their own generation capacity. PURPA also required that a QF be owned by an entity that was not already a utility company.

EPAct expanded the universe of “independent” power generation facilities by authorizing utility companies to own independent power generation facilities – that is, power generation facilities that were not captive to a particular utility but could sell to multiple buyers – but without the preferential rates available to QFs; such independent generation facilities are referred to as “exempt wholesale generators” (EWGs). EPAct also required utilities to open up their interstate transmission systems to accommodate wholesale sales of power by competing producers. FERC has the responsibility to oversee these sales of electricity between utilities. FERC also reinterpreted the FPA’s requirement that wholesale electric rates be “just and reasonable” to allow market-based prices to be considered just and reasonable rates.

These changes, along with the decisions by individual states such as California to reorganize their state electric markets along a similar model, resulted in a major shift in the way electricity was generated, transmitted and sold. Rather than electricity being seen as a service provided by regulated monopolies at regulated prices, it became a commodity to be produced and sold at prices set by the market. This in turn created opportunities for energy companies like Enron to enter into the market to buy and sell electricity and even to provide retail service to customers.

#### B. Natural Gas

The evolution of the natural gas market had similar attributes to that of the electric market. In this case, natural gas pipelines previously served in the role of the “integrated” utility; they purchased gas from producers, transported it, and resold it to local natural gas distribution utility companies. Here too, FERC through its authority under the Natural Gas Act to regulate interstate pipelines,<sup>7</sup> has moved to require pipelines to “unbundle” these services and allow others to ship natural gas on their pipelines. In other words, FERC has essentially required interstate pipelines to serve as interstate “common carriers” providing transportation to others who purchase or sell natural gas directly.<sup>8</sup> As in the case of electricity, this has provided opportunities for energy trading companies like Enron to buy and sell natural gas that were not previously available. FERC continued to approve both the rates and construction of pipelines, including those owned by Enron.

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<sup>7</sup> 15 U.S.C. § 717.

<sup>8</sup> 15 U.S.C. § 717(c).

C. Oil Pipelines

FERC regulates interstate oil pipelines, which Enron also owned, under the Interstate Commerce Act, through which it has also begun to extend market-based rate authority.

In all three areas – electricity, natural gas, and oil – FERC has been instrumental in transforming the way energy products and services are bought and sold from one that relied upon cost-of-service based rates established by FERC, to market-based rates where prices are determined by a competitive marketplace.<sup>9</sup> Enron was at the forefront of these changes, both arguing for their implementation and structuring its businesses and business strategy to take advantage of them. In the process, Enron became the largest U.S. trader of electricity and natural gas – and one of the most significant companies within FERC’s jurisdiction.

**II. FERC’S OVERSIGHT OF ENRON**

Although FERC does not directly regulate Enron Corp. (essentially a holding company for the company’s many and diverse operating subsidiaries) as a corporation, *per se*, the Commission has jurisdiction over many of Enron’s energy marketing, generation, and transmission subsidiaries and activities. In response to the Committee’s request, FERC identified 24 electricity marketers, generators or transmitters, 15 gas pipelines, and 5 oil pipelines that are Enron subsidiaries or affiliates and that either are so-called “jurisdictional entities” under the FPA, Natural Gas Act or Interstate Commerce Act or are QFs that must be certified by FERC under PURPA. In addition, Enron appears to have several other electric affiliates that are subject to FERC’s jurisdiction or certification requirements.<sup>10</sup>

Not surprisingly, therefore, FERC had thousands of contacts with Enron concerning Enron’s FERC-regulated subsidiaries and affiliates over the ten-year period examined by Committee staff. The vast majority of these involved routine matters such as rate filings, reporting requirements, and system operation. In addition, Enron was very aggressive about using, and seeking to use, the regulatory process to further its own strategic business goals and to

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<sup>9</sup> Cost-of-service based rates are rates that are based on how much it costs for the utility company or pipeline to provide the service. It is calculated by analyzing the costs of building generation equipment, transmission facilities, personnel, financing, and other costs. In contrast, market-based rates are the price that the seller can get for the product in the marketplace. As part of the transition from one rate system to another, FERC has both directly and indirectly required the establishment of a variety of market mechanisms – from auctions by pipelines for available capacity to centralized trading exchanges.

<sup>10</sup> In the course of its investigation, Committee staff came across a number of Enron-affiliated entities, primarily QFs and EWGs, beyond those identified by FERC, that either had filed certifications with FERC or were discussed in internal Enron documents.

protect its economic interests in matters within FERC's purview; these matters ranged from the promotion of the deregulation of the electric and natural gas markets to FERC's response to the California energy crisis.<sup>11</sup> Enron intervened in dozens, if not hundreds, of proceedings before the Commission to this end.<sup>12</sup> Enron, moreover, was an active member of a number of industry organizations and coalitions and the company's employees often met with FERC commissioners and staff either as participants in association events or as representatives of the associations themselves.

Among the many Enron matters that came before FERC, or were subject to FERC oversight in recent years, four stood out as examples of significant regulatory failure. In each case, the Enron practices left unpursued by FERC likely contributed, directly or indirectly, to the company's collapse, distorted the appearance of its financial condition, and/or inflicted harm on energy consumers and the energy industry. The Committee staff's findings with respect to each of these matters is set forth in detail below.

A. Enron Wind Farm Transactions

In January 1997, Enron purchased Zond Wind Energy Corporation, a manufacturer and developer of wind energy generation equipment and projects. As a result, Enron became the majority owner of a number of wind farm projects that were considered "qualifying facilities" (QFs) under PURPA and so were eligible for preferential rate treatment.

Shortly thereafter, in August 1997, Enron completed its acquisition of a public utility company located in Oregon -- Portland General Electric (PGE). Under PURPA, however, QFs cannot be owned by a public utility or its holding company. Thus, because Enron now owned a

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<sup>11</sup> Enron Corp., "Enron Federal Government Affairs - Outlook & Goals for 1999" (Enron document nos. EC-W 000000228-000000234); Enron Corp., "Overview of Key Energy Policy Issues" (Enron document nos. EC-W 000001131-000001139).

<sup>12</sup> Enron also appears to have sought more broadly to influence policy matters within the Commission's jurisdiction. Enron's Government Affairs office had at least eight people dedicated to working on FERC matters. *See* Enron Corp., "Government Affairs Directory," (Enron document no. EC-W 000003398-000003406), at 6. This was, of course, part of a much reported on, broader effort on the part of Enron to shape its regulatory environment at both the state and federal level: Enron's internal government affairs department documents indicate that the company budgeted \$37.2 million for government affairs activities in 1999, \$33.6 million in 2000 and \$32.5 million in 2001. *See* Enron Corp., "Government Affairs," November 2001 (Enron document nos. EC 000124004-000124010) at 7. It is unknown what portion of these funds were spent on FERC-related activities. Given the company's extensive interactions with FERC, it may well have been a substantial amount. Enron internal government affairs department documents, for example, indicate that Enron was spending \$2 million per year just to promote the creation of Regional Transmission Organizations. *See id.* at 5.

public utility company, the wind farm projects it had purchased would no longer be eligible for QF status. In order to maintain the QF status of the wind farms, Enron found it necessary to divest itself of ownership interests in a number of these projects. In a number of cases, however, Enron seems to have only appeared to divest itself of ownership, while in fact effectively retaining the risks and benefits of ownership. Enron subsequently repurchased its interest in some of these wind farms in 2000, relying on legal arguments that it was otherwise exempt from the usual ownership requirements to retain the wind farms' QF status.

With respect to both the sales and repurchases of its ownership interests in the wind farms, Enron, as was required, filed documents with FERC informing it of the transactions. FERC, however, failed to give adequate – or, in some cases, any – scrutiny to these submissions.<sup>13</sup>

#### *1. Regulatory Requirements*

There are a number of technical and ownership requirements that a facility must meet in order to qualify as a QF. Most relevant here, PURPA requires that a QF be owned by an entity that is not primarily engaged in the sale or generation of electric power.<sup>14</sup> FERC has interpreted this requirement to mean that an applicant must demonstrate that “no more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company.”<sup>15</sup> To determine ownership, FERC looks to two factors: the exercise of control and the stream of benefits accruing to each participant. That is to say, a public utility or utility holding company may not have more than 50% control over the facility and may not receive more than 50% of the stream of benefits – typically defined by FERC as profits, losses and surplus after return of initial capital contribution.<sup>16</sup>

FERC regulations provide two alternative means by which the owner of an eligible facility may obtain QF status for that facility. First, the owner may file a formal application with FERC requesting Commission certification of the facility's QF status, which the Commission

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<sup>13</sup> Although FERC reviewed and approved the Enron/PGE merger that triggered the QF ownership requirement, FERC did not consider or attach any conditions to its approval to ensure that the QF ownership requirement was met.

<sup>14</sup> 16 U.S.C. § 796(17).

<sup>15</sup> 18 C.F.R. § 292.206(b).

<sup>16</sup> See *CMS Midland, Inc.*, 38 FERC 61,244 (1987); *Ultrapower 3*, 27 F.E.R.C. 61,094 (1984). This analysis applies where the facility is held by a partnership, as was the case with most of Enron's wind farms discussed herein; where there is direct corporate ownership, FERC is able to measure equity ownership more directly – by whether a utility owns more than 50% of the project's stock.

may grant or deny.<sup>17</sup> Or, at the owner's option, it may file a "self-certification," attesting that the facility meets the requirements for a QF.<sup>18</sup> Whenever there are changes in material facts about the facility, including changes in ownership, the owner must recertify the facility, again either by formal application to the Commission or by "self-recertification."<sup>19</sup>

When formal certification or recertification of QF status is sought, FERC publishes a notice of the application in the Federal Register and allows interested parties to move to intervene before ruling on the application.<sup>20</sup> When a facility owner files a self-certification or self-recertification, no notice is published, although a copy of the self-certification notice must be served on the utilities to which the QF expects to sell electricity and on state regulatory authorities.<sup>21</sup> As a matter of policy, FERC does not review self-certifications or self-recertifications, unless an affected utility raises an objection to the certification.

In the case of its wind farm sales and repurchases, Enron in some cases requested formal recertifications from FERC, while in others, it filed self-recertifications.

## 2. *RADR Transactions*

### a. **Wind Farm Sales**

In or about May 1997, Enron sold a 50% interest in each of three wind farm projects to a special purpose entity named RADR, which had allegedly been set up by Enron Chief Financial Officer Andrew Fastow and his deputy, Michael Kopper. These transactions were among those that underlay the civil and criminal charges recently brought against Fastow and Kopper.<sup>22</sup> The Justice Department and SEC have alleged that these transactions were entered into by RADR so as to "enable Enron to retain secret control over the . . . wind farms while appearing to maintain

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<sup>17</sup> 18 C.F.R. § 292.207(b).

<sup>18</sup> 18 C.F.R. § 292.207(a).

<sup>19</sup> 18 C.F.R. § 292.207(d).

<sup>20</sup> 18 C.F.R. § 292.207(b)(4).

<sup>21</sup> 18 C.F.R. § 292.207(a)(1).

<sup>22</sup> See Complaint, *SEC v. Kopper*, Civ. Action No. H-02-3127 (S.D. Tex. August 21, 2002); Information, *United States v. Kopper*, Cr. No. H-02-0560 (S.D. Tex. August 20, 2002); Complaint, *SEC v. Fastow*, Civ. Action No. H-02-3666 (S.D. Tex. Oct. 2, 2002); Indictment, *United States v. Fastow*, Cr. No. H-02-0665 (S.D. Tex. Oct. 31, 2002).

eligibility for QF status,”<sup>23</sup> and that it was understood that Enron would repurchase its interests in the wind farms from RADR at some point in the future.

Documents produced by Enron to the Committee and its Permanent Subcommittee on Investigations further suggest that Enron may not have legitimately transferred its interest in these wind farms. Minutes of a May 1997 meeting of the Finance Committee of Enron’s Board of Directors, for example, strongly imply that Enron did not consider the transactions to be true sales and fully expected to retain control over the projects. Thus, the minutes indicate that, although the arrangement was expected to satisfy FERC’s requirements for transfer of ownership, it was “not a sale for book purposes” and that Enron therefore could continue to recognize revenues from the projects.<sup>24</sup> In addition, the minutes describe Enron’s right to repurchase the projects, noting that Enron would retain a “call option to repurchase the assets in future and sell in ‘non-fire sale’ environment” – an indication that Enron, forced to divest its interests in the wind farms quickly because of QF concerns, was using the sales to RADR to temporarily “park” the projects until it could obtain what it hoped would be more lucrative financial returns.<sup>25</sup> Financially, the minutes reveal that Enron provided 97% of RADR’s initial capital by way of a loan from one of its subsidiaries and that Enron intended to indemnify RADR against future tax, environmental and other liabilities.<sup>26</sup>

The nature of these wind farm transactions is further confirmed by a 2001 report by PriceWaterhouseCoopers on its “due diligence” review for the Fastow-controlled partnership LJM when LJM was contemplating purchasing Enron’s entire renewable energy subsidiary. The report, consistent with the Finance Committee minutes, notes that, because Enron “retained all the risks and rewards associated with the projects and retained an option to repurchase the shares,” the transaction was not treated as a sale and revenue from the projects was accounted for as income from joint ventures.<sup>27</sup> The due diligence report further reveals that Enron also guaranteed RADR a minimum return on its investment.<sup>28</sup>

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<sup>23</sup> Information, *United States v. Kopper*, Cr. No. H-02-0560 (S.D. Tex. August 20, 2002) at 3; *see also* Indictment, *United States v. Fastow*, Cr. No. H-02-0665 (S.D. Tex. Oct. 31, 2002) at 4.

<sup>24</sup> Enron Finance Committee Meeting, May 5, 1997 (Enron document nos. EC 000025710 - 000025733) at document no. EC 000025730 (“Conclusions”).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*, at Enron document nos. EC 000025727 - 000025729.

<sup>27</sup> PriceWaterhouseCoopers, *Project Storm: Draft Report*, July 6, 2001 (Enron Document No. LJM 022403) at 100, 131.

<sup>28</sup> *Id.* at 131.

FERC reviewed and accepted each of these transfers of ownership. With respect to each of the three wind farm projects in which RADR was purportedly acquiring an interest, Enron, through a subsidiary, filed with FERC a formal application for recertification of QF status.<sup>29</sup> FERC staff reviewed each of these applications, and on June 30, 1997, FERC issued orders finding that the new ownership structure met the Commission's requirements and granting the applications.<sup>30</sup> Regardless of whether FERC can have been expected to have uncovered the full extent of the fraud arising out of these transactions, the applications submitted by Enron provided sufficient information to have raised serious questions as to the legitimacy of the sales, and FERC should have at least been alerted to the possibility that its own requirements for QF status had not been met.

The applications do not disclose that Enron executives controlled RADR, but they do reveal that Enron (through a subsidiary) will loan RADR all the money to purchase its interest in the wind farm projects; that an Enron affiliate will indemnify the owners of RADR for certain tax liabilities; that Enron (again, through a subsidiary) has an option to repurchase RADR's interest in the projects; that the land for the facilities will be leased from an Enron affiliate; and that the same Enron affiliate will receive fees for providing operation and maintenance services to the facilities. Taken together, these facts raise a substantial issue about whether ownership has truly been transferred and strongly suggest that Enron is likely to retain more than 50% control and receive more than 50% of the stream of benefits arising from the project.

In reviewing these applications, however, FERC does not appear to have understood or even to have tried to understand the financial arrangements – loans, repurchase options, indemnifications, and fees – described to it by Enron. According to FERC staff, QF applications at the staff level are reviewed by engineers or others with technical expertise to determine the QFs compliance with technical requirements, but typically no one with financial expertise reviews the applications for conformity with the ownership requirements. FERC apparently

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<sup>29</sup> Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Company*, FERC Docket No. QF87-365-003 (filed May 14, 1997); Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-003 (filed May 14, 1997); Request for Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, FERC Docket No. QF-90-43-002 (filed May 14, 1997).

<sup>30</sup> *Zond Windsystems Holding Company*, FERC Docket No. QF87-365-003 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997); *Sky River Partnership*, Docket No. QF91-59-003 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997); *Victory Garden Phase IV Partnership*, FERC Docket No. QF-90-43-002 (Order Granting Application for Recertification as a Qualifying Small Power Production Facility, June 30, 1997). In each of these cases, the determination to grant the application was made by FERC's Director of the Division of Opinions and Corporate Applications, acting under authority delegated from the Commission.

never probed the salient question of who controlled RADR,<sup>31</sup> for instance, and Committee staff could find no reference suggesting that FERC either knew or cared that Enron was not treating the “sale” of these facilities as a sale on its own books.

Rather, in its orders granting the wind farms QF status, FERC is conclusory in its analysis, largely parroting back Enron’s representations without further scrutiny. Thus, with respect to the additional moneys Enron would receive from the wind farms’ lease payments and from operations, maintenance and consulting fees to Enron affiliates, FERC unquestioningly accepts that because Enron and RADR each formally have 50% control over the facility and the agreements therefore theoretically could not be entered into without RADR’s assent, that these fee agreements should be presumed to have resulted from “arm’s-length” negotiations. Because FERC viewed these transactions as done at arm’s length, moreover, it determined that, in accordance with its ordinary practice, these additional fees, as well as the money Enron will receive from the loan it is providing to RADR, should not be counted as part of Enron’s share of the “stream of benefits” from the facility. At no point did FERC question why, where there is formally equal control, all the benefits would appear to accrue to one party nor did FERC see the extent of these benefits as possible evidence that this was in fact not an arm’s-length transaction. Overall, FERC appears to have been far more concerned with the form, rather than the substance, of these transactions.

Had FERC probed these transactions, it would have been difficult for it to certify that these transactions met the QF ownership test. In fact, the transactions appear to have been sham sales.

#### **b. Wind Farm Repurchases**

In 2000-2001, Enron reacquired a majority interest in a number of QF facilities, including the three RADR projects as well as at least two others. In each of these cases, Enron filed a “self-recertification” with FERC informing it of the change in ownership and asserting that that facility – though now majority or entirely owned by a utility holding company – maintained its eligibility for QF status.<sup>32</sup>

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<sup>31</sup> In its applications to FERC, Enron represents only that the managing partner of RADR is owned by three individuals, who are left unidentified.

<sup>32</sup> Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Co.*, Docket No. QF87-365-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, Docket No. QF90-43-003 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Cabazon*  
(continued...)

Enron based its self-recertification on FERC regulations issued pursuant to PURPA that provide an exception to the utility ownership limitations for QFs for utility holding companies that are exempt “by rule or order” pursuant to section 3(a)(3) or 3(a)(5) of PUHCA.<sup>33</sup> FERC’s practice, moreover, is to treat a company’s “good faith” application to the SEC for an exemption under these sections of PUHCA – unless and until it is denied by the SEC – to be sufficient to qualify for this PURPA exception.<sup>34</sup> As Enron had recently filed such an exemption application with the SEC,<sup>35</sup> the company asserted that it should be deemed exempt for purposes of the utility ownership limitations.<sup>36</sup> In addition, Enron noted that it was in the process of selling PGE, its sole electric utility subsidiary; once the sale was complete, Enron explained, it would no longer be a utility holding company and so no longer subject to the QF ownership restrictions.<sup>37</sup>

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<sup>32</sup>(...continued)

*Power Partners LLC*, Docket No. QF95-186-004 (filed January 24, 2001); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Power Partners I LLC*, Docket No. QF99-92-001 (filed January 24, 2001).

<sup>33</sup> 18 C.F.R. § 292.206(c)(1). These PUHCA sections provide that the SEC may exempt from the requirements of PUHCA a company that is only “incidentally” a public utility holding company and is primarily engaged in other businesses (15 U.S.C. § 79c(a)(3)) or a company that “derives no material part of its income” from companies the principal business of which is that of a public utility company (15 U.S.C. § 79c(a)(5)).

<sup>34</sup> See *Doswell Limited Partnership and Diamon Energy, Inc.*, 56 F.E.R.C. 61,170 (1997). FERC based this policy on an analogous provision in PUHCA, which provides that the filing of an application in good faith shall exempt the applicant from any obligation imposed under PUHCA. See 15 U.S.C. § 79c(c).

<sup>35</sup> Enron Corp. Form U-1, Application under the Public Utility Company Holding Act, SEC File No. 70-9661 (April 14, 2000).

<sup>36</sup> Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Windsystems Holding Co.*, Docket No. QF87-365-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Sky River Partnership*, Docket No. QF91-59-004 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Phase IV Partnership*, Docket No. QF90-43-003 (filed August 3, 2000); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Cabazon Power Partners LLC*, Docket No. QF95-186-004 (filed January 24, 2001); Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Victory Garden Power Partners I LLC*, Docket No. QF99-92-001 (filed January 24, 2001).

<sup>37</sup> *Id.*

Because Enron proceeded by self-recertifications in these cases and the recertifications were not initially subjected to challenge by an affected utility company, the self-recertifications were, per FERC staff's standard practice, left unreviewed.<sup>38</sup>

FERC's failure to review the self-recertifications was compounded by the SEC's inaction on Enron's application for the PUHCA exemption. At the time it filed the application with the SEC, Enron was already exempt from PUHCA on other grounds. From an SEC standpoint, therefore, the further exemption request was unnecessary. Nonetheless, Enron made clear in its application to the SEC that its purpose in applying for the additional PUHCA exemption was solely to get out from under FERC's QF ownership rules. Enron, moreover, strongly suggested that it had no interest in the SEC's ruling on the exemption application before the sale of PGE was either completed or abandoned.<sup>39</sup>

The SEC to date has not ruled on Enron's application for the PUHCA exemption, although it recently announced it would hold a hearing on the matter.<sup>40</sup> Since the application was initially filed, Enron's intended sale of PGE was abandoned and a subsequent proposed sale to another buyer also fell through; thus, Enron still owns PGE. Coupled with FERC's lack of review of the self-certifications, the net result of all this is that Enron's mere application to the SEC has allowed it to continue to avoid FERC's QF utility ownership restrictions.

Throughout the two-and-half years that Enron's exemption application has been pending with the SEC, furthermore, neither FERC nor the SEC has questioned whether that application was, or continues to be, in "good faith," as FERC requires for it to serve as a basis for exemption

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<sup>38</sup> In a meeting with Committee staff, one FERC staff member observed that, with respect to self-certifications, the Commission does nothing other than to "put a number on a piece of paper."

<sup>39</sup> See Enron Corp. Form U-1, Application under the Public Utility Company Holding Act, SEC File No. 70-9661 (April 14, 2000); Letter from Joanne C. Rutkowski, LeBoeuf, Lamb, Greene & MacRae to Catherine A. Fisher, Assistant Director, Office of Public Utility Regulation, Division of Investment Management, Securities and Exchange Commission, dated April 13, 2000. In a 2001 presentation to SEC staff, Enron asserted that "the SEC and Enron agreed to delay pursuing a formal order on the Application pending the PGE sale." Enron Corp., "Alternative PUHCA Exemption for QF Relief - SEC Staff Presentation," July 27, 2001. In an interview with Committee staff, SEC staff denied that there was such an agreement, but stated that it was nonetheless their priority to complete the regulatory review of the PGE sale before turning their attention to Enron's exemption application.

<sup>40</sup> See *Applications of Enron Corp. for Exemptions Under the Public Utility Holding Company Act of 1935*, SEC Administrative Proceeding File No. 3-10909 (Order Scheduling Hearing, October 7, 2002). This announcement was made coincident with the release of the Committee staff's report on the SEC's oversight of Enron.

from ordinary QF ownership requirements. Indeed, each suggests this is the responsibility of the other.<sup>41</sup> According to their own accounts, at no point did either agency contact the other to discuss the pending application.

Finally, outside prodding has done little to mitigate FERC's disregard for ensuring that its PURPA requirements are met. In March and April 2002, Southern California Edison (SoCalEd) filed motions with the SEC and FERC, respectively, seeking to intervene in the agencies' respective proceedings in these matters.<sup>42</sup> SoCalEd argued that Enron's substantially changed circumstances following its collapse rendered its application to the SEC for the PUHCA exemption no longer in "good faith" (if it ever had been) and that, as a result, the validity of the QF status of the relevant wind farms had been brought into question. Until the SEC recently announced it was scheduling a hearing in this matter, neither agency had acted on SoCalEd's motions. In fact, not only did FERC not act on this application, FERC responded to SoCalEd by letter informing the company that there was no pending proceeding in which to intervene, but that if SoCalEd wished to have its motion treated as a "petition for declaratory order" and so considered by the Commission, the company would need to submit a \$16,000 filing fee.<sup>43</sup> Only after the Committee announced the instant hearing did FERC initiate an investigation into the appropriate status of three of the wind farms.<sup>44</sup>

In sum, the failure of either agency to act vigilantly in these matters – with respect to the

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<sup>41</sup> In conversations with Committee staff, SEC staff asserted that the decision to rely on a good faith application was FERC's and suggested that it was up to FERC to determine if the application met that agency's standards for good faith. FERC staff, for its part, argued that the application was made to the SEC and that an attempt by FERC to determine whether such an application was in good faith before the SEC had a chance to rule on it would be preemptively second guessing its sister agency's decision.

<sup>42</sup> Motion to Intervene and Opposition of Southern California Edison Company, *Enron Corp.*, SEC File No. 70-09661 (filed March 26, 2002); Motion to Intervene of Southern California Edison Company, *In re Victory Garden Power Partners I, LLC* (FERC Docket No. QF99-92), *ZWHC LLC* (FERC Docket No. QF87-365), *Victory Garden Phase IV Partnership* (FERC Docket No. QF90-43), *Sky River Partnership* (FERC Docket No. QF91-59), and *Cabazon Power Partners LLC* (Docket No. QF95-186) (filed April 3, 2002).

<sup>43</sup> Letter from Magalie R. Salas, Secretary, Federal Energy Regulatory Commission, to James B. Woodruff, Esq., Senior Attorney, Southern California Edison Company, dated May 28, 2002.

<sup>44</sup> *Investigation of Certain Enron-Affiliated QFs*, FERC Docket No. EL03-17-000 (Order Initiating Investigation and Hearing, issued October 24, 2002). FERC's investigation appears only to encompass the RADR wind farms and not the at least two other QFs in which Enron reacquired a majority interest.

wind farms self-recertifications or the related PUHCA exemption application – left a regulatory “black hole” that Enron has been able to exploit. It has enabled Enron to retain QF status for projects which may not be eligible for it – and in so doing, permitted Enron to collect higher rates than it may be legitimately entitled to.<sup>45</sup>

### 3. *Cabazon Transaction*

In addition to the three RADR sales, Enron sought to transfer its ownership interest in another wind farm project, Cabazon, apparently also in order to retain that project’s QF eligibility. In contrast to the RADR wind farms, in the case of Cabazon, Enron did not file a formal application for certification of QF status. Instead, on November 30, 1998, Enron (through a subsidiary) submitted a self-recertification to FERC, asserting that it had transferred a 50% ownership interest in the facility to The Nature Conservancy (TNC), a non-profit organization, thereby complying with the utility ownership limitations.<sup>46</sup> Approximately six weeks later, Enron implicitly represented that it had reacquired this interest. In a self-recertification filed on January 8, 1999, Enron claimed to now own 40% of the project and that the remaining 60% interest was now owned by another outside party.<sup>47</sup> Just the previous day, Enron had represented in yet another self-recertification for the same project that it and TNC each had a 50% ownership interest.<sup>48</sup>

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<sup>45</sup> SoCalEd estimates that from July 1997 to April 2002, the wind farms at issue have been able to collect as much as \$176 million more than if they had not had QF status. E-mail from Susan Kappelman, Southern California Edison Co. to David Berick, Professional Staff, Senate Committee on Governmental Affairs, dated September 6, 2002. Committee staff has not attempted to independently confirm this number nor have we been able to quantify other financial benefits, such as tax credits and depreciation, that Enron may have received from its ownership interests in these projects.

<sup>46</sup> Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-001 (filed November 30, 1998). It is not clear why Enron waited until a year after Enron acquired PGE and thus became a utility holding company to make such a certification of ownership.

<sup>47</sup> Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-003 (filed January 8, 1999).

<sup>48</sup> Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility, *Zond Cabazon Development Corporation*, FERC Docket No. QF95-186-002 (filed January 7, 1999).

According to TNC, however, it never acquired an ownership interest in Cabazon.<sup>49</sup> On November 18, 1998, Enron did assign TNC the rights to receive 50% of the net profits from the Cabazon project.<sup>50</sup> There is no indication, however, that Enron transferred any ownership interest in, or any right of control over, the facility to TNC,<sup>51</sup> and according to TNC representatives, TNC did not understand this assignment to be the transfer of an ownership stake in Cabazon. Under FERC interpretation, the right to 50% of the stream of benefits from a facility, without more, is insufficient to establish ownership for QF eligibility purposes.<sup>52</sup> Effective January 8, 1999, Enron terminated the assignment agreement.<sup>53</sup>

The fact that Enron's filings indicated that it was engaging in a series of ownership changes with respect to the Cabazon QF, including an apparent year-end, short-term assignment of ownership rights to a tax-exempt organization, should clearly have raised concerns with FERC, had FERC staff so much as examined the self-recertifications. Consistent with its policy and practice, FERC, however, did not examine the self-recertifications, nor did it provide public notice that the recertifications had even been filed. Consequently, it did not ask Enron for the supporting details of the ownership arrangement (only an assertion of the ownership allocation was made in the filings, with none of the underlying details reported or relevant documents provided), nor did it contact TNC about the recertification. The result was that FERC missed another opportunity to identify possible wrongdoing by Enron and to ensure that only legitimate QFs were receiving the benefits of that designation.

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<sup>49</sup> E-mail from Karen Berky, Director, Government Relations, The Nature Conservancy, to David Berick, Professional Staff, Senate Committee on Governmental Affairs, dated September 30, 2002.

<sup>50</sup> Assignment Agreement between Zond Cabazon Development Corporation and The Nature Conservancy, dated November 18, 1998 (Enron document nos. EVE 1788500.0002 - 1788500.00006).

<sup>51</sup> Indeed, the Assignment Agreement specifically provides that "[n]otwithstanding any other provision of this Assignment, Assignee [TNC] is not a partner, joint venturer, alter ego, manager, controlling person or other business associate or co-participant of any kind or nature whatsoever of Assignor [Zond Cabazon Development Corp., an Enron subsidiary] and Assignee does not intend to assume such status." *Id.* at 5.

<sup>52</sup> See *Coso Energy Developers et al.*, 85 F.E.R.C. 61,355 (Order Denying Applications for Recertification as Qualifying Facilities, December 16, 1998)

<sup>53</sup> Letter from John A. Lamb, Cabazon Power Partners LLC to Laurel Mayer, Esq., The Nature Conservancy, dated January 11, 1999, (Enron document no. EVE 1788500.0001).

B. Enron Online

In October 1999, Enron launched an internet-based electronic trading platform, Enron Online, to trade natural gas and electric power and, later, other commodities. Online energy trading quickly became a significant portion of the energy trading market: in 2001, it was estimated to account for approximately 38% of natural gas and 17% of electric power marketed in the U.S.; at the time, these figures were projected to grow to 72% for natural gas and 45% for electric power by 2005.<sup>54</sup> Until Enron's bankruptcy, Enron Online was widely acknowledged to be the leading platform for such trading.

Despite these developments in online trading, FERC appears initially to have been largely indifferent to their significance. It was not until May 2001 that FERC's General Counsel initiated a staff-level inquiry into the status of electronic trading in the electric power and natural gas markets, in general, and the role played by Enron Online, in particular. FERC staff were asked to evaluate Enron Online's dominant position in electronic trading in the energy industries and to determine its impact on natural gas and electric markets. A report discussing these matters was completed on August 16, 2001.<sup>55</sup>

The report found that, unlike some online trading platforms which operate as third-party, "many-to-many" exchanges matching willing buyers and sellers, Enron Online operated as a proprietary extension of Enron's trading units, including entities regulated by FERC. In other words, in this so-called "one-to-many" exchange, an Enron trader was a party, either as a buyer or seller, to every trade on Enron Online. Therefore, only Enron would know valuable information about the actual volumes and prices transacted on its trading platform – and, of course, how the prices charged in any particular transaction were set or how they compared to those charged in other, similar transactions.

The report also observed that Enron Online simply served as a trading platform for other

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<sup>54</sup> Memorandum from Marvin Rosenberg and Perry L. Brown, Economists, Office of Markets, Tariffs and Rates; Kim G. Bruno, Attorney, Office of General Counsel; and Mary C. Lauerman, Auditor, Office of the Executive Director to Kevin P. Madden, General Counsel; Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates; Donald J. Gelinas, Associate Director, Office of Markets, Tariffs and Rates; and John M. Delaware, Deputy Director, Office of the Executive Director, Re: Inquiry into EnronOnline, August 16, 2001 (hereinafter "Enron Online Report") at 9 (citing Forrester Research, Inc., "Net Energy Hits Hypergrowth" April 2001).

<sup>55</sup> Enron Online Report, note 54, above. On May 14, 2002, Chairman Lieberman wrote to FERC Chairman Pat Wood to express concern about a number of issues raised by this FERC staff report. Chairman Wood responded with a letter to Chairman Lieberman on May 28, 2002. The instant memo reviews the problems identified in Chairman Lieberman's May 14 letter, supplemented by additional information that has since become available.

Enron subsidiaries, shouldering no financial risk on its own. In other words, the financial risk of all the trades conducted through Enron Online remained with these other subsidiaries. This meant the solvency of Enron as a whole was important to the viability of Enron Online and to Enron's trading activity.

With that observation in mind, the report asked whether financial problems at Enron would threaten the energy markets. The report answered the question in two ways. First, it concluded that Enron did not have sufficient market share to disrupt the energy market if it failed. According to the report, Enron accounted for 16 percent of gas trading and 13 percent of electric power trading in North America, with the majority of Enron's trading transacted through Enron Online. In the report's view, the energy market could continue functioning smoothly absent Enron's market share. Second, the report concluded that, in any event, the chance of Enron failing financially was remote. The report provided little support for this conclusion.

Finally, the report found that Enron Online gave a competitive advantage to Enron's own trading units by reducing their transaction costs, giving them wider access to the market, and providing them better market intelligence, but concluded that there was no reason for concern.

In short, though the report identified a number of areas that ought to have troubled FERC as the federal government's lead energy regulator, it found no reason for concern and no cause for action. This was a critical mistake.

First, though FERC staff identified the potential risk inherent in (a) a trading model that exposed the corporation to very large financial risks, and (b) the company's dependence on its corporate credit worthiness to maintain its trading capability and to fulfill its trading commitments, FERC staff failed to take the logical next step to thoroughly understand the significance of this finding. Instead, they conducted only a cursory analysis of Enron's financial standing, concluding that Enron was unlikely to fail as a result of overextending credit to its trading customers. This was obviously a mistake; although the scenario imagined in the report did not come to pass, in fact Enron was financially unstable, and within a few months, had collapsed completely.

Second, the analysis that led to the conclusion that Enron's market share was insufficient to negatively impact the market in the event of the company's failure was far too cursory. The report based its conclusion upon limited industry-supplied data that looked only at the national picture. FERC should have based its conclusion on more thorough data from regional markets, where market concentration would likely have been of greater concern. Moreover, although Enron's failure did not result in major short-term disruptions of energy markets, FERC failed to foresee the broader market effect of Enron's collapse. In Enron's wake, the entire energy trading sector has suffered significant financial distress. As Standard & Poor's (S&P) observed in a recent evaluation of the U.S. utility industry, "[t]he general weakening of credit quality in the U.S. power industry began well before the California and Enron Corp. debacles of 2001, but it

has certainly been exacerbated by them.”<sup>56</sup> In the first six months of 2002, S&P reported “an unprecedented 78 downgrades among holding companies and operating subsidiaries.”<sup>57</sup>

Third, while FERC staff concluded that the Commission need not worry about the competitive advantage that Enron Online provided to Enron traders, there is now evidence that Enron in fact likely exploited this advantage to manipulate prices, particularly in California and the Western markets. Much of this evidence is set out in FERC’s own post-mortem investigation of energy company activities during the Western energy crisis of 2000-2001, an “initial report” issued in August 2002.<sup>58</sup> One of the key advantages apparently misused by Enron was one identified in the 2001 Enron Online report – the enhanced “market intelligence” available to it through Enron Online, that is, the ability to see the details of the individual trades going on behind the scenes, while competitors were limited to the summary results posted online. For example, FERC staff’s 2002 report on the Western energy markets describes one case where Enron and an unidentified counterparty made 174 trades with each other on Enron Online in a single day for natural gas being delivered into the California market at the height of the energy crisis.<sup>59</sup> Other users of Enron Online, however, could only see the bid and ask prices for these transactions; they could not see that the same parties were involved in all of these trades. The net effect of these trades – which, the FERC staff report notes, took place at higher prices than trades with other parties – was to increase the price throughout the day. Though FERC staff stopped short of affirmatively concluding that Enron was attempting to use Enron Online to manipulate market data, it found in its 2002 report that the level of trading activity was “difficult to rationalize as normal or standard business practice.”<sup>60</sup> In short, the 2001 staff inquiry concluded that there was no reason for concern about Enron Online’s competitive advantage; the 2002 initial investigation report reaches the opposite conclusion.

The effect of any such price manipulation was magnified, furthermore, by another characteristic of Enron Online (also identified by FERC staff in its 2001 Enron Online report) – its use as a significant, but unverifiable, source of price discovery for other market participants.

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<sup>56</sup> S&P, “Credit Quality for U.S. Utilities Continues Negative Trend in Second Quarter,” July 12, 2002.

<sup>57</sup> *Id.*

<sup>58</sup> Staff of the Federal Energy Regulatory Commission, “Initial Report on Company-Specific Separate Proceedings and Generic Reevaluations; Published Natural Gas Price Data; and Enron Trading Strategies. Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices,” Docket No. PA02-2-000, August 2002 (hereinafter, “Initial Report on the Western Energy Markets”)

<sup>59</sup> *Id.* at 53.

<sup>60</sup> *Id.* at 54.

That is to say, energy traders throughout the industry routinely relied on Enron Online to find out current market prices. Indeed, FERC staff, in its 2002 report on the Western energy markets, found that Enron Online had “played [] a significant, even a dominant, source of price discovery for natural gas products” in the California market.<sup>61</sup> Moreover, Enron Online’s reported prices were a significant component of industry price indices published by third parties.<sup>62</sup> Thus, the effect of any price manipulation by Enron through Enron Online would be compounded as the inflated prices infected these supposedly independent reports as well. Enron Online’s lack of price transparency and the potential therefore for price manipulation were noted in the 2001 Enron Online report; indeed, FERC staff recommended that, if requested, the Commission should not approve a price index based on Enron Online transactions unless more detailed transaction information was made publicly available.<sup>63</sup> Despite highlighting these issues, however, FERC took no further action to investigate whether Enron was manipulating prices or otherwise abusing the advantages with which Enron Online provided it.<sup>64</sup>

Fourth, FERC staff failed to follow up on many of the issues raised by the report. Particularly troubling, given the concerns identified in the report related to Enron’s financial risk, it appears that there was never any formal process established within FERC for monitoring the financial status of Enron – North America’s largest energy trader – not even following the unexpected resignation of Enron CEO Jeffery Skilling on August 14, 2001. This was a key red flag that occurred just days before the final report was transmitted to FERC managers and, along with news reports about some of Enron’s questionable financial practices, helped persuade staff

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<sup>61</sup> *Id.* at 51.

<sup>62</sup> FERC staff’s Initial Report on the Western Energy Markets notes that in response to agency staff requests to National Gas Intelligence (NGI), NGI reported that a number of its sources relied on Enron Online as their primary price discovery mechanism, even by traders who did not transact on Enron Online. *See id.* at 52.

<sup>63</sup> Enron Online Report at 15-16.

<sup>64</sup> The apparent distortion of published price indices by data from Enron does not appear to be an isolated problem. In the past month, three other energy trading companies – Dynegy, American Electric Power, and Williams Cos. – have publicly disclosed that their traders provided inaccurate information to energy industry publications that compile and publish price indices. See Chip Cummins, “Williams Traders Gave False Data,” *Wall Street Journal*, October 28, 2002; “AEP Dismisses Five for Providing Inaccurate Market Data for Indexes,” AEP Press Release, October 9, 2002; “Dynegy Dismisses Six Employees, Will Discipline Seven Others for Violations of Company Policies,” Dynegy Press Release, October 18, 2002; “Williams Discloses Natural Gas Trade Reporting Inaccuracies,” Williams Cos. Press Release, October 25, 2002.

at the SEC to begin that agency's investigation into Enron's financial condition.<sup>65</sup> Even once the full magnitude of Enron's financial problems began to take shape in mid-October following Enron's restatement of earnings and public confirmation of the SEC's investigation of the company, there appears to have been no formal effort within FERC to monitor the financial condition of the company or assess possible market impacts. FERC even failed to follow the recommendation made in the staff's August 16, 2001 report that the team that prepared it continue to monitor effectively developments at Enron Online and other electronic trading platforms. There was no effort made at the agency to ensure that this recommendation was heeded.

The significance of FERC's failures to pay more attention to Enron's financial condition is underscored by the agency's reaction, late last year, to news of Enron's collapse. When Enron's demise became evident in November 2001, FERC officials were apparently troubled enough about the potential impacts of the collapse on the energy market – the very concern dismissed in their August report – to raise these matters with representatives of the Federal Reserve, the White House National Economic Council, and Enron itself.<sup>66</sup>

Another very troubling facet of the August 2001 report is that it was not distributed to any of FERC's commissioners prior to, or during, Enron's collapse to inform their decision-making, and it is unclear at what point any of the information contained in the report may have been provided to the Commission. Thus, a report that might have served as a warning wound up being little more than a footnote in the story of Enron's collapse. Moreover, at the same time the report was being prepared, the Commission was debating the appropriate methodology to calculate refunds to consumers in California and the Western markets. The methodology adopted relies, in part, on the energy prices reported in certain public indices.<sup>67</sup> Had the Commission been given

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<sup>65</sup> Report of the Staff of the Senate Committee on Governmental Affairs on "Financial Oversight of Enron: The SEC and Private-Sector Watchdogs," S. Prt. 107-75 (October 7, 2002) at 28.

<sup>66</sup> See Letter from Pat Wood, III, Chairman, FERC to the Honorable Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated April 12, 2002 (listing telephone conversations between Rob Gramlich from the Office of the Chairman of FERC to the White House National Economic Council and the Federal Reserve Board of San Francisco); Letter from Pat Wood, III, Chairman, FERC to the Honorable Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated March 4, 2002, (response to question 3(a), at 188) (noting that there were multiple communications between FERC and Enron, including a communication between William Scott Miller of FERC's Office of Markets, Tariffs and Rates and Rick Shapiro of the Enron Corp.).

<sup>67</sup> *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Service*, 96 F.E.R.C. 61,120, 61,518 (Order Establishing Evidentiary Hearing Procedures, Granting Rehearing in Part, (continued...))

the information uncovered by staff, it could have learned the important fact that the prices reported in such indices were potentially unreliable and subject to manipulation.<sup>68</sup>

Finally, in examining new online markets such as Enron Online, FERC initially did not even bother to address a critical but unresolved question – whether the Commission had jurisdiction over such online trading platforms – even though it was generally understood by FERC staff that electronic platforms such as Enron Online were expected to become the dominant way in which both electricity and natural gas were traded. At the time of the Enron Online inquiry, an accompanying legal memorandum analyzing FERC's jurisdiction over online trading, including Enron Online, was to have been prepared. The memorandum, however, was not completed until July 2002; in fact, nothing was done about finishing it until Chairman Lieberman raised questions about it in his May 15, 2002 letter to Chairman Wood. Ultimately, FERC staff concluded that the Commission likely had jurisdiction over one-to-many type trading platforms for physical electric energy.<sup>69</sup> Without completing its jurisdictional analysis, however, FERC was poorly positioned to take any action with respect to abusive practices by Enron Online.

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<sup>67</sup>(...continued)

and Denying Rehearing in Part, issued July 25, 2001) (adopting the recommendation to “use daily spot gas prices” based on the average of spot prices as reported by Gas Daily, NGI's Daily Gas Price index and Inside FERC's Gas Market Report, in calculating refunds).

<sup>68</sup> This was not the only instance where the Commissioners may not have been given information relevant to the refund proceeding. In July 2001, FERC's Chief Accountant prepared a memorandum describing the findings of a staff audit to determine whether the books and records of power companies selling power in California inappropriately reflected the cost of generating electric power. The memo noted that “our initial work disclosed various preliminary observations about the costs of generating electricity that may be useful to Commission staff involved in the refund negotiations for overcharges by numerous sellers of energy into the State of California.” Memorandum from John M. Delaware, Deputy Executive Director and Chief Accountant to Walter C. Ferguson, Chief of Staff, Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates, and Kevin P. Madden, General Counsel on “Audit of the Component Costs of Generating Electric Power,” undated, at 1 (FERC staff informed Committee staff that the memo was prepared on July 20, 2001). The memo was addressed to the Chief of Staff, FERC's General Counsel, and the Director of the Office of Markets, Tariffs and Rates, but was apparently neither formally submitted to the Commission nor relied upon by the Commission in its initial determination on a refund methodology.

<sup>69</sup> Memorandum from Dennis Lane, Solicitor, Larry Gasteiger, Beth Pacella, and Laura Vallance, through Cynthia Marlette, General Counsel, to the Commission, re: The Commission's Legal Authority to Regulate “One-To-Many” Internet-Based Trading of Energy Products, July 24, 2002.

Completion of this analysis would also have been useful in clarifying the jurisdictional boundaries between FERC and the Commodity Futures Trading Commission (CFTC) regarding energy trading activities and products, including online trading, and to better define the two agencies' respective market monitoring responsibilities in these developing markets. CFTC does not have general regulatory authority over a one-to-many trading platform such as Enron Online,<sup>70</sup> but it does have authority to take action against certain fraudulent or manipulative trading practices.<sup>71</sup> Thus, both FERC and CFTC have at least some regulatory responsibility for online energy trading. Yet, until after Enron filed for bankruptcy, there were no meaningful discussions between the two agencies to identify and coordinate their respective roles in overseeing these sorts of trading platforms, apart from some FERC staff visits to CFTC to educate themselves about the regulation of commodity markets in general.

The jurisdictional analysis was also important to clarify FERC's authority in the face of Enron's apparent determination to avoid regulation of Enron Online and exploit the regulatory gap between FERC and CFTC. The company asserted to FERC that its online trading operations were already subject to "federal oversight" by FERC and CFTC, and an internal memo titled "Talking Points addressing Common Misperceptions" suggested the talking point "There is no regulatory gap."<sup>72</sup> In fact, however, Enron acknowledged only very limited jurisdiction by either agency over its online trading. A November 2001 internal Enron Government Affairs Department document lists as a current activity "Preserve EnronOnline's unregulated status,"<sup>73</sup> and a July 2001 internal Enron memo – written contemporaneously with FERC's investigation into Enron Online – speaks of Enron's "strategy to defend regulatory structuring surrounding EOL [Enron Online] and EOL products."<sup>74</sup> Thus, an earlier assertion of jurisdiction may have made clear to Enron that its electronic trading was in fact subject to FERC oversight.

Enron Online and other electronic trading platforms are precisely the sort of emerging market institutions that one would expect FERC to anticipate, understand, monitor and address as it moved to deregulate energy markets. Even though FERC eventually initiated an inquiry examining such trading platforms – suggesting some level of concern within the agency about

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<sup>70</sup> 7 U.S.C. § 2(h)(1).

<sup>71</sup> 7 U.S.C. §§ 2(h)(2)(B) and 2(h)(2)(C).

<sup>72</sup> Enron Corp., "Electronic Platforms and Energy Trading, Talking Points addressing Common Misperceptions," undated (Enron document nos. EC 000124057-124065), at 3.

<sup>73</sup> Enron Corp., "Enron Government Affairs," November 2001 (Enron document nos. EC 000124004-000124010), at 3.

<sup>74</sup> Enron Corp., "Update on Federal Government Affairs Energy Crisis Campaign," July 27, 2001 (Enron document no. ECp000060512).

their growing influence – and found that, in fact, the use of online trading platforms and their trading volume were expected to grow dramatically, the agency failed to give these mechanisms the scrutiny they deserve. It is particularly troubling that FERC identified so many red flags – about the financial risks inherent in a one-to-many trading model, about the potential for price manipulation in such a system – and yet, underestimating or misunderstanding their significance, did not take action on any of them. And it is indicative of FERC’s failure to live up to its responsibilities that it did not even finish its legal analysis of the scope of its jurisdiction over these new fast-growing electronic markets until prodded by Chairman Lieberman. Had FERC followed up on its observations, continued to closely monitor Enron and asserted its authority over Enron Online, it might have stopped some of Enron’s abusive practices, lessened the harm to energy consumers, and prevented the substantial effects on the energy sector as a whole.

### C. Affiliate Transactions

Whenever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions.<sup>75</sup> Indeed, concerns about self-serving affiliate transactions were part of what led to the original passage of PUHCA and the FPA in the 1930’s.<sup>76</sup> Among Enron’s dubious practices, the company on various occasions appears to have improperly used transactions with its affiliates to further its own financial ends. FERC, however, either had no rules or inadequate rules to address these practices, or, where it had put rules into place, no effective means of monitoring whether companies such as Enron were complying with them.

There are a number of ways in which FERC-administered rules and policies attempt to discourage improper interaffiliate transactions. Most basic, there is the requirement that entities within FERC’s jurisdiction may charge only “just and reasonable rates.” Were a company whose rates are set in whole or part by FERC – like Enron’s natural gas pipeline subsidiaries – to imprudently enter into an unfavorable transaction with an affiliate, the company would not, in principle, be able to collect the additional costs associated with that transaction, because rates based on such costs would not be reasonable.<sup>77</sup> In addition, FERC, pursuant to statute, has issued rules for “Uniform Systems of Accounts” for electric utilities, natural gas companies and

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<sup>75</sup> One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.

<sup>76</sup> See, e.g., 15 U.S.C. § 79a(b)(2) (setting forth the legislative basis for PUHCA, including that investors and consumers may be adversely affected “when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm’s-length bargaining or from restraint of free and independent competition”).

<sup>77</sup> See *Violet v. FERC*, 800 F.2d 280, 282 (1<sup>st</sup> Cir. 1986).

oil pipelines that require these companies to maintain detailed accounting records, including information concerning loans and other transfers between jurisdictional entities and their affiliates.<sup>78</sup> Such records are subject to FERC inspection and review, presumably a deterrent to improper interaffiliate financial transactions.<sup>79</sup> Most specifically directed at the potential problems of interaffiliate transactions are FERC's "standards of conduct" that apply to companies engaged in interstate electricity or natural gas transmission. The standards of conduct are designed to prevent electric utility companies or gas pipelines, which often exercise monopoly or near-monopoly control over transmission in a given geographic area, from offering to sell and transmit electricity and natural gas to or for their affiliates except to the same extent and under the same terms that the deals are offered to others. Among other things, the standards of conduct require generally that employees involved in the transmission of electricity or natural gas must function independently of those engaged in the wholesale trading of these commodities.<sup>80</sup>

All in all, however, such measures are relatively modest and apparently proved completely inadequate to deter Enron, as the company now appears to have engaged in a number of inappropriate interaffiliate transactions. Perhaps most notable of these interaffiliate transactions are loans that two of Enron's natural gas pipeline subsidiaries obtained for their parent company last November. Specifically, on November 1, 2001, as Enron struggled to avoid bankruptcy, the company announced that JP Morgan Chase & Co. and Citigroup Inc. had

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<sup>78</sup> 18 C.F.R. Parts 101 (electric utilities), 201 (natural gas companies), and 352 (oil pipelines). The relevant statutes require these companies to keep financial accounts, records and memoranda such as may be prescribed by the Commission as necessary or appropriate. 16 U.S.C. § 825(a) (Federal Power Act); 15 U.S.C. 717(g) (Natural Gas Act); 49 App. U.S.C. 20 (Interstate Commerce Act).

<sup>79</sup> 16 U.S.C. § 825(a); 15 U.S.C. 717(g); 49 App. U.S.C. 20.

<sup>80</sup> 18 C.F.R. Part 37 (standards of conduct for electric utilities); 18 C.F.R. Part 161 (standards of conduct for natural gas companies). The Commission has recently proposed a single, new set of standards of conduct that would apply to both natural gas pipelines and electric utilities and would broaden the affiliate relationships covered by the standards. Standards of Conduct for Transmission Providers, 66 Fed. Reg. 50919 (Notice of Proposed Rulemaking, October 5, 2001). Though not a codified requirement, individual companies typically also have "codes of conduct" that govern the relationship between the company's power marketing arm and its traditional public utility affiliates. *See, e.g., Heartland Energy Services, Inc.*, 68 F.E.R.C. 61,223, 62,064-65 (1994) (describing the actions the company, as a condition of it being granted the authority to charge market-based rates, has agreed to take in order to prevent "affiliate abuse").

committed to loan it a total of \$1 billion.<sup>81</sup> The loans were actually made to two of Enron's FERC-regulated, interstate pipeline subsidiaries – Northern Natural Gas Company (\$450 million) and Transwestern Pipeline Company (\$550 million) – and were secured by the assets of those pipeline companies. The vast majority of these loan proceeds were subsequently transferred to Enron in the form of unsecured loans from the pipelines to their parent company.<sup>82</sup> After Enron declared bankruptcy a few weeks later, it made no payments on these loans, and the pipeline companies (which did not file for bankruptcy) were left to pay off the entire amount of the obligations to the banks – a matter of concern because ordinarily such costs would be passed on to shippers who use the pipelines, and ultimately to retail natural gas customers.

In March 2002, FERC began a nonpublic investigation relating, in part, to these transactions and related financial practices,<sup>83</sup> and on August 1, 2002, issued an Order to Respond to Northern Natural and Transwestern, directing those companies to “state why they have not violated the Commission’s Uniform System of Accounts for natural gas companies, and why the costs and indebtedness associated with [the November loans] were not imprudently incurred and therefore unrecoverable by the pipelines in any future rate proceedings before [FERC].”<sup>84</sup> One of the pipeline companies, Northern Natural (which is no longer owned by Enron), has entered into a consent agreement with FERC and agreed not to include the costs associated with the

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<sup>81</sup> “Enron Secures Commitments for Additional \$1 Billion in Financing,” Enron Corp. Press Release, November 1, 2001. The loans were made through the banks’ investment banking arms, JPMorgan and Salomon Smith Barney Inc., respectively. A portion of the loan made by Citigroup was used by Enron to pay off an earlier, unsecured loan from Citigroup, with the apparent result that Citigroup was able to replace its unsecured debt with secured debt shortly before Enron’s bankruptcy. See *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002) at 3.

<sup>82</sup> Transwestern and Northern Natural provided the loans to Enron in exchange for promissory notes that stated they were subordinated to prior payment of all senior indebtedness upon the dissolution, liquidation, or reorganization of Enron. See *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002). The loans transactions with Transwestern was entered into November 13, 2001; the transaction with Northern Natural was entered into November 19, 2001.

<sup>83</sup> Specifically, the investigation was regarding “financial data related to transactions, activities and accounting practices that may have impaired the financial condition of entities subject to the Commission’s jurisdiction for the benefit of corporate parents or other affiliates or associated entities of jurisdictional companies.” See *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order to Respond, Issued August 1, 2002) at 2.

<sup>84</sup> *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order to Respond, Issued August 1, 2002), at 1.

controversial loan in any future rate proceedings;<sup>85</sup> the other, Transwestern, continues to dispute FERC's allegations, arguing that the loans were in fact prudent given the facts known at the time.<sup>86</sup>

In addition to these enormous loans, there is preliminary evidence suggesting that Enron may have engaged in a more extensive practice of exploiting the cash generating powers of its pipeline subsidiaries. Documents prepared by JP Morgan Chase in connection with its consideration of the November pipelines loans note that "for years, cash from the pipelines has been used to support operations at Enron Corp."<sup>87</sup> At minimum, accounting practices by Enron's pipeline subsidiaries leave open questions about the nature of Enron's interaffiliate transactions. The pipeline companies, as well as certain other Enron subsidiaries regulated by FERC, had "cash management agreements" with Enron, whereby, at the end of each day, all remaining cash at the subsidiaries was transferred to Enron, which held and invested it; the subsidiaries themselves maintained no cash reserves. This cash management practice is not unique to Enron.<sup>88</sup> Nonetheless, Enron appears to have made more extensive use of it than did other energy companies. Information provided by FERC reveals that the amounts transferred by Enron-owned pipeline companies to Enron in 2000 was substantially greater than the amounts transferred by subsidiaries owned by others in the industry to their parents.<sup>89</sup> Moreover, the amount transferred

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<sup>85</sup> *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (Order Approving Stipulation and Consent Agreement, issued August 8, 2002).

<sup>86</sup> Response of Transwestern Pipeline Company, *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-00 (filed September 3, 2002).

<sup>87</sup> JP Morgan Global Syndicated Finance, "Structuring Summary, Project Bluehorseshoe," September 17, 2002, at 3.

<sup>88</sup> Such cash management practices can provide benefits, such as ensuring that money from all affiliates are invested rather than sitting idle. They also have risks, however: funds swept into a parent's account typically become the property of the parent and the subsidiary loses all legal interest in those funds. As became apparent in the case of Enron, this arrangement can be particularly problematic when one of the companies files for bankruptcy. See Regulation of Cash Management Practices, 67 Fed. Reg. 51150, 51151 (Notice of Proposed Rulemaking, August 7, 2002).

<sup>89</sup> According to data made available by FERC to Committee staff, Enron-affiliated gas pipeline companies in 2000 had an average balance in their Accounts 146 – accounts used to record receivables from associated companies – of approximately \$195 million, while non-Enron pipelines had an average Account 146 balance of slightly over \$6 million. "Account 146 (Accounts Receivable from Associated Companies) balances as of year end," table prepared by FERC staff.

by Enron subsidiaries itself grew sharply from 1997 to 2000.<sup>90</sup>

In investigating the cash management practices of Enron and others in the industry, FERC found that the records kept were often inadequate to enable a clear understanding of the companies' financial practices, including, for example, whether and to what extent the parent companies were paying interest to the subsidiaries on the moneys that had been transferred to the parent.<sup>91</sup> With respect to Enron, FERC has alleged that its pipeline subsidiaries did not even have written agreements with Enron governing their cash management practices.<sup>92</sup> As a result of its investigation, FERC recently proposed to amend its rules governing the Uniform Systems of Accounts to mandate changes in how cash management agreements are administered and reported. FERC's proposal would also limit the amount of funds that can be swept from a subsidiary subject to FERC's jurisdiction to a parent company; under the proposed rules, subsidiaries would have to maintain at least 30% of their capital in their own accounts.<sup>93</sup>

In addition to possibly exploiting its pipelines to boost its own financial position, it appears that Enron also used another affiliate, Portland General Electric (PGE), to engage in improper transactions affecting the California power market.

On May 22, 2002, PGE responded to a FERC request that participants in the California and Western markets document whether they had engaged in alleged abusive trading practices.<sup>94</sup> This request was made as part of the Commission's on-going investigation into Enron's trading practices in the California market. While stating in its response that it "does not believe that it has engaged in the strategy contemplated in the Enron memoranda or by the Commission's

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<sup>90</sup> The average Account 146 balance for Enron-affiliated gas pipelines companies increased from approximately \$44 million in 1997 to approximately \$195 million in 2000. "Account 146 (Accounts Receivable from Associated Companies) balances as of year end," table prepared by FERC staff.

<sup>91</sup> Regulation of Cash Management Practices, 67 Fed. Reg. 51150, 511152 (Notice of Proposed Rulemaking, August 7, 2002).

<sup>92</sup> *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (Order to Respond, issued August 1, 2002) at 4. Transwestern has disputed these allegations. See Response of Transwestern Pipeline Company, *In re Investigation of Certain Financial Data*, FERC Docket No. IN02-6-000 (filed September 3, 2002) at 23-28.

<sup>93</sup> Regulation of Cash Management Practices, 67 Fed. Reg. 51150, 51151 (Notice of Proposed Rulemaking, August 7, 2002).

<sup>94</sup> Response of Portland General Electric Company to the Commission's May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002).

request for admission,” PGE nonetheless acknowledged that “some transactions conducted by Portland General during 2000-2001 may have resulted in the company purchasing power from the Cal PX [California Power Exchange] and reselling power from its portfolio of supplies at prices higher than those paid to the Cal PX.”<sup>95</sup>

As part of its response to the Commission, PGE also included transcripts of some of its trading transactions, which include discussions of a series of transactions that PGE engaged in at the request of Enron traders in the spring of 2000. The apparent purpose of some of these transactions was to assist Enron in exporting power from California, with the intention of reimporting it back to the state at a higher price. According to a legal analysis done in 1999 at PGE’s request, Enron’s power marketing arm believed that they had found a “loophole in the design of the new competitive marketplace in California which can be exploited to make a profit. . . .”<sup>96</sup> These transactions also included so-called “sleeve transactions,” where a third party is used to facilitate transactions between affiliates who are otherwise prohibited from trading by FERC’s standards of conduct and the companies’ codes of conduct. In one of the transcripts provided by Portland General, a power scheduler for Washington Water Power – which served as a third party in one transaction – explained to his PGE counterpart that he was “. . . sleeving it [the power] just because you can’t buy it. They [Enron] can’t sell it to you.”<sup>97</sup>

The transcripts also suggest that some Portland General personnel may have been uncomfortable with some of these transactions. For instance, one PGE employee responsible for scheduling power transmission, told another employee “I’ll sure be glad when we’re sold and they can’t pull this [expletive] anymore.”<sup>98</sup> Despite the scheduler’s stated concern, the transactions she was discussing were processed.

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<sup>95</sup> *Id.* at 6. For more on Enron’s allegedly abusive practices in the California market, see Subsection D, below.

<sup>96</sup> Memorandum from John Mass, LeBoeuf, Lamb, Greene & MacRae L.L.P., to File, August 2, 1999, at 3; (Attachment II.B.-133 to Response of Portland General Electric Company to the Commission’s May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

<sup>97</sup> Transcript of Portland Scheduling Calls, April 15, 2000, at 2 (Attachment III.B.-87 to Response of Portland General Electric Company to the Commission’s May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

<sup>98</sup> Transcript of Scheduler Telephone Conversation, April 6, 2000, at 29 (Attachment III.B.-46 to Response of Portland General Electric Company to the Commission’s May 8, 2002 Data Request and Request for Admissions, *Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, FERC Docket No. PA02-2-000 (filed May 22, 2002)).

In August 2002, FERC opened formal investigations into questionable transactions in the California energy markets between Enron and PGE and between Enron and others using PGE as a middleman, looking at whether, among other things, the companies violated the Commission's standards of conduct; these investigations are ongoing.<sup>99</sup>

While it is a positive development that FERC is now investigating potential wrongdoing concerning Enron's interaffiliate transactions and seeking to strengthen some of the relevant accounting rules, at the same time it is troubling that FERC failed to address these issues at an earlier stage. In the case of the pipeline loans, the Commission seems to have been largely blind to the possibility of financial chicanery in interaffiliate transactions. Despite periodic audits of company accounts and records, FERC apparently did not fully appreciate the inadequacy of much of the information being kept or the significance, for example, of large interaffiliate financial transfers, and such practices were not identified as problems warranting Commission action until after Enron's collapse.<sup>100</sup> With respect to Enron's transactions with PGE, FERC already has rules restricting interaffiliate sales of power or power transmission capacity that apparently prohibited these transactions. The Commission, however, has not developed the capacity to monitor whether interaffiliate transactions are in fact taking place or the terms or circumstances of those transactions. Unfortunately, it is not enough to simply set up the market rules; to fulfill its mission FERC must understand what is actually happening in the market. Without doing so, FERC is left to hope, but not to know, that the rules are being followed.

#### D. California/Western Market Trading and Marketing Abuses

Severe energy problems in California began in the spring of 2000, only two years after the state's energy deregulation plan was put into place. FERC had already received reports from energy experts in California that raised concerns about the exercise of market power as far back

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<sup>99</sup> *Portland General Electric Company et al.*, FERC Docket No. EL02-114-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002); *Avista Corporation et al.*, FERC Docket No. EL02-115-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002).

<sup>100</sup> FERC staff had performed audits of Transwestern and Northern Natural in 2000 for the years 1997-1998, for the limited purpose of validating the annual charges to be paid by the pipeline companies to the agency (which were based on gas revenues). See Letter from John M. Delaware, Deputy Executive Director and Chief Account, Office of the Executive Director, FERC to Robert Chandler, Director, Accounting and Reporting, Transwestern Pipeline Company, dated October 11, 2000; Letter from John M. Delaware, Deputy Executive Director and Chief Account, Office of the Executive Director, FERC to Robert Chandler, Director, Accounting and Reporting, Northern Natural Gas Company, dated October 11, 2000. In addition, regulated companies must submit certain financial information annually to FERC, including the amount of receivables from associated companies (so-called Account 146 data).

as 1998.<sup>101</sup> The state's investor-owned utilities placed the blame for the crisis on power sellers and marketers who, they said, were unfairly manipulating the system to score tremendous profits. The power marketers, on the other hand, pointed to flaws in the structure of the new California system.

FERC staff investigated allegations of possible market abuses in the summer and fall of 2000. They concluded that power sellers had the *potential* to manipulate the power market, but the Commission staff stated that there was no evidence to indicate whether any individual company engaged in *actual* market abuse. In its response to the staff report, the Commission agreed with this conclusion, stating: "While this record does not support findings of specific exercises of market power, and while we are not able to reach definite conclusions about the actions of individual sellers, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the [Federal Power Act]."<sup>102</sup>

The staff report suggested that further investigation was needed before determining whether the power sellers and marketers did, in fact, manipulate the system.<sup>103</sup> However, it took 15 months – until February 2002, after Enron had collapsed and questions were raised about its business practices – before the Commission would order an investigation into the market behavior of individual companies. Once begun, however, this preliminary investigation would uncover evidence suggesting that some of the types of abuses that had been alleged to take place in California did, in fact, occur.

In August 2002, Commission staff produced an interim investigative report that described the manipulative trading practices that Enron's traders and others had allegedly engaged in.<sup>104</sup> Based on the findings of this report, the Commission is now conducting three formal investigations to further review allegations that individual companies, including Enron,

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<sup>101</sup> Market Surveillance Committee of the California ISO, "Preliminary Report on Operation of the Ancillary Services Markets of the California System Operator (ISO)," August 19, 1998; Market Monitoring Committee of the California Power Exchange, "Report on Market Issues in the California Power Exchange Energy Markets," August 17, 1998.

<sup>102</sup> *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,121, 61,350 (Market Order Proposing Remedies for California Wholesale Electric Markets, issued November 1, 2000).

<sup>103</sup> "Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities," FERC, November 1, 2000, at 5-16.

<sup>104</sup> Initial Report on the Western Energy Markets, note 58, above.

manipulated the California market.<sup>105</sup> Last month, Timothy Belden – who headed Enron’s Western trading desk – pled guilty to a charge of conspiracy to commit wire fraud based on allegations that, from 1998 to 2001, he and others at Enron engaged in trading strategies designed to manipulate energy prices in the California market.<sup>106</sup>

As noted earlier, we cannot say with certainty that an earlier investigation and more aggressive activities by the Commission would have prevented Enron’s collapse. However, because of the California power crisis in 2000 and early 2001, FERC specifically examined the operation of those markets and was presented with the opportunity, if not the obligation, to review Enron’s trading practices. An earlier examination by the Commission of the type of practices engaged in by Enron could have led to an earlier investor and regulatory review of Enron’s vaunted commodity trading business, and then to larger questions about its business activities. This did not occur.

The fact that the Commission is only now investigating allegations of market abuse by individual companies is deeply troubling, particularly for the many consumers who were adversely affected by the California power crisis. Without the threat of timely enforcement by a regulatory agency to hold market participants accountable, rules cannot serve their purpose as a deterrent to abusive market action.

#### 1. *Power Crisis in California*

In the late 1990s, California became one of the first states to deregulate its electricity industry. As part of its deregulation plan, the State’s large investor-owned utilities (IOUs) were required to divest themselves of large portions of their generating capacity.<sup>107</sup> Instead of generating it themselves, the IOUs were required to purchase electricity on several complex wholesale spot markets established by the California Power Exchange (PX) and the California Independent System Operator (ISO). Through these markets, thousands of transactions were conducted each day. Electricity was bought and sold for the “day-ahead” market, for the “same-day” market, and for other electricity supply components, such as extra generating reserves.

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<sup>105</sup> *Portland General Electric Company et al.*, FERC Docket No. EL02-114-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002); *Avista Corporation et al.*, FERC Docket No. EL02-115-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002); *El Paso Electric Company et al.*, EL02-113-000 (Order Initiating Investigation and Establishing Hearing Procedures and Refund Effective Date, issued August 13, 2002).

<sup>106</sup> Plea Agreement, *United States v. Belden*, No. CR 02-0313 MJJ (N.D. Cal. October 17, 2002); Information, *United States v. Belden*, No. CR 02-0313 (N.D. Cal. October 9, 2002).

<sup>107</sup> The California IOUs retained their nuclear plants, and some other assets, but were required to sell the electricity produced by these plants into spot markets established by the California Power Exchange (PX).

Once the IOUs purchased the electricity on the wholesale market, they could, in turn, deliver it to their customers through the state-wide electric grid. The California deregulation plan also established the ISO to operate this grid and to ensure that there was an adequate supply of electricity to meet customers' demands. When there was a shortage in the supply of electricity relative to the demand on the California PX, the ISO would purchase additional energy. The price the ISO would pay power sellers and marketers, such as Enron, for this additional energy was capped when the power was purchased from in-state sources; when the ISO purchased from out-of-state sources, however, there was no price cap.

In addition to wholesale price caps, California's deregulation plan also required a freeze on retail electricity rates. While this freeze was often described as a "cap" on retail prices, it was originally considered a *minimum* floor price that the IOU could charge its customers. This floor price would allow the IOUs to recover the cost of investments, known as "stranded costs," that were made during their tenure as regulated monopolies. Retail rate freezes are common in essentially all deregulation plans. In California's case, the freeze stayed in effect until all of the individual utilities' stranded costs were recovered or until March 2002, whichever came first. Consequently, when San Diego's IOU recovered all of its stranded costs in 1999, retail rate "caps" for the area were lifted. Rate caps remained in place for other consumers who were served by IOUs that had not recovered all of their stranded costs.

The energy crisis in California began in the spring of 2000 when a power shortage in the wholesale market increased the price of electricity that IOUs were purchasing on the California PX. The absence of retail rate caps for the San Diego IOU meant that the additional costs on the wholesale market could be transferred directly to its ratepayers. As a result, these ratepayers saw their electric bills increase by 200 to 300 percent. However, consumers served by the other California IOUs were not immediately affected by the wholesale price spikes. Their IOUs had not fully recovered their stranded costs, and as such, were still operating under the retail price caps. Because of these caps, the IOUs were not allowed to transfer their additional costs to consumers. As a result, IOUs began losing large sums of money. One IOU was even forced into bankruptcy.

On June 28, 2000, the California ISO responded to the crisis by lowering the wholesale price caps for power generated within the state and purchased by the ISO on its spot market. The cap was reduced from \$750 per megawatt hour to \$500, and later \$250, in an attempt to lower how much the power sellers and marketers were charging the ISO and, in turn, reduce the rates for consumers.<sup>108</sup>

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<sup>108</sup> According to a presentation made by Southern California Edison to the Director of FERC's Office of Markets, Tariffs, and Rates (OTMR), the total cost of electricity for California for the month of June 2000 even under the \$750 cap was over \$3.6 billion, roughly half of what the state had spent for electricity for the entire year of 1999. Southern California Edison Company, "Status of California Electricity Markets," August 3, 2000.

2. *FERC's Investigation of the California and Western Markets*

As problems arose in 2000, there is a strong argument that the Commission – which had jurisdiction over trades through the California PX and ISO because they involved wholesale sales of electricity – should have shown greater concern based on previous reports it received of possible anti-competitive behavior in the market.<sup>109</sup> Certainly, problems in the California market were not a new issue to FERC. For example, in an August 19, 1998 report to the ISO board that was transmitted to FERC the same day, the Market Surveillance Committee for the PX found that the market was not functioning in a competitive manner.<sup>110</sup> Even more forcefully, in another report to FERC from the same time period, the Market Monitoring Committee for the PX found that “the current market problems are sufficiently severe that they call for short-term intervention in the markets, such as price caps.”<sup>111</sup>

On July 26, 2000, FERC ordered its staff to investigate the five so-called “bulk power” markets in the U.S. to examine how the electricity markets in different regions were functioning. On August 23, 2000, FERC initiated a second, formal investigation in response to a complaint filed by San Diego Gas & Electric pursuant to Section 206 of the Federal Power Act.<sup>112</sup> The FERC Chairman also directed the staff to accelerate the portion of the bulk power investigation relating to the California and Western markets so that it could be used to inform the

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<sup>109</sup> By contrast, the State of California was primarily responsible for overseeing retail power sales. To the extent that the ISO had been delegated authority by FERC to set rate caps for wholesale power, these caps only applied to in-state generators. It is alleged that Enron took advantage of this situation by exporting power from California with the intention of re-importing it back to the state. See Memorandum from Christian Yoder and Stephen Hall, Stoel Rivers LLP, to Richard Sanders, re: Traders Strategies in the California Wholesale Power Markets/ISO Sanctions, December 6, 2000, at 6-7. By doing so, the company could apparently avoid the price caps that the ISO placed on California-generated power and receive higher payments for electricity that appeared to be generated out-of-state. Only FERC had the authority to regulate power imported from one state to another.

<sup>110</sup> Market Surveillance Committee of the California ISO, “Preliminary Report on Operation of the Ancillary Services Markets of the California System Operator (ISO),” August 19, 1998.

<sup>111</sup> Market Monitoring Committee of the California Power Exchange, “Report on Market Issues in the California Power Exchange Energy Markets,” August 17, 1998.

<sup>112</sup> *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 92 F.E.R.C. 61,172 (Order Initiating Hearing Proceedings To Investigate Justness And Reasonableness Of Rate Of Public Utility Sellers In California ISO and PX Markets And To Investigate ISO and PX Tariffs, Contracts, Institutional Structures And Bylaws; And Providing Further Guidance To California Entities, issued August 23, 2000).

Commission's decisions regarding the California market.<sup>113</sup>

On November 1, 2000, the FERC staff released its report on the California and Western bulk power market and the causes of the summer 2000 electricity price spikes. The report, and the subsequent changes proposed by the Commission, focused on the structural problems in the California market, rather than on the specific actions of individual companies operating within the market.<sup>114</sup>

The investigation leading up to the November 1 report was extremely limited in scope and duration – the staff conducting the investigation was not even given subpoena authority, and the investigation was completed in a very short period of time (roughly three months). Although the Commission directed the staff to focus on California and the Western markets in its August 23, 2000 order, there does not in fact appear to have been any significant shift in investigative priorities. Staff reports for all five bulk power regions, including the California/Western report, were issued on the November 1, 2000 date originally established in July. In addition, key market participants, observers and regulators, such as utility commissions in surrounding Western states and the Bonneville Power Administration, were never interviewed even though the report repeatedly acknowledges that the Western market is an interconnected, interdependent market.<sup>115</sup>

Because of the limited scope of their investigation, FERC staff did not pursue all of the major potential problems that existed in the California market. Most notably, FERC staff failed to fully address allegations of market manipulation by individual power selling companies operating in California. For instance, FERC staff appears not to have given sufficient attention to reports done by a variety of California sources regarding market behavior. On August 10, 2000, for example, the Department of Market Analysis of the California ISO issued a report that examined price spikes that had occurred in May - June 2000. The ISO report found that market participants were exercising market power, stating “the observed market power was the combined effect of the bidding activity of in-state and out-of-state generation resources.”<sup>116</sup> An even more detailed analysis of the California market was submitted to the Commission by the

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<sup>113</sup> “Commission Addresses California Electricity Markets, Orders Investigation,” FERC Press Release, August 23, 2000; *see also San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 92 F.E.R.C. at 61,603.

<sup>114</sup> “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” November 1, 2000.

<sup>115</sup> Although the report lists entities with whom interviews were done, many of the listed “interviews” were group meetings with FERC staff and not what Committee staff view as investigative interviews.

<sup>116</sup> Department of Market Analysis, California Independent System Operator, “Report on California Energy Market Issues and Performance: May-June, 2000,” August 10, 2000, at 5.

ISO on October 20, 2000.<sup>117</sup>

As they acknowledge in their November 1, 2000 report, FERC staff was aware of such “concerns” about market abuses, including the exporting of power out of California. They noted that one of these concerns was “that generators exporting power were gaming the system in order to increase prices.”<sup>118</sup> Their report goes on to observe that “(t)he concern seems to be that megawatts are exported by the very same entities who then sell the megawatts back in real time at high prices. Several generators reported contracting a significant proportion of their supply forward outside of California, and the buyers of that power may have exported it back to California at some later date.”<sup>119</sup>

Representatives of California’s investor-owned utilities also met with the co-director of the FERC investigation and other FERC staff on August 17, 2000, to discuss this export issue and other allegations of market abuse. One of the utilities, Southern California Edison, presented a detailed list of alleged trading abuses such as intentional creation of transmission system congestion and megawatt laundering – the export of power out of California and the subsequent re-importation at higher prices.<sup>120</sup>

Despite this evidence of possible market abuse that FERC staff had received, their November 1, 2000 report concluded that there was nothing to indicate whether an individual company engaged in *actual* market abuse. Instead, the staff suggested that power sellers and marketers had merely the *potential* to exercise market power in the summer of 2000. They stated that further investigation was needed to “substantiate any charges of market power abuse,” and presented the Commission with the option of continuing the investigation to examine these alleged market power abuse issues in greater detail.<sup>121</sup>

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<sup>117</sup> Declaration of Eric Hildebrandt, *San Diego Gas & Electric Co. v. All Sellers of Ancillary Services*, F.E.R.C. Docket No. EL00-95-000, attached to Letter from Edward Berlin, Swidler Berlin Shereff Friedman, LLP to the Honorable David B. Boerges, Secretary, FERC, dated October 20, 2000.

<sup>118</sup> “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” FERC, November 1, 2000, at 5-14, 5-15.

<sup>119</sup> *Id.* at 5-15.

<sup>120</sup> Gary Stern, Southern California Edison, “California Electricity Markets: Issues for Examination,” August 17, 2000.

<sup>121</sup> “Staff Report to the Federal Energy Regulatory Commission on Western Markets and the Causes of the Summer 2000 Price Abnormalities,” November 1, 2000, at 5-16.

Coincident with the publication of the bulk power investigation reports, the Commission on November 1, 2000 also issued an order finding that “(w)hile this record does not support findings of specific exercises of market power, and while we are not able to reach definite conclusions about the actions of individual sellers, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight, and can result in unjust and unreasonable rates under the FPA.”<sup>122</sup> The order went on to propose a variety of mitigation measures aimed at changing the operation of the California spot markets operated by the California PX and the ISO; initial mitigation measures were actually imposed by a further Commission order on December 15, 2000.<sup>123</sup> (It should be noted that this initial mitigation order would prove wholly inadequate to address the crisis in California and FERC was forced to put substantially stronger measures in place the following spring.)

While issuing its mitigation proposals, the Commission did nothing to address the problem of individual companies’ abusive practices, including responding to staff’s proposal to continue its investigation, for almost 15 months after receiving the staff bulk power report. This was despite the fact that FERC continued to receive additional evidence that market abuse was occurring. In February 2001, for example, the market oversight unit of the California ISO, responding to reports that FERC had insufficient data on market abuse, submitted a new study of the bidding behavior of 15 individual companies, including Enron. Finally, on February 13, 2002, the Commission ordered FERC staff to begin a preliminary investigation.<sup>124</sup>

With one exception – a single, isolated instance involving standby generation units being withheld from service – the February 13, 2002 order was the first action that FERC took to independently investigate the market behavior of any electricity market participant in the California and Western markets. And it took an additional six months before FERC initiated formal investigations of such participants. Had the Commission agreed to start a more thorough investigation immediately following the release of the November 2000 staff report, it may well have uncovered earlier the type of evidence it believed necessary to substantiate the charges of market abuse in California.

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<sup>122</sup> *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,121, 61,350 (Order Proposing Remedies for California Wholesale Electric Markets, issued November 1, 2000).

<sup>123</sup> *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 93 F.E.R.C. 61,294 (Order Directing Remedies for California Wholesale Electric Markets, issued December 15, 2000).

<sup>124</sup> *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 F.E.R.C. 61,165 (Order Directing Staff Investigation, issued February 13, 2002).

Indeed, on October 3, 2000 – nearly a month before the staff’s bulk power report was issued – Enron itself began its own internal investigation<sup>125</sup> of the company’s trading practices in the California energy market when outside attorneys and senior Enron legal counsel and staff met in an all-day session with Enron traders in Portland, Oregon.<sup>126</sup> This meeting included, among others, Timothy Belden, Richard Sanders, who headed litigation for Enron North America, and Mary Hain, a director in Enron’s Government Affairs department, who, as discussed below, had a couple of months earlier given a presentation to FERC staff on issues related to the California market.<sup>127</sup> A follow-up meeting with senior Enron legal staff (including Sanders) was held on November 4-5, 2000.<sup>128</sup> Another meeting took place in December 2000.<sup>129</sup>

Enron’s internal investigation ultimately resulted in a December 6, 2000 memorandum that analyzed in detail a range of strategies that Enron traders may have used to exploit the structure of the California market to increase Enron’s profits – the so-called “Get Shorty,” “Death Star,” “Fat Boy,” and “Ricochet” trading strategies – and discussed the “sanction provisions of the California Independent System Operator (‘ISO’) tariff.”<sup>130</sup> As the head of Enron’s Western trading desk at the time, Timothy Belden was a participant in the internal investigation that produced these memoranda. As noted above, Belden subsequently pled guilty

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<sup>125</sup> This internal investigation of its trading practices was initiated by Enron in order to respond to subpoenas and inquiries from the California Public Utility Commission, and to related inquiries and litigation. See Deposition of Christian Good Yoder, *Nevada Power Company et al. vs. Duke Energy Trading and Marketing et al.*, FERC Docket No. EL02-26-000 *et al.*, June 18, 2002, at 20 (hereinafter, “Yoder Deposition”).

<sup>126</sup> Deposition of Stephen C. Hall, *Nevada Power Company et al. vs. Duke Energy Trading and Marketing et al.*, FERC Docket No. EL02-26-000 *et al.*, July 11, 2002, at 18 (hereinafter, “Hall Deposition”); Yoder Deposition at 27; Invoice from Stoel Rives LLP to Christian Yoder, Enron Capital & Trade Resources Corp, re: Enron North America, California Power Matters, dated November 27, 2000 (itemizing attorney services), available at <http://caag.state.ca.us/newsalerts/2002/02-058.htm>.

<sup>127</sup> E-mail from Mary Hain to James Steffes, et al, dated August 29, 2000 (Enron document no. ECu000060541); Hall Deposition at 18.

<sup>128</sup> Yoder Deposition at 48.

<sup>129</sup> *Id.* at 50.

<sup>130</sup> Memorandum from Christian Yoder and Stephen Hall, Stoel Rivers LLP, to Richard Sanders, re: Traders Strategies in the California Wholesale Power Markets/ISO Sanctions, December 6, 2000. There is another, nearly identical version of this memorandum that is dated December 8, 2000. Both versions of the memorandum were released to the public by FERC on May 6, 2002.

to a charge of conspiracy to commit wire fraud, related to allegations that he engaged in trading strategies designed to manipulate prices in the California energy market. In his plea agreement, Belden acknowledged that between 1998 and 2001, he and “other individuals at Enron agreed to devise and implement a series of fraudulent schemes” in the California market that were designed to “obtain increased revenue for Enron from wholesale electricity customers and other market participants . . . .”<sup>131</sup>

### 3. *Enron’s Efforts to Influence FERC*

Enron was heavily invested in the success of the deregulation of energy markets in general and in California in particular.<sup>132</sup> Deregulation represented opportunities for its energy trading and energy services businesses, as well as new market opportunities in the United States and overseas. It was important to Enron, therefore, that the California crisis not be blamed on deregulation or market systems or on the market players in a deregulated environment.

Documents obtained by the Committee indicate that Enron attempted to directly and indirectly influence FERC’s investigation of the California market and subsequent decision-making. As indicated by an internal e-mail obtained by the Committee, and confirmed by the Commission staff, Enron representative Mary Hain made a presentation to the FERC “bulk power” investigation team on August 24, 2000 as part of a meeting that the team held with a group of power marketers.<sup>133</sup> The message Enron sought to convey was that high prices in California were the result of scarce supply and that FERC should be “discouraged . . . from taking any action that would hurt the vibrant wholesale market in the [sic] California and the rest

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<sup>131</sup> Plea Agreement, *United States v. Belden*, No. CR 02-0313 MJJ (N.D. Cal. October 17, 2002); Information, *United States v. Belden*, No. CR 02-0313 (N.D. Cal. October 9, 2002).

<sup>132</sup> For example, on January 20, 2000, Enron held its annual equity analyst conference, announcing “(g)rowth prospects remain strong for Wholesale Energy Operations and Services, Enron’s largest business. Wholesale energy growth in North America is expected to be driven by the continuing deregulation of power markets in the United States and large-scale outsourcing utilities and large energy consumers.” A year later, at the January 2001 conference, Enron announced increased earning targets based in part on “Enron’s further strengthening of its long-standing lead in the North American wholesale energy market, significant expansion of its European wholesale energy business, and extension of Enron’s business model into new, large markets” as well as a doubling in its retail energy business. See “Enron Hosts Annual Analyst Conference; Provides Business Overview and Goals for 2000,” Enron Corp. Press Release, January 20, 2000; “Enron Announces Increased Earnings Target for 2001 to \$1.70 - \$1.75 Per Share,” Enron Corp. Press Release, January 25, 2001.

<sup>133</sup> E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000 (Enron document no. ECu000060541); Letter from Kevin F. Cadden, Director of External Affairs for FERC, to David Berick, Senate Committee on Governmental Affairs, dated June 19, 2002.

of the West. . . .<sup>134</sup> According to an internal Enron e-mail, on August 25, 2000, Timothy Belden, then head of Enron's Western trading desk, had a discussion with FERC investigators and sent them another presentation – “What To Do About Western Wholesale Markets?” – which reiterated this basic message that the price spikes were due to physical supply shortages and structural flaws in the California market.<sup>135</sup>

Even after the Commission issued its initial mitigation order in December 2000, Enron continued to be actively involved in efforts to address the California crisis. For example, Ken Lay met with members of the Clinton Administration in early January 2001 to discuss the crisis. On January 9, 2001, Lay attended a “summit” organized by the White House to talk about possible solutions to the energy crisis in California. The President's chief economic advisor Gene Sperling, FERC Chairman James Hoecker, Treasury Secretary Lawrence Summers and Secretary of Energy Bill Richardson were among the 30-50 people that attended the summit.<sup>136</sup> On January 13, 2001, Ken Lay also participated in what appears to be a follow-up meeting to the January 9 summit.<sup>137</sup>

Thereafter, the company launched a major public relations and lobbying campaign in early 2001 apparently designed to indirectly influence the outcome of FERC's decision-making with regard to California. The Enron campaign consisted of an extensive multi-faceted effort to influence policy decisions not only in California, but throughout the Western U.S., in other key markets such as New York, where it was feared that other potentially damaging electricity shortages and price spikes would occur, and at the federal level.<sup>138</sup> The campaign was directed by Enron's corporate head of government affairs with the assistance of the Washington DC-

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<sup>134</sup> E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000, (Enron document no. ECu000060541).

<sup>135</sup> E-mail from Mary Hain to James Steffes, *et al.*, dated August 29, 2000 (Enron document no. ECu000060541); Tim Belden, Enron North America, Presentation on “What To Do About Western Wholesale Markets?,” August 25, 2000 (Enron document nos. ECu000060613-ECu000060664). FERC staff could not confirm that the discussion had taken place, but acknowledged that they do have a copy of the presentation.

<sup>136</sup> Letter from James J. Hoecker, Swidler Berlin Shereff Friedman LLP, to Susan J. Cort, Esq., Office of General Counsel, FERC, March 12, 2002, at 3; Carolyn Lochhead, “Progress Toward Deal to Cut Power Cost / D.C. energy talks run late into night,” *San Francisco Chronicle*, January 10, 2001.

<sup>137</sup> Letter from James J. Hoecker, Swidler Berlin Shereff Friedman LLP, to Susan J. Cort, Esq., Office of General Counsel, FERC, March 12, 2002, at 3.

<sup>138</sup> Enron Corp., “Advancing Electric Competition in the Wake of California; Enron's Campaign to Affect Policy and Public Opinion,” February 5, 2001 (Enron document nos. ECp000061965-ECp000062027).

based lobbying firm Quinn, Gillespie and Associates.<sup>139</sup>

A February 5, 2001 briefing on the campaign identified six overall objectives – “Isolate California and communicate a market based message; Retain a market-based electricity structure in California; Minimize California impact and Governor Davis’ message across the West; Facilitate federal action: FERC and Congress; Identify and manage potential energy crisis in other states–New York, Florida, others?; Refine and increase public affairs effort among policy makers, the media, opinion makers, electricity consumers.”<sup>140</sup>

As the campaign progressed, the goals and objectives were refined. A May 4, 2001 campaign briefing identified five federal goals relevant to FERC: to encourage FERC and the White House to promote competition in electric markets; to convince FERC to extend its jurisdiction over all aspects of electricity transmission, including over federal, state, and municipal power agencies that are not otherwise subject to FERC jurisdiction; to encourage the Administration to complete confirmation of its FERC nominees; to educate Members of Congress and the Administration about the West Coast energy crisis and encourage them to allow the market to work and to take efforts to increase supply and reduce demand; and to block price cap legislation and administrative orders.<sup>141</sup>

As reflected in the May 4 briefing, one of Enron’s goals was to complete the confirmation of FERC nominees in hope of creating a more proactive FERC that would address the growing threat that the California crisis presented to deregulation. On January 8, 2001, Enron’s Chairman and Chief Executive Officer Kenneth Lay wrote to Clay Johnson, Executive Director of the Bush-Cheney Transition team, and Vice President-elect Cheney, to offer Enron’s recommendations on “the kind of individuals we think you should be looking for” when filling vacancies at FERC.<sup>142</sup> Attached to the letter was a list of seven potential candidates, with brief

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<sup>139</sup> *Id.* at Enron document no. ECp000061966. In addition to its work on Enron’s California campaign, Quinn Gillespie and Associates also lobbied the White House on behalf of Enron on other issues, such as the National Energy Policy. *See, e.g.*, E-mail from Ed Gillespie to Andrew D. Lundquist, dated April 3, 2001, 3:47 pm (Office of the Vice President document no. 188); E-mail from Ed Gillespie to Andrew D. Lundquist, dated April 3, 2001, 9:48 am (Office of the Vice President document no. 479).

<sup>140</sup> Enron Corp., “Advancing Electric Competition in the Wake of California; Enron’s Campaign to Affect Policy and Public Opinion,” February 5, 2001 (Enron document nos. ECp000061965-ECp000062027), at Enron document no. ECp000061967.

<sup>141</sup> Enron Corp., “Advancing Electric Competition in the Wake of California; Enron’s Campaign to Affect Policy and Public Opinion,” May 4, 2001 (Enron document nos. 000003222-000003237), at Enron document no. ECu000003226.

<sup>142</sup> Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. (continued...)

biographies of each candidate, including Pat Wood and Nora Brownell. Lay called Johnson twice to follow up on the January 8<sup>th</sup> letter.<sup>143</sup> A February 12, 2001 memo to Mr. Lay from Linda Robertson, head of Enron's Washington office, described Enron's priorities in preparation for a call by Mr. Lay to Mr. Johnson concerning "...Commissioner vacancies at FERC." The memo stated that "Enron has strongly supported Pat Wood, a Republican, as Commission Chairman." The memo continued, "(a) number of candidates are said to be under consideration for the second Republican seat at FERC. Enron has on several occasions discussed with transition and now Bush Administration officials the candidacy of Nora Brownell as our first pick for the second open seat." The memo noted that Ms. Brownell was under consideration "on the strength of Enron's interest," but faced competition from another candidate reportedly supported by Pennsylvania Governor Tom Ridge and that Enron was working to "...mitigate the Governor's alleged concerns with her candidacy."<sup>144</sup> In addition, Lay called Senior Advisor to the President Karl Rove to express his support for Nora Brownell's appointment to FERC.<sup>145</sup>

Even after Wood and Brownell were nominated, it appeared that Enron's government affairs office continued to push for a quick confirmation of their nominations. In a memo to Lay prior to his April 17, 2001 meeting with the Vice President, Linda Robertson and Tom Briggs, who oversaw federal regulatory affairs for Enron, urged him to "...take the opportunity to convey to the Vice President the imperative of an expedited confirmation of Pat Wood and Nora Brownell." The memo suggested that their appointments would "...mitigate one of the significant political problems confronting passage of the Administration's energy agenda, namely the call by Democrats and Western state members for price caps." It further suggested that these appointments would allow FERC to

'release some of the political steam in the system' by adopting more visible pricing steps in Western markets, such as the bid cap measures in place in Texas and the Northeast ISO. Thus, more aggressive action by the FERC on both market power issues and pricing issues would give the Administration enormous political cover and would allow them to redefine the debate on their own terms.<sup>146</sup>

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(...continued)

Lieberman, dated May 22, 2002, Attachment at 2; Letter from Kenneth L. Lay to Clay Johnson, dated January 8, 2001 (Executive Office of the President document nos. 980-982).

<sup>143</sup> Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 2.

<sup>144</sup> Memorandum from Linda Robertson to Ken Lay, dated February 12, 2001 (Enron document nos. EC 000123909).

<sup>145</sup> Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 1-2.

<sup>146</sup> Memorandum from Linda Robertson and Tom Briggs to Ken Lay, re: Meeting with  
(continued...)

According to Ms. Robertson, the confirmations were not actually discussed during the meeting with the Vice President.

Beyond the matter of FERC nominees, Enron executives appeared to bring their message on the California power crisis directly to key Bush Administration officials. On April 5, 2001, Jeffrey Skilling met with Secretary of Treasury Paul O'Neill, and other Treasury Department officials, to discuss the West Coast energy crisis.<sup>147</sup> Ken Lay and Linda Robertson apparently raised the California issue during their 30 minute meeting with the Vice President on April 17, 2001.<sup>148</sup> The White House has indicated that Assistant to the President and Director of the National Economic Council Larry Lindsey had "a few communications" with Ken Lay, "most likely about the California electricity shortage."<sup>149</sup>

It is, of course, difficult to evaluate the impact of Enron's far-reaching efforts on decision-making at FERC. As detailed above, for a long time FERC insisted (and to some extent still does insist) that the problems in California were the result of structural flaws in market design and declined to investigate the possibility that there had been abusive behavior on the part of individual energy companies – a position consistent with that advocated by Enron. It is impossible to know how much Enron's lobbying campaign influenced FERC's thinking on this issue and how much FERC was simply predisposed to this view. It should be noted that when the crisis in California became severe, FERC, on June 19, 2001, did ultimately issue an order extending price caps and other mitigation measures to the entire Western market,<sup>150</sup> a decision contrary to one of Enron's stated goals. In response, Enron found it necessary to immediately issue a press release from then-CEO Jeffery Skilling, reiterating his confidence that price controls would not have an impact on Enron's earning targets for both the second quarter and the year.<sup>151</sup>

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(...continued)

Vice President Cheney, dated April 13, 2001, (Enron document nos. EC2 000026045-26105), at Enron document no. EC2 000026052.

<sup>147</sup> Letter from John Duncan, Assistant Secretary for Legislative Affairs, Department of the Treasury, to Senator Joseph I. Lieberman, Chairman, Committee on Governmental Affairs, dated April 22, 2002, at 1.

<sup>148</sup> Letter from Alberto R. Gonzales, Counsel to the President, to The Honorable Joseph I. Lieberman, dated May 22, 2002, Attachment at 3.

<sup>149</sup> *Id.* at 2.

<sup>150</sup> *San Diego Gas & Electric Co. v. Sellers of Energy Ancillary Service*, 95 F.E.R.C. 61,418 (Order on Rehearing of Monitoring and Mitigation Plan for the California Wholesale Electric Markets, Establishing West-Wide Mitigation, and Establishing Settlement Conference, issued June 19, 2001).

<sup>151</sup> "Enron Reiterates Confidence In Operations and Earnings Outlook," Enron Press Release, June 19, 2001.

Nonetheless, documents reviewed by the Committee show that Enron did aggressively pursue this campaign including contacts with Western governors and regulators and contacts with the Administration to promote the nominations of Nora Brownell and Pat Wood, to discuss the California energy crisis, and to promote open access and competition in electricity markets during the Administration's deliberations on energy policy.

### III. CONCLUSION AND RECOMMENDATIONS

For many years, FERC has been at the forefront of the restructuring of the wholesale electricity and natural gas markets from ones based on FERC-determined cost-of-service rates to markets based on competition. Throughout this process, FERC has both recognized the need, and yet inexplicably failed, to establish a framework to effectively regulate the sale and delivery of natural gas and electricity in the new, competitive markets it was creating. The General Accounting Office (GAO)<sup>152</sup> has previously told us as much. And now, Enron provides a striking case study of many of the inadequacies of FERC's current regulatory system – inadequacies that apparently allowed Enron officials to engage in a variety of questionable and, in some cases, allegedly fraudulent financial and commercial transactions at the expense of customers, investors, and competitors.

Although FERC's Chairman has acknowledged some of these structural shortcomings in both formal agency comments to GAO and in an August 12, 2002, letter to Chairman Lieberman, the Committee staff investigation of FERC's interactions with Enron indicates that the proposals being made by FERC do not appear adequate to address the range of regulatory challenges that confront FERC in this new environment – challenges exemplified by Enron Corp. as it aggressively sought to take advantage of the flaws, gaps, and inadequacies in the regulatory system.

One of FERC's chief responses has been to create a new Office of Market Oversight and Investigations (OMOI) dedicated specifically to oversee the electric and natural gas markets.<sup>153</sup> While it is too early to conclude whether this new office will address the sorts of problems raised by Enron's trading practices and other types of market manipulation that occurred in the California and Western energy markets, Committee staff seriously doubts that without more it will transform the agency into the proactive, aggressive regulator needed to protect consumers

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<sup>152</sup> U.S. General Accounting Office, "Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight," GAO-02-656, June 2002.

<sup>153</sup> OMOI was formally created on August 12, 2002. The other initiatives include: promotion of regional transmission organizations, revision of public utility filing requirements, promulgation of standard market design rules, and promoting development of energy infrastructure.

from the greed and subterfuge Enron's collapse revealed.<sup>154</sup>

Simply rearranging the bureaucracy, however, is not the answer. FERC must work in concert with other regulatory agencies; it must request and be given sufficient resources to monitor the marketplace and carry out all of its regulatory responsibilities, and it must retool what goes on under its own regulatory roof not only within OMOI, but throughout the agency. Simply put, FERC must reorient itself to a changed and increasingly complex competitive industry – a change that FERC itself has fostered, but failed to adapt to.

Orienting the Mission Toward Proactive Oversight and Enforcement Throughout the Agency

FERC has not institutionally accepted regulation and enforcement as a primary mission, nor has it taken sufficient steps to reassure Committee staff that it will. The new market oversight office, even if staffed sufficiently and run well, is not designed to address problems identified in the Committee staff investigation such as FERC's ineffective handling of the status of Enron's wind farms or its QF certification process generally, or oversight of financial transactions regulated subsidiaries and holding companies. In other examples of FERC's lax attitude towards its regulatory duties, the agency received an anonymous complaint on April 26, 2002, about pricing practices of Enron's oil pipeline subsidiary, EOTT Partners. The complaint was filed into FERC's information management system without any review by FERC staff, even though the Commission was actively investigating other Enron trading activities.<sup>155</sup> Nor did FERC feel compelled to implement the Federal Civil Penalties Inflation Act as amended by the 1996 Debt Collection Improvement Act, which required it to increase civil penalties. It took a letter from GAO on July 16, 2002, asking about FERC's compliance to jog the agency to action.<sup>156</sup> These are all regulatory functions outside the purview of the new office.

The establishment of the OMOI does not absolve FERC of the responsibility to aggressively address problems throughout its jurisdiction. **If FERC is to be an effective protector, regulator, and overseer of the nation's increasingly deregulated energy marketplace, it must recognize the need for a total cultural reorientation of its regulatory approach.**

<sup>154</sup> As part of its effort to strengthen its enforcement activities, FERC has requested that Congress expand its civil and criminal penalty authority under the FPA and Natural Gas Act. We support this request and believe that is important to give FERC additional and/or stronger enforcement tools. We also note, however, that such tools will almost certainly be inadequate without an overall reorientation of the Commission's enforcement efforts.

<sup>155</sup> Unsigned memo to Federal Energy Regulatory Commission, "SUBJECT: Tip on Enron Corp's crude oil price fixing," filed by FERC April 26, 2002.

<sup>156</sup> See Letter from Pat Wood, III, Chairman, FERC, to The Honorable Joseph H. [sic] Lieberman re: FERC's Compliance (RM02-11-000) with the 1990 Federal Civil Penalties Inflation Act, As Amended, dated August 28, 2002.

### Allocation of Resources

Examining FERC's commitment to enforcement resources is one way to measure its institutional priorities. Yet even in an area FERC claims is a high priority, it falls short. FERC appears to have committed fewer staff and less resources to monitoring and policing the market compared to the efforts of many other independent regulatory agencies.

In his letter to Chairman Lieberman outlining FERC's response to the GAO report, FERC Chairman Wood reported that the Commission had initially transferred 57 employees to the new OMOI office, that it intended also to move attorneys involved in enforcement actions to the new office, and that it was recruiting for additional positions. Altogether, in its FY 2003 budget request, FERC asked for 110 full-time equivalents (FTEs) for the new office and identified a total of 250 FTEs as participating in agency-wide monitoring and enforcement activities.<sup>157</sup> The remaining 140 or more FTEs would be in other offices with responsibilities involving litigation and dispute resolution, rulemakings, identification of data requirements, mergers and other corporate applications, and financial auditing that could broadly be attributed to market monitoring and enforcement.<sup>158</sup>

Based on the total number of FTEs requested for the entire agency for FY2003, FERC intends to allocate only 8.8 percent of its FTEs to the OMOI. Even if we assume all 250 FTEs are dedicated to market oversight, 20 percent of the agency's FY2003 FTEs would be committed to broadly defined market oversight and enforcement responsibilities.<sup>159</sup>

This resource commitment appears to be less than that of other independent regulatory and enforcement agencies. A review by the Congressional Research Service estimates that the CFTC, SEC and Federal Trade Commission (FTC) have committed FY2003 FTEs of roughly 28 percent, 33 percent, and 60 percent, respectively, of their total agency FTEs to enforcement.<sup>160</sup>

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<sup>157</sup> Federal Energy Regulatory Commission, FY2003 Congressional Budget Request and Annual Performance Plan, February 2002; Letter from Pat Wood, III, Chairman, FERC, to the Honorable Joseph H. [sic] Lieberman, re: GAO Report Entitled Energy Markets: Concerted Actions Needed by FERC to Confront Challenges that Impede Effective Oversight, dated August 19, 2002, at 2 and Attachment C.

<sup>158</sup> E-mail from Don Chamblee, FERC, to David Berick, Senate Committee on Governmental Affairs, dated February 25, 2002, and attached memorandum "Response to David Berick Concerning the Need for an Additional \$7 Million and 50 FTEs."

<sup>159</sup> The President's FY2003 Budget Request for the Federal Energy Regulatory Commission requests a total of 1250 FTEs for FERC.

<sup>160</sup> "Enforcement Activities at Selected Federal Agencies," Congressional Research  
(continued...)

The same review reported that the Federal Communications Commission (FCC) allocated approximately 14 percent of its FY2003 FTEs specifically to its Enforcement Bureau and overall dedicated a total of approximately 31 percent of its FTEs to enforcement activities across several bureaus. If we look at budget dollars, FERC intends to devote less than 15% of its FY2003 budget to these activities, whereas the CFTC budgets 28% and the FCC budgets 24%.

Although these interagency comparisons are obviously not precise, they provide at least one indicator of the priority given to enforcement and oversight activities by other federal regulatory agencies. Given the array of problems FERC faces, it does not measure up well. **FERC must devote more resources to market oversight and enforcement.**

#### Coordination with Other Agencies

As the markets and activities FERC regulates become more complex, they frequently involve the jurisdiction of more than one federal agency. FERC, however, has not made coordination with other agencies a priority.

In the case of SEC-administered PUHCA exemptions, discussed above, that affected the FERC-determined QF status of Enron's wind farms, the SEC and FERC never discussed how to coordinate even the exchange of information concerning exemption requests filed with the SEC. Indeed, even after Southern California Edison petitioned both the SEC and FERC about the status of the wind farms last March and April, there was no interagency communication in response. More fundamentally, FERC and the CFTC have yet to figure out their respective roles in an increasingly sophisticated energy market that involves both physical energy products and commodities futures and other derivatives – whether the issue involves oversight of online trading platforms or some other aspect of the market. Notably, FERC does not even have interagency information or regulatory coordination agreements with either the CFTC or the SEC, nor with other key regulatory or financial agencies. Although interagency agreements are not a necessity for agencies to work together, it is essential that the agencies in fact coordinate. These types of agreements are a basic, first step for such coordination.

Subsequent to Enron's collapse, FERC has begun to take some tentative steps toward improved coordination with other federal agencies. In December, for example, the FERC Chairman sent a letter to the Chairman of the CFTC asking to discuss how the two agencies could better work together, and FERC is currently coordinating its investigation in the California and Western markets with other federal agencies. Nonetheless, this coordination is not routine for the agency nor fully embedded in its understanding of its mission. **FERC must make coordination with other federal regulatory agencies an institutional priority.**

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<sup>160</sup>(...continued)  
Service, September 6, 2002.

Intra-Agency Communication

Finally, this memorandum has highlighted a number of instances where important information developed or uncovered by staff in one part of the agency has not made its way to other parts of the agency or to the Commission. A failure to communicate or share important information within the agency is a failure to perform the basics of the job.

One example is the FERC staff's Enron Online report which looked at Enron's highly leveraged financial condition but was not given to the Commissioners even as Enron was collapsing. Another example, with perhaps even clearer consequences, relates to the Commission's consideration of how to calculate refunds to consumers in the California electricity market. At the same time the Commission was deliberating on this matter, there were two FERC staff inquiries examining directly relevant issues. The first was the Enron Online inquiry which looked at published price indices and ultimately concluded that they were unreliable. The second was a series of audits conducted by the Office of the Chief Accountant examining the cost of generating the electricity that was being sold by individual companies into the California market; a memo was even written by the Chief Accountant to the Chief of Staff and other senior managers at FERC stating that information contained in the audits would likely be of value to those working on the refund matter.<sup>161</sup> Yet, Committee staff found that none of this information was presented to the Commission nor made available to participants in the refund proceeding. The reliability of the Commission's preferred refund methodology has subsequently been brought into question; indeed, the FERC staff's 2002 initial report on the California markets has recommended that the refund methodology be revised because it's based on faulty price indices. This will likely result in further delays in getting deserved refunds to consumers.

Having capable staff able to ask the right questions is critical, but will not solve FERC's problems if the information the staff uncovers does not make its way to the Commission and others at the agency who can make use of it. **FERC must improve its internal coordination of staff activities and communication with the Commissioners themselves.**

Conclusion

FERC's experience with Enron demonstrates that the agency is no match for the sophisticated, competitive, profit-driven companies it regulates. Although the creation of OMOI is a positive development, unless it is adequately and appropriately staffed and supplemented with more aggressive regulatory efforts throughout the Commission, it is unlikely to succeed in transforming FERC into the effective market overseer it needs to be.

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<sup>161</sup> Memorandum from John M. Delaware, Deputy Executive Director and Chief Accountant to Walter C. Ferguson, Chief of Staff, Daniel L. Larcamp, Director, Office of Markets, Tariffs and Rates, and Kevin P. Madden, General Counsel on "Audit of the Component Costs of Generating Electric Power," undated, at 1 (according to FERC staff, the memo was prepared on July 20, 2001).

FERC must do far more to be vigilant, to incorporate an aggressive enforcement ethic into its everyday work, to effectively coordinate with other agencies, and to ensure that relevant information is made available to those who need it in order for FERC to fulfill its mission and to protect consumers and investors in the increasingly complex and continually evolving energy markets.

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### Enron Federal Government Affairs - Outlook & Goals for 1999

The Congress will follow the regular process of adopting an annual budget and going through the expiring authorization programs, appropriating the necessary annual funds and considering a variety of tax measures and cuts. Enron will have a significant interest in various aspects of this process.

All currently introduced legislation which has not been enacted into public law will expire upon the adjournment of the 105th Congress. Congress has targeted adjournment for October 9<sup>th</sup> and should convene the 106<sup>th</sup> Congress on January 27<sup>th</sup>.

#### Tax Issues

1) Product Tax Credit for Enron Wind Power: The production tax credit extension may not occur in 1998. There is also a chance because the PTC does not expire until June 30, 1999 and the other extenders have already expired, we will not be extended this year. Goal: Production tax credit extension of five years (we will likely get only three years; we will have to decide whether to go for the additional years.)

2) Foreign Tax Simplification Issues: Four items in the Foreign Tax Simplification bill currently introduced by Congressmen Houghton and Levin and Senators Hatch and Baucus. Even if the House does a big bill in the 105<sup>th</sup> Congress, only two issues will likely be included in the bill this year. One will be the exclusion for foreign-owned pipeline income. The other is the exclusion for transmission of high voltage electricity (similar to the pipeline issue.) Goal: Pass all foreign tax simplification issues in 1999. Additional foreign tax issues will likely come to the forefront that haven't yet been considered -- these will come up because of new deals that Enron will be doing internationally and haven't been uncovered yet.

3) Tax-related Derivatives Issues: These issues are included in the Administration's tax proposal. Enron has been working with a coalition lead by White & Case. Goal: Include the derivatives provision in the final tax bill. Continue work with the Tax Department to come up with alternatives to legislation that solve the problem.

4) Alternative minimum tax (AMT) for corporations: Congressman Archer included an AMT provision in 1997, so Congress may not provide additional help this soon. Goal: Additional AMT relief in 1999.

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5) Notice 98-11: IRS Notice 98-11, which would have limited the use of hybrid transactions by multinational companies to reduce their foreign tax liabilities, was put on hold in until later in 1999 or 2000. This issue will likely return either in IRS regulation form or legislation and EOG will want to get involved again. Goal: Work to see that IRS regulations or Congressional action does not prohibit or penalize existing Enron hybrid transactions.

6) Fundamental Tax Reform: Hearings may occur in 1999, as indicated by House Ways & Means Committee who is in charge of this project. Fundamental tax reform will not pass in 1999. Goal: Monitor activity in Congress and possibly participate in hearings. (Enron will need to decide if we want to participate.)

7) Other Tax Issues: Solar Enterprise Zone/Tax Credit.

#### International Issues

1) Foreign Operations Appropriations: FY 2000 foreign operations appropriation legislation, which includes funding for Export-Import Bank (Ex-Im), Overseas Private Investment Corporation (OPIC), and Trade and Development Administration (TDA). There is a possibility that the Administration may submit a supplemental appropriations bill to cover the FY 1999 Ex-Im shortfall, which is \$1 billion lower than current demands on the bank. Goal: Support the highest appropriation for export assistance programs in the FY 2000 Foreign Ops. bill., as well as passage of a possible supplemental appropriation bill for the Ex-Im shortfall.

2) Reauthorization of Ex-Im, OPIC and TDA: Ex-Im Bank's reauthorization expires September 30, 2001. OPIC's authority expires in 1999. Goal: Pass multi-year reauthorizations of OPIC and Ex-Im.

3) Sanctions and other punitive legislation: Legislation placing various sanctions, unilateral and multilateral, on relations with various countries will likely continue to be a major issue in the next Congress. Both religious persecution and child labor sanctions will be carried over from this Congress, as will other unilateral sanctions. Legislation to make it more difficult to implement unilateral trade sanctions through reform of the process that Congress uses in considering sanctions will be carried over from the 105<sup>th</sup> Congress. Goal: Oppose unilateral trade sanctions. Support sanction reform legislation.

- 4) International Monetary Fund (IMF): IMF is facing a significant shortfall in reserve funding, if the 105<sup>th</sup> does not provide adequate funding this may be an issue in the 106<sup>th</sup>. Goal: Support adequate funding for IMF replenishment.
- 5) China NTR: Annual extension of Normal Trade Relations (NTR, formerly known as MFN) with China. Goal: Annual extension of China NTR, or possibly a permanent extension of China NTR.
- 6) Fast Track Authority: Fast track authority allows the President to negotiate trade bills which will be voted on by Congress with a straight up or down vote (i.e. no amendments). Fast track may be voted on by the House before it adjourns this year, but is likely to fail or be pulled from consideration. Goal: Passage of fast track authority in the 106<sup>th</sup> Congress.
- 7) Personnel: Nominations for Ambassadors and Executive Branch Confirmation  
Follow various nominations before the Senate, and support nominations when appropriate.
- 8) Other Issues:
- Repealing Sec. 907 of the Freedom Support Act (Azerbaijan Sanctions), as well as legislation supporting a Trans-Caspian pipeline.
  - Africa Growth and Development Act (if not passed in 105th Congress)
  - Jackson Vanik waiver for Vietnam
  - Support for the Department on Commerce Advocacy Center (in Commerce, Justice State Dept. Appropriations)

Domestic Issues:

- 1) Electricity Restructuring: drafting legislation, testifying at hearings, building coalitions, on-going education and message development. Goal: pass in House transmission reliability, customer choice, energy services, stranded cost recovery, aggregation and PUHCA repeal legislation while successfully modifying damaging language on reciprocity, consumer "right to know", consumer benefits funds, PURPA and environmental provisions.
- 2) Oil & Gas Royalties: Ongoing effort by the Minerals Management Service (MMS) of the Department of the Interior (DOI) to finalize new regulations regarding crude oil royalty valuation, and development of similar regulations for gas, that attempt to capture for the federal government value added downstream of federal lease production. Goal: Reach a permanent solution, rather than continuing to pass appropriations riders to temporarily prevent MMS from finalizing its regulations. This includes, passage of royalty-in-kind legislation, or

some type of negotiated solution between industry and MMS that is legally-binding and monitored by Congress.

3) Commodity Futures Trading Commission (CFTC)/Derivatives: Recent CFTC "concept release" has raised new questions about who has the authority to regulate derivatives. CFTC to be reauthorized before 2000. Goal: Obtain a statutory exemption from CFTC regulation for energy derivatives, prevent a movement of regulatory authority over energy derivatives to other financial regulatory agencies (Fed, Treasury, SEC). Maintain light handed regulation.

4) Global Climate Change/Clean Air: December 1997 Kyoto treaty, as well as EPA actions on CO<sub>2</sub>, NO<sub>x</sub>, particulate matter, and mercury have escalated the debate on clean air regulation and climate change prevention. Goal: Introduction and debate of bi-partisan legislation on "credit for early action" to reduce greenhouse gases and other bills that employ market-based solutions to climate change. Ongoing education of Congress, environmental, and industry groups as to the potential for market based solutions to climate change, as well as support for Enron new business opportunities arising from the climate change debate.

5) Bankruptcy Reforms: provisions in consumer and business bankruptcy legislation could affect federal oil and gas leasing, impacting ECT lending to producers and EOG lease development. Goal: Pass bankruptcy technical corrections that clarify treatment of production payments under the bankruptcy code. Defeat Department of Interior proposals to change the classification of federal mineral leases under the bankruptcy code, work with Congress and possibly DOI to address producer and lender concerns.

6) Houston Ship Channel: Contentious issue over reimbursement for pipeline relocations caused by deepening/widening work performed by the Houston Port Authority and Army Corps of Engineers. Goal: Work with the Port of Houston to identify and pursue federal appropriations that will fund pipeline relocations to at least 50% of the cost. Work to divert possible litigation by pipeline coalition against the Army Corps of Engineers or Port of Houston to recover relocation costs.

7) Hydro Re-licensing: a) Portland General "Pelton Round Butte Project" competitive license application from Warm Springs Tribes, and b) legislation to reform the federal re-licensing process. Goals: a) work with PGE and counsel to identify and educate policy makers within DOI and other environmental/resources agencies and Congress as to why PGE should be granted a renewed license in 2001, or full value of rate based dollars, and b) work with hydropower

industry groups toward introduction of bi-partisan legislation to streamline the re-licensing process.

8) Transwestern/Navajo Nation: negotiations with the Navajo Nation over Standing Rock compressor station construction, 2003 pipeline right-of-way renewal and specific lateral expansion. Goal: Successful agreements for pipeline right-of-way renewal, with government affairs support with Congress and federal agencies.

9) Florida Gas Transmission's SOONER project (CONFIDENTIAL): Proposed FGT construction of an oil pipeline from Baton Rouge, LA to south Florida. Goal: Possible work with U.S. Maritime Administration (MARAD) and Congress to implement reforms to the MARAD loan guarantee program which would mitigate the potential competitive disadvantage to oil pipelines from tankers (without jeopardizing Enron's use of MARAD loan guarantees in power barge projects). Prefer special funding to Sooner for environmental demonstration.

10) Nuclear Waste: PGE requires Nuclear Regulatory Commission approval for one time movement of containment vessel plus permanent waste site. Goal: Achieve NRC approval and heavily monitor permanent waste debate.

11) Treatment of Gas Pipelines on the Outer Continental Shelf (OCS): Clarification is needed to rectify a "dual" transportation market offshore. While 48% of offshore pipelines in the Gulf of Mexico are considered interstate transmission lines subject to FERC regulation, 45% are producer-owned gathering lines not subject to FERC regulation. Goal: legislation or FERC regulation to permit offshore transmission lines to be treated as gathering lines (rather than pipelines regulated by FERC) and establish a complaint process for all pipelines under the OCS Lands Act.

12) Reforms to the National Environmental Policy Act (NEPA): streamline and expedite the way federal agencies do environmental reviews during construction of pipeline, hydropower, water, or other infrastructure projects. Supplement efforts with INGAA study, proposed for 1999.

13) Opening of federal lands to oil & gas exploration and development: position Enron to take advantage of possible trend developing within Department of Energy, Department of Interior, U.S. Forest Service to allow drilling on federal lands. Goal: Work with environmental community and Congress to highlight the advantages Enron brings as a "green" company toward being a good environmental steward for such projects on federal land.

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14) FERC regulatory modernization for gas pipelines: ongoing education efforts with Congress on FERC's efforts to move toward greater competition by modernizing regulation in areas such as treatment of gas pipelines on the outer continental shelf, removing price caps on the short term markets, providing pipelines the ability to negotiate terms and conditions.

15) Environmental issues: monitor and analyze legislation on issues such as Superfund, RCRA, clean water, wetlands, clean air, endangered species, and regulatory reform to look for opportunities for amendments or improvements that would benefit Enron and industry.

16) Department of Defense/Federal Government Privatization: monitor legislation dealing with privatization of DoD and other federal government energy and water facilities. Goal: Support Enron Federal Solutions, Inc. by assisting with meetings and contacts with key policy makers; introduce legislative amendments as necessary to enable goal achievement.

17) Pipeline Safety Reauthorization: ongoing work on legislation and regulation regarding pipeline safety reauthorization, user fees, demonstration projects, improvements to state "one-call" systems, and other safety measures.

18) Health Care Reform: This Congress has been focused on reforming health management organizations and providing patient protections. Similar, and perhaps more far-reaching, proposals may be considered in the next Congress. Goal: Work to ensure that any health care legislation does NOT include increases in employer liabilities beyond current ERISA regulations, loss of employer tax deduction for health care expenses, or significant increases in health care cost to the employer to achieve compliance costs.

19) Private Use: Congress will pass legislation to either repeal or codify the I.R.S. Ruling. Goal: Pass legislation to codify.

20) BPA: Congress will address market power issues and debt issues associated with BPA, TVA and Power Marketing Authorities. Goal: Pass legislation to assure FERC equivalency of all transmission and mitigate market power abuses.

21) Railroads: Congress will have hearings and possible legislation to address monopoly power. Goal: monitor debate and report to ECT.

22) Other Issues:

- Encryption legislation
- Year 2000 (Y2K) Compliance legislation
- Pension Issues (ESOP and Portability)
- OSHA reform

Unanticipated Issues will arise in every Congress which must be addressed as they arise.

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### Overview of Key Energy Policy Issues

The debacle in the California energy market has provided those who do not support or do not understand competitive wholesale markets, an opportunity to exploit problems in an attempt to roll back progress made in restructuring the industry. This has caused Congress and the FERC to focus unwarranted attention on the role of competitive power traders and power plant operators that may have engaged in "price manipulation", "economic withholding" and other alleged dubious behavior. Consequently, policy makers who are not regularly exposed to the workings of energy commodity markets are eager to take measures that they believe will increase transparency and prevent market abuse. Unfortunately, FERC regulators and lawmakers may take actions that could be detrimental to Enron, rather than address fundamental reforms necessary to improve competitive wholesale markets.

Such actions being considered include:

- Legislation prohibiting FERC from mandating utility participation in an RTO.
- Legislation compelling disclosure of information about the quantity and price of each sale of electric energy made in wholesale markets.
- Amending FERC's marketing affiliate rules in such a way as to unduly hinder transactions between gas and power transmission companies and their affiliates.
- Legislation and/or FERC rules restricting the ability of entities to transact under market-based rates if the FERC finds that the market is not "competitive" or if a seller has "unmitigated market power in the generation or transmission of electricity".

Despite temptations and pressure to take such steps, FERC should be commended for continuing to move forward with market reform – especially for its bold (and unanimous) decision to establish 4 large RTOs.

However, there remains a fundamental problem with the lack of understanding among the Commissioners and others formulating energy policy of how commodity markets work and how Enron and its online trading platform actually enhance transparency and competition. The lack of understanding increases the risk that FERC will take remedial measures to address pricing and market manipulation, rather than dealing with the root causes of ineffective wholesale competition. Therefore, throughout the discussions, every opportunity should be taken to explain how Enron and other energy traders contribute to competition and that the FERC should move forward with RTO formation and other fundamental reforms rather than attempt to ferret out non-existent manipulation. You may want to be prepared to discuss the following:

- Overview of how EnronOnline operates and how parties can access EnronOnline to monitor prices. However, it should be emphasized that EnronOnline is not used as a defined reference price for OTC contracts. (If this were the case, there would be heightened concerns about regulating EnronOnline.)
- Explain the role of Enron as a “market maker” and describe how this role contributes to competition and price transparency.
- Explanation of how derivative products and other risk management products contribute to efficiency and benefit consumers.
- Emphasize that underlying fundamentals of the physical market (e.g., supply and demand; transmission constraints; competitive market structure; availability of reliable information) impact the value of derivative products (swaps, options, etc.) – NOT THE OTHER WAY AROUND! Therefore, FERC should focus on correcting the underlying physical operation of the market rather than dwelling on the role of traders.
- Accordingly, Congress and the FERC should take steps to 1) mandate creation of four large regional transmission organizations (RTOs); 2) eliminate the native load exception to FERC open access rules that allows for separate and discriminatory terms of access to the interstate transmission grid; 3) mandate that non-jurisdictional transmission companies participate in RTOs; 4) expedite siting of gas and power transmission facilities and establish uniform and non-discriminatory terms of power plant interconnections to the transmission grid.
- Describe how formation of RTOs and other measures will enhance competition and transparency and how this, in turn, will benefit consumers (particularly in those states that are introducing competition into retail markets).

## ENRON'S FERC PRIORITIES

### Formation of Large Regional Transmission Organizations

#### Background

In 1996, the FERC issued Order No. 888, which required transmission companies subject to FERC jurisdiction to provide non-discriminatory terms of access to its transmission grid. Utilities operating in tight pool arrangements (NYPP, NEPOOL, PJM) were required to either file reformed power pooling agreements or establish an Independent System Operator (ISO) system consistent with the principles outlined by the FERC. Ultimately, NYPP, PJM, NEPOOL and the California utilities opted to form ISOs.

In 1999, the FERC found continued discrimination in the provision of transmission services by vertically integrated utilities. To remedy this discrimination, FERC issued Order No. 2000 that established a *voluntary approach* to formation of regional transmission organizations (RTOs) that would assume operating control of public utilities' transmission assets. The FERC's goal was to form RTOs voluntarily and in a timely manner, but it warned that it would reconsider what other steps it would take to realize its goal of RTO formation.

Clearly dissatisfied with the pace and quality of RTO formation, on July 12, 2001, the FERC unanimously ordered expedited 45-day mediation proceedings to conduct good faith negotiations to address unresolved issues in the formation of independent RTOs in the Northeast (combining the NYISO, NE ISO and PJM) and Southeast regions of the United States. When acting on the July 12 orders, FERC stated its strong preference for a single RTO in each of a handful of regions around the country: the Northeast, the Southeast, the Midwest, and the West. The FERC also indicated its preference to adopt the PJM trading platform, a model that Enron's traders now prefer.

The presiding administrative law judge for each mediation proceeding will file a formal report with the Commission, which will then determine what further action is required. The ALJ has issued its report for the Southeast RTO proceeding and has made recommendations that are favorable to Enron. The ALJ report for the Northeast RTO is due next week.

#### Critical Issues

Despite the FERC's aggressive policy initiative to form 4 large RTOs, the fact remains that compliance is voluntary. Moreover, Transmission Operators that profess a willingness to participate in RTOs (e.g., the NY utilities) are determined to delay the process indefinitely and may refuse to participate in a FERC-defined geographic area. An added complexity that could delay RTO formation is the desire of certain utilities to form stand-alone, for-profit, Transcos that would function within an RTO (e.g., New England).

There is also significant political hostility to the FERC's effort to establish 4 RTOs. A number of State Governments, Members of Congress and State Public Service Commissions have objected to the FERC's bold move, raising concerns about service reliability (especially NY City and Long Island) and objecting to an intrusion on State's rights by the Federal Government. State regulators have also argued that creation of super RTOs will disrupt state retail competition programs that were established in reliance on the existence of existing ISO structures.

Enron is confident that we are winning the RTO battle at the FERC, particularly with regard to implementing RTO trading arrangements conducive to Enron's business. However, Enron is concerned that implementation dates are being unreasonably delayed. In the case of the Northeast RTO, some of the most aggressive advocates argue that a

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realistic commencement date is November 2003. Enron is advocating an implementation date of December 2002.

#### **Enron's Position**

- **RTO participation should be mandatory.**
- **Non-jurisdictional transmission companies (i.e., TVA, munis, co-ops) should be required to participate in RTOs.**
- **The 4 large RTOs articulated by FERC are of sufficient scope and size to promote competition in wholesale and retail markets.**
- **The implementation date of the RTOs should be December 2002.**
- **Although Enron supports the concept of for-profit Transcos, we must be certain that the concept will not delay timely RTO formation.**

#### **Key Points to Raise at Meeting**

1. The Commission has made great progress in the RTO arena recently by advocating four large RTOs in the country.
2. The mediation proceedings were helpful, but strong guidance from the Commission is now needed in the formation of each of the four RTOs:
  - o if important decisions and details are left to stakeholders, no further progress will be made;
  - o the Commission must provide a detailed blueprint for the formation of these large RTOs and then allow stakeholders to work out the remaining details.
3. Although the Commission's jurisdiction and authority to order RTOs are being challenged, there are many options available to the Commission to entice entities to join RTOs:
  - o loss of market based rate authority for failure to join;
  - o a section 206 investigation of all existing wholesale power sales rates to consider and adjust the rates of return;
  - o prohibit governmental transmission owners to utilize other jurisdictional transmission facilities (reciprocity);

We have drafted a pleading laying out these procedural vehicles and would like to file it with the Commission, if this would be helpful.

4. The Commission must remain committed to its "Day 2" RTO implementation date of December 15, 2002. Provided that the Commission gives clear, unambiguous directions on RTO formation, this deadline can be achieved.

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### Market Based Rates and Market Mitigation

#### **Background**

Wholesale power marketers and generators are granted authority to sell power at market-based rates upon demonstrating to the FERC that they do not have, or have adequately mitigated (e.g., by providing open access transmission service) market power in generation and transmission. The market power determination arises in a number of proceedings, particularly in merger and acquisition proceedings and when existing sellers are up for tri-annual sales re-authorization (Enron must file in January of 2003).

In making its market power determination, the FERC relies upon a "hub and spoke" market analysis *that has never resulted in a finding of unmitigated market power*, and thus a denial of market based rate authority. Consequently, the Commission is coming under increased political pressure to re-evaluate its process for granting market-based rates and to consider a more stringent market power evaluation methodology.

Specifically, Commissioner Massey has dissented in a number of recent FERC decisions authorizing market based rate authority. Moreover, Senator Bingaman's energy bill contains language that will make it more difficult for the FERC to grant market based rate authority.

#### **Summary of Issues**

A shift to a more stringent market power analysis will mean that the FERC will find flaws in market operations and barriers to market entry. For example, Massey would widen the analysis of market power to include an examination of transmission constraints, market concentration at various load levels, transmission rates and terms of access, the availability of "appropriate hedging instruments" and other factors. If the Commission finds that the market is not competitive, it can take measures to mitigate market power.

On one hand, a more stringent market power analysis could be beneficial in that it could give the FERC more leverage to attack market structural issues that impede wholesale competition (e.g., lack of RTO participation, other transmission issues). On the other hand, a strict test that cannot be passed invites the Commission to intrude upon market operations of traders and generators whenever the FERC observes pricing that does not comport with expectations.

Moreover, the FERC lacks jurisdiction to address many factors that inhibit effective competition. For example, the Commission may find that market concentration for peak power could be mitigated by retail demand reduction, but it lacks jurisdiction to compel participation by retail customers in a demand reduction program. Therefore, there is a risk that the Commission will rely on price mitigation (price caps) to address the symptoms of inadequate competition rather than tackle the root causes.

### **Enron Position**

The most fundamental barrier to competition in wholesale markets is the lack of effective RTOs. The Commission has ample evidence demonstrating that vertically integrated utilities continue to discriminate in providing transmission access in order to maintain a competitive advantage in supply and generation. Therefore, it is appropriate to consider removal of market based rate authority for transmission owning utilities that continue to delay participation in effective RTOs.

However, there is a danger that the Commission will overreach with its analysis and penalize market participants that are able to contribute to competitive wholesale markets despite existing barriers to entry.

### **Key Points**

- Formation of effective RTOs will address the bulk of any market power concerns. Therefore, inordinate attention on market based rate authority could prove distracting.

### **California and Pacific Northwest Price Mitigation Measures and Refunds**

#### **Background.**

On August 23, 2000, FERC instituted proceedings under FPA section 206 to investigate the rates for energy and ancillary services into the Cal ISO and PX real time markets, in response to a complaint filed by SDG&E. A similar proceeding was initiated by Puget Sound to examine power prices in the Pacific Northwest. On December 15, 2000 FERC issued an order finding that the electric market structure and rules in California were "seriously flawed" and coupled with an imbalance of supply and demand, cause "unjust and unreasonable rates for short-term energy...under certain conditions." The Commission ordered a number of remedies to correct these flaws.

The FERC established an interim market proxy price of \$150 and declared that prices above the proxy were presumed to be unjust and unreasonable unless a party was able to demonstrate otherwise. Failure to justify costs above the clearing price would trigger a refund obligation. The interim methodology was to be replaced by a new methodology by May 1, 2001. On April 26, 2001 the FERC adopted a price mitigation plan for the California market. The FERC modified the price mitigation formula and extended its application throughout the western States in an order dated June 19, 2001. The FERC's June 19<sup>th</sup> decision also ordered a settlement conference to be held before its Chief Administrative Law Judge to resolve refund issues for past periods.

Parties made little progress in settling the refund issues and the ALJ recommended that FERC order a trial type evidentiary hearing limited to developing a factual record against which to apply a refund methodology, and recommended that a refund methodology be applied retrospectively.

On July 25, 2001, the Commissioners substantially adopted the Judge's recommendations and ordered the refund proceeding.

**Status of Proceeding and Key Dates:**

Prehearing conferences have been held on August 13 and September 5. Currently, discovery and case preparation are ongoing. Testimony on the mitigated price and the seller refund amounts/offsets thereto, are due on October 15 and October 26, respectively. The hearing is to occur on November 14-20, and the Judge must certify his findings to the Commission by December 13.

**Summary of Key Issues and Enron's Position:**

Enron has filed a request for rehearing of the FERC's July 25<sup>th</sup> order and it is likely that this will be appealed to the Circuit Court. Enron strongly believes that no refunds, especially retroactive refunds, are warranted. There has been no finding that any market participant in the California spot markets has abused market power. Enron has simply conducted business in accordance with its tariff and all applicable tariffs, rules and regulations applicable in the California wholesale market. However, given the fact that this is a refund proceeding, Enron must be allowed to offset its purchases in the market against any refunds that are attributable to its sales in the market. Enron must also be permitted the opportunity to offset the receivables it is owed by California parties against refund amounts ultimately determined to be due.

**What is at stake for Enron:**

At stake is certainty and finality of transactions in conducting its business in accordance with applicable rules, regulations, orders and laws. Chilling effect on deregulation initiatives throughout the U.S. Financial exposure is also a result. However, the financial exposure in the California proceeding is not considered to be material. If netting between purchases and sales is allowed, Enron estimates that it will owe approximately \$ 4 million. Enron has greater exposure in the Pacific NW proceeding where parties are demanding approximately \$100 million in refunds from Enron.

**Key Points to be Made:**

- Enron recognizes the difficult task that the Commission has confronted over the past year as it attempted to deal with a hopelessly misguided market structure and resulting conditions brought about by political conditions in the state of California. We commend the Commission for having taken forceful and economically rational measures to fix California's market structure. The time has now come to end the investigations related to past activities in electricity markets in California and throughout the WSCC and to move forward for the benefit of the consumers.

### Changes to Transmission Marketing Affiliate Rules.

#### **Background**

In response to the controversy surrounding the activities of El Paso Gas Pipeline and its marketing affiliate, the FERC initiated a review of its existing gas and power marketing affiliate rules to determine whether the rules need to be revised in light of rapidly changing market conditions.

It is anticipated that the FERC will amend the marketing affiliate rule and standards of conduct for natural gas pipelines to more closely resemble the more stringent rules applicable to power transmission providers, particularly with regard to reporting of discounts to affiliates and reporting of transfers between transmission companies and affiliates.

Enron expects that the FERC will issue a notice of proposed rulemaking (NOPR) at the September 26<sup>th</sup> meeting and a final rule may be implemented early in 2002.

#### **Summary of Issues**

Without the benefit of a published NOPR, it is difficult to define the issues being considered. However, Enron's biggest concern is that the Commission will impose unduly restrictive conditions on pipeline marketing affiliates that will impede operations. At this point we do not expect divestiture to be a problem.

#### **Enron Position**

- Enron supports expanding the definition of "marketing affiliate" to include generation affiliates of the gas pipeline.
- Blanket application of the stringent electricity rules to the gas pipeline industry is unwarranted due to the fundamental differences in the structure of the two industries. Specifically, unlike the power industry, the gas industry is completely unbundled and pipelines are not in the merchant business. Therefore, many of the abuses that could occur on the electric side do not occur in the gas business.

#### **Key Points to Raise**

- There are few problems with the existing gas pipeline marketing affiliate rule. The rule has served the industry well for nearly 15 years. The Commission should address the El Paso problem and other allegations on a case-by-case basis and spend their remaining resources on addressing other fundamental problems in the market.
- If the Commission intends to change the rule, it should keep in mind that marketing affiliates are key players in commodity markets and that they should not be unduly burdened with requirements or restrictions that hamper commercial innovation and transactions.

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<i>Jeff Brown, Director</i> 400 Professional Park Drive Goodlettsville, TN 37072	Phone #: 615-851-5499 Fax #: 615-851-5497 Pager #: 888-916-2267	Implementation / Environmental
Assistant: Marcia Linton, EB 1061a	Phone #: 713-853-3226	
<i>Susan Covino, Director</i> 10 Hoagland Drive Belle Mead, NJ 08502	Phone #: 908-359-7658 Fax #: 908-359-0896 Pager #: 888-916-7183	Mid Atlantic / New York / New England
Assistant: Marcia Linton	Phone #: 713-853-3226	
<i>Aleck Dadson, Regional Director</i> ECT Canada Corp. 150 York St., Suite 900 Toronto, Ontario M5H-3S5	Phone #: 416-214-1740 Fax #: 416-214-4540 Cellular #: 416-906-1856 Pager #: 416-468-3049	Canada
Assistant: Cindy Derecskey	Phone #: 416-214-9230	
<i>Jeff Dasovich, Director</i> 101 California Street, Suite 1950 San Francisco, CA 94111	Phone #: 415-782-7822 Fax #: 415-782-7854 Pager #: 888-916-7184	California
Assistant: Christopher Malone	Phone #: 415-782-7841	EC-W 000003398

<p><u>Ashley Dietz, Analyst</u> 1400 Smith Street, EB 1040a Houston, TX 77002</p> <p>Assistant: Margo Reyna, EB1037b</p>	<p>Phone #: 713-853-5309 Fax #: 713-646-8160</p> <p>Phone #: 713-853-9191</p>	South Central / South East
<p><u>Gary Foster, Director</u> 1400 Smith Street, EB 1045a Houston, TX 77002</p> <p>Assistant: Ginger Dernehl</p>	<p>Phone #: 713-853-4527 Fax #: 713-646-8160 Pager #: 888-916-7181</p> <p>Phone #: 713-853-7751</p>	Public Relations
<p><u>Howard Fromer, Director</u> 130 Washington Ave. Albany, NY 12210</p> <p>Assistant: Marcia Linton</p>	<p>Phone #: 518-427-0531 Fax #: 518-427-0734 Pager #: 888-916-2261</p> <p>Phone #: 713-853-3226</p>	Mid Atlantic / New York / New England
<p><u>Bruno Gaillard, Specialist</u> 101 California Street, Suite 1950 San Francisco, CA 94111</p> <p>Assistant: Christopher Malone</p>	<p>Phone #: 415-782-7810 Fax #: 415-782-7854 Pager #: 888-766-4105</p> <p>Phone #: 415-782-7841</p>	California
<p><u>Janel Guerrero, Manager</u> 1400 Smith Street, EB 1039b Houston, TX 77002</p> <p>Assistant: Maureen McVicker</p>	<p>Phone #: 713-853-9104 Fax #: 713-646-8160 Pager #: 888-906-9878</p> <p>Phone #: 713-853-1808</p>	Implementation / Environmental
<p><u>Ed Hamb, Associate</u> 1400 Smith Street, EB 1057a Houston, TX 77002</p> <p>Assistant: Marcia Linton</p>	<p>Phone #: 713-853-9010 Fax #: 713-646-8160 Pager #: 888-794-4467</p> <p>Phone #: 713-853-3226</p>	Mid Atlantic / New York / New England
<p><u>Rob Hemstock, Manager</u> ECT Canada Corp. Suite 3500, Canterra Tower 400 - 3<sup>rd</sup> Ave. SW Calgary, Alberta Canada T2P 4H2</p> <p>Assistant: Linda Sietzema</p>	<p>Phone #: 403-974-6746 Fax #: 403-974-6707 Cellular #: 403-818-6797</p> <p>Phone #: 403-974-6908</p>	Canada
<p><u>Nancy Hetrick, Director</u> 1400 Smith Street, EB 1056 Houston, TX 77002</p> <p>Assistant: Maureen McVicker</p>	<p>Phone #: 713-853-7414 Fax #: 713-646-8160 Pager #: 888-912-1426</p> <p>Phone #: 713-853-1808</p>	Implementation / Environmental

<u>Barbara Hueter, Director</u> 400 Metro Place North Dublin, OH 43017-3375  Assistant: Laurie Knight	Phone #: 614-760-7472 Fax #: 614-791-6149 Pager #: 888-916-2260  Phone #: 614-760-2704	Great Lakes / Midwest
<u>Paul Kaufman, Regional Director</u> Three World Trade Center 121 SW Salmon, 3WTC-0306 Portland, OR 97204  Assistant: Lysa Akin	Phone #: 503-464-7945 Fax #: 503-464-3740 Pager #: 888-916-2262  Phone #: 503-464-7927	West
<u>Robin Kittel, Manager</u> 701 Brazos Street, Suite 310 Austin, TX 78701  Assistant: Margo Reyna	Phone #: 512-320-5974 Fax #: 512-320-5991 Pager #: 888-274-5062  Phone #: 713-853-9191	South Central / South East
<u>Sue Landwehr, Director</u> 5402 Parkdale Drive, Suite 104 Minneapolis, MN 55416  Assistant: Marcia Linton	Phone #: 612-513-5928 Fax #: 612-593-0229 Pager #: 888-916-2264  Phone #: 713-853-3226	Great Lakes / Midwest
<u>Leslie Lawner, Director</u> 712 N. Lea Roswell, NM 88201  Assistant: Marcia Linton	Phone #: 505-623-6778 Fax #: 505-625-2820 Pager #: 800-342-0407  Phone #: 713-853-3226	West
<u>Lara Leibman, Manager</u> 1400 Smith Street, EB 1040b Houston, TX 77002  Assistant: Ginger Dernehl	Phone #: 713-853-9193 Fax #: 713-646-8160 Pager #: 888-274-0741  Phone #: 713-853-7751	Market Power / Code of Conduct
<u>Kathleen Magruder, Vice President</u> 1400 Smith Street, EB 1030 Houston, TX 77002  Austin Office Address: 701 Brazos Street, Suite 310 Austin, TX 78701  Assistant: Margo Reyna	Phone #: 713-853-7225 Fax #: 713-646-8160 Pager #: 888-397-1821  Phone #: 512-320-5965 Fax #: 512-320-5991  Phone #: 713-853-9191	South Central / South East

<u>Sue Mara, Regional Director</u> 101 California Street, Suite 1950 San Francisco, CA 94111 Assistant: Christopher Malone	Phone #: 415-782-7802 Fax #: 415-782-7854 Pager #: 888-916-7185 Phone #: 415-782-7841	Regional Director - California
<u>Sandra McCubbin, Director</u> 101 California Street, Suite 1950 San Francisco, CA 94111 Assistant: Christopher Malone	Phone #: 415-782-7843 Fax #: 415-782-7854 Pager #: 888-916-7187 Cellular: 916-768-7227 Phone #: 415-782-7841	California
<u>Becky Merola, Director</u> 400 Metro Place North Dublin, OH 43017-3375 Assistant: Laurie Knight	Phone #: 614-792-6021 Fax #: 614-791-6149 Pager #: 888-916-2269 Phone #: 614-760-2704	Mid Atlantic / New York / New England
<u>Janine Miquen, Regional Director</u> 400 Metro Place North Dublin, OH 43017-3375 Assistant: Laurie Knight	Phone #: 614-718-6335 Fax #: 614-791-6149 Pager #: 888-916-2270 Phone #: 614-760-2704	Regional Director - Great Lakes Midwest
<u>Steve Montovano, Director</u> 400 Metro Place North Dublin, OH 43017-3375 Assistant: Sharon Eley	Phone #: 614-792-6030 Home Fax #: 614-760-9734 Fax #: 614-791-6149 Pager #: 888-916-7186 Phone #: 800-888-8305 x301	Mid Atlantic / New York / New England
<u>Sue Nord, Director</u> 2 Capitol Plaza Concord, NH 03301 Assistant: Terri Miller	Phone #: 603-224-5942 Fax #: 603-224-7601 Pager #: 800-559-4935 Phone #: 603-223-2520	Policy Development / Coordination
<u>Mona Petrochko, Director</u> 101 California Street, Suite 1950 San Francisco, CA 94111 Assistant: Christopher Malone	Phone #: 415-782-7821 Fax #: 415-782-7854 Pager #: 888-916-7188 Phone #: 415-782-7841	California
<u>Thom Reichelderfer, Manager</u> 400 Metro Place North Dublin, OH 43017-3375 Assistant: Laurie Knight	Phone #: 614-791-6159 Fax #: 614-791-6149 Pager #: 888-916-7189 Phone #: 614-760-2704	Great Lakes / Midwest

<u>Frank Rische, Manager</u> 343 Thornall Street, 5 <sup>th</sup> Floor Edison, NJ 08837  Assistant: Sharon Eley	Phone #: 800-888-8305 x223 Fax #: 732-549-5701 Pager #: 888-916-7150  Phone #: 800-888-8305 x301	Mid Atlantic / New York / New England
<u>Jim Steffes, Senior Regional Director</u> 1400 Smith Street, EB 1060 Houston, TX 77002  Assistant: Marcia Linton	Phone #: 713-853-7673 Fax #: 713-646-8160 Pager #: 888-906-9876  Phone #: 713-853-3226	Mid Atlantic / New York / New England
<u>Jim Tarpey, Director</u> One Tabor Center 1200 17 <sup>th</sup> St., Suite 2750 Denver, CO 80202  Assistant: Jessica Wentworth	Phone #: 303-575-6491 Fax #: 303-534-7607 Pager #: 888-916-2259  Phone #: 303-575-6482	West
<u>Kate Wagner, Manager</u> 1400 Smith Street, EB 1039a Houston, TX 77002  Assistant: Margo Reyna	Phone #: 713-853-5880 Fax #: 713-646-8160 Pager #: 888-208-7447  Phone #: 713-853-9191	South Central / South East
<u>Lisa Yoho, Director</u> 1775 Eye Street NW, Suite 800 Washington, DC 20006	Phone #: 202-466-9155 Fax #: 202-835-0971 Pager #: 888-906-9874	Mid Atlantic / New York / New England

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<u>Tom Defaney, Director</u> 4742 N. 24 <sup>th</sup> Street, Suite 165 Phoenix, AZ 85016	Phone #: 602-840-3800 Fax #: 602-840-3804 Cellular #: 602-321-5017	FERC
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<u>Mary Hain, Director</u> Three World Trade Center 121 SW Salmon, 3WTC-0306 Portland, OR 97204	Phone #: 503-464-8862 Fax #: 503-464-3740 Pager #: 800-905-9242	FERC
Assistant: Lysa Akin	Phone #: 503-464-7927	
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<u>Sarah Novosel, Director</u> 1775 Eye Street NW, Suite 800 Washington, DC 20006	Phone #: 202-466-9160 Fax #: 202-955-8496	FERC
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<u>Charles Yeung, Manager</u> 1400 Smith Street, EB 1036a Houston, TX 77002	Phone #: 713-853-0348 Fax #: 713-646-8160 Pager #: 800-605-8249	FERC
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EC-W 000003403

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<p>Assistant: Earlene Kaiser, EB 50M07</p>	<p>Phone #: 713-853-7870</p>	
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<p>Assistant: Earlene Kaiser</p>	<p>Phone #: 713-853-7870</p>	
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<p>Assistant: Sandy Rodriguez, EB 4359</p>	<p>Phone #: 713-853-7183</p>	
<p><u>Gerriann Warner, Executive Secretary</u> 1400 Smith Street, EB 50M05a Houston, TX 77002</p>	<p>Phone #: 713-853-5036 Fax #: 713-853-7297</p>	

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<p>Assistant: Miriam Brabham, EB1037a</p>	<p>Phone #: 713-345-7407</p>	
<p><u>Roger Fragua, Manager</u> 1400 Smith Street, EB 1036b Houston, TX 77002</p>	<p>Phone #: 713-853-6546 Fax #: 713-646-8160 Pager #: 800-503-6647 Cellular #: 713-907-2600</p>	
<p>Assistant: Miriam Brabham,</p>	<p>Phone #: 713-345-7407</p>	

Mexico		
<p><u>Ricardo Charvel, Director</u> <u>Enron de Mexico</u> Av. Vasco de Quiroga 2121 PH-505 Edificio Corporativo Piramide Col. Pena Blanca Santa Fe Mexico D.F. 01210 Mexico</p>	<p>Phone #: 011-525-258-9925 Fax #: 011-525-570-5372 Cellular #: 011-525-104-5765</p>	<p>EC-W 000003404</p>

<b>Water</b>		
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Assistant: Lora Sullivan	Phone #: 202-466-9142	
<u><i>Cynthia Sandherr, Vice President, Federal Legislative Affairs</i></u> 1775 Eye Street NW, Suite 800 Washington, DC 20006	Phone #: 202-466-9143 Fax #: 202-828-3372 Cellular #: 202-253-2632	
Assistant: Stacey Bolton	Phone #: 202-466-9141	
<u><i>Jeffrey Keeler, Director, Federal Legislative Affairs</i></u> 1775 Eye Street NW, Suite 800 Washington, DC 20006	Phone #: 202-466-9157 Fax #: 202-828-3372 Cellular #: 202-210-9143	
Assistant: Amy Fabian	Phone #: 202-466-9144	
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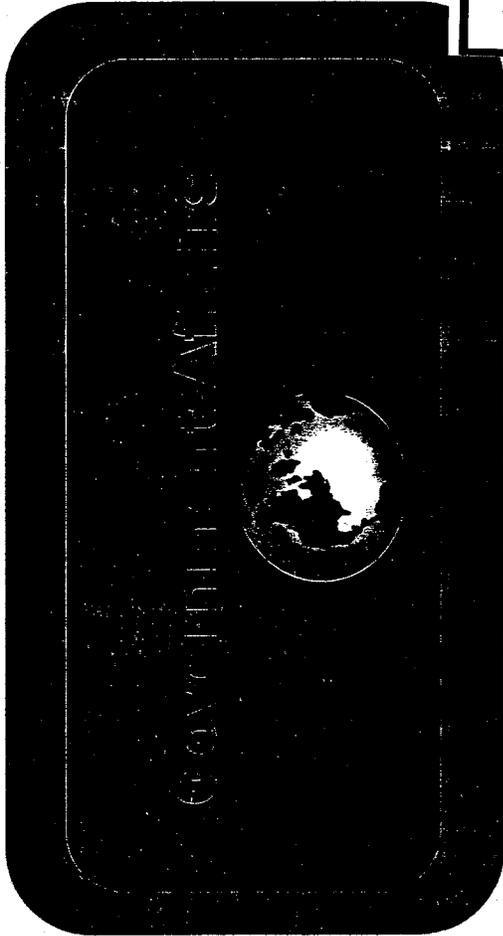
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<b>Competitive Analysis</b>		
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<b>Public Policy</b>		
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Assistant: Joan Stransky	Phone #: 713-853-7431	
<b>Information and Administration</b>		
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<u>Lynnette Barnes, Research Analyst</u> 1400 Smith Street, EB 1061b Houston, TX 77002	Phone #: 713-853-9287 Fax #: 713-646-8160	
<u>Linda Lawrence, Rates/Research Analyst</u> 1400 Smith Street, EB 1062b Houston, TX 77002	Phone #: 713-853-6872 Fax #: 713-646-8160	
<u>Stephanie McMurray, Research Analyst</u> 1400 Smith Street, EB 1062a Houston, TX 77002	Phone #: 713-853-6850 Fax #: 713-646-8160	
<u>Salisha Ramos, Clerk</u> 1400 Smith Street, EB 1054 Houston, TX 77002	Phone #: 713-853-6607 Fax #: 713-646-8160 Pager #: 713-902-9127	EC-W 000003406



Committee on Governmental Affairs

EXHIBIT #A-4



November 2001

EC 000124004

## Enron Government Affairs

- Electricity, natural gas, and telecom are regulated as essential services—politics shapes our markets as much as economics
- Enron Government Affairs responds to this reality by working aggressively in policy arenas to create and protect commercial opportunities (ENA, EES, EBS, EGM, EIM, EN)
- There is significant risk in taking markets as they come
- Recent events are generating political momentum toward the supposed “safety net” of government regulation and away from open markets

EC 000124005

## Government Affairs Current Activities

### *Regulatory Risk Management*

- Protect Enron's retail tariff short position across 30 utilities throughout North America (\$2MM, 6 people)
- Minimize California crisis' impact on Enron, e.g. pursue complaint at CPUC to recoup negative CTC (\$2MM, 6 people)
- Litigate California and Pacific Northwest Refund Proceedings at FERC (\$1MM, 2 people)
- Prevent imposition of exorbitant right-of-way fee on 800 miles of EBS fiberoptic cable on public lands (\$100K, 1 person)
- Preserve EnronOnline's unregulated status; Manage regulatory risk associated with financial trading (\$100K, 2 people)

Note: This is a snapshot of current activities. Resource allocation to specific issues is adjusted over time in response to external events and commercial priorities. Resource numbers reflect: (1) cost of outside services, and (2) FTEs.

EC 000124006

## Government Affairs Current Activities

### *Deal Support*

- Provide regulatory support for sale of PGE (\$0, 2 people)
- Provide regulatory support for siting, interconnection and development of power plants (\$500K, 3 people)
- Provide regulatory support and relationships to assist in development of municipal aggregation programs (\$100K, 2 people)
- Negotiate interconnection agreements for EBS that enable access to wholesale pricing for incumbent network elements (\$500K, 2 people)

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EC 000124007

Note: This is a snapshot of current activities. Resource allocation to specific issues is adjusted over time in response to external events and commercial priorities. Resource numbers reflect: (1) cost of outside services, and (2) FTEs.

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## Government Affairs Current Activities

### Advocacy

- Support FERC initiative to create four Regional Transmission Organizations (\$2MM, 15 people)
  - Congress
  - Administration (FERC/DOE)
  - Governors
  - State Public Utilities Commissioners
  - Other Stakeholders
  
- Support retail electricity market openings in Texas, Nevada, Ohio and Ontario (\$1MM, 6 people)

Note: This is a snapshot of current activities. Resource allocation to specific issues is adjusted over time in response to external events and commercial priorities. Resource numbers reflect: (1) cost of outside services, and (2) FTEs.

SN AL-AG-0901

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EC 000124008

## Government Affairs Current Activities

### Origination

- Working under the auspices of a FERC proceeding to turn back 2 MMcf/day of uneconomic capacity to El Paso (Contract demand is approximately \$2,000,000 per month through 6/2006) (\$25K, 1 person)
- Working with Connecticut officials to obtain state funding for \$124,000,000 fuel cell project (\$150K, 1 person)
- Working with Montana officials to facilitate potential transactions as provider of last resort (\$25K, 1 person)

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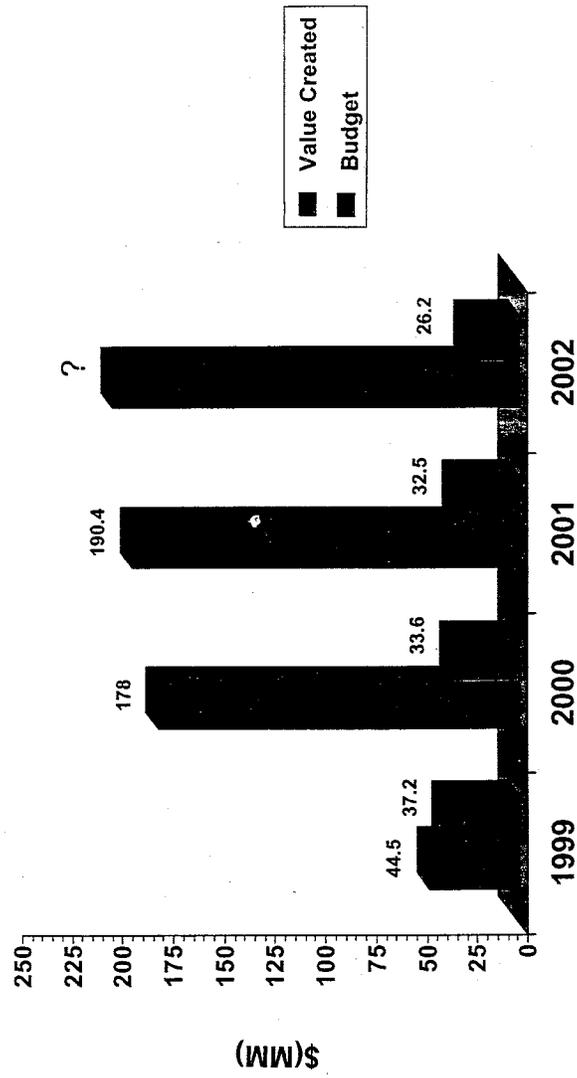
EC 000124009

Note: This is a snapshot of current activities. Resource allocation to specific issues is adjusted over time in response to external events and commercial priorities. Resource numbers reflect: (1) cost of outside services, and (2) FTEs.

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# Government Affairs: Value Created Vs. Budget



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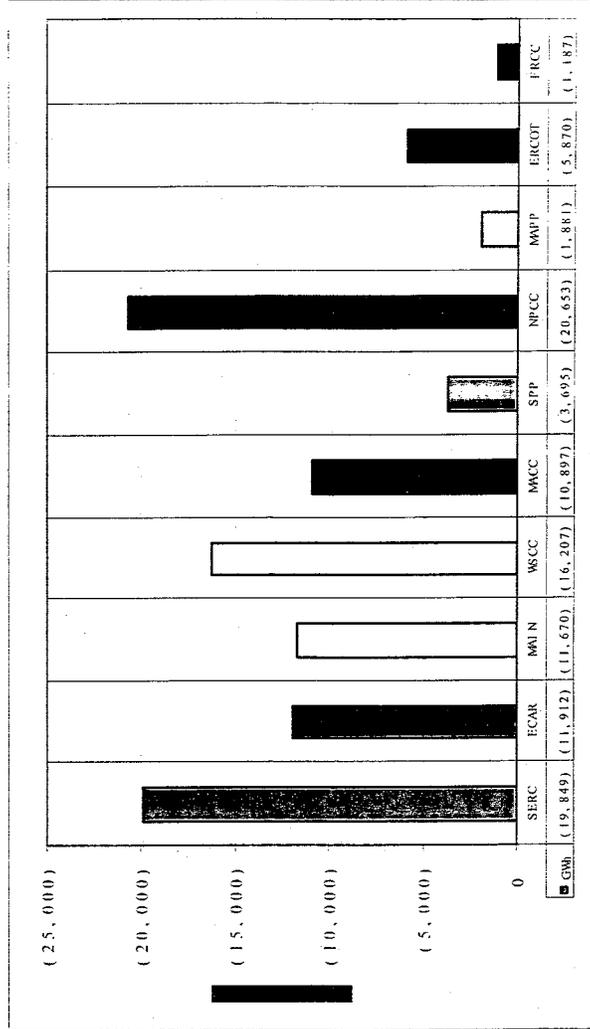
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## EGA Value Created, Sep . 2000 – Sep. 2001

Project	Value
EBS Network ROW	\$50.8 million
EPMI-TVA Settlement	\$29.0 million
Allocation of 3C/KWh Surcharge for PG&E	\$26.6 million
No 3c/kWh Surcharge for DA Customers	\$23.3 million
ENA West Fork	\$ 7.5 million
NYISO TCC	\$ 6.0 million
Central Hudson Refunds	\$ 5.6 million
SoCal Gas Dispute	\$ 3.9 million
MECC Aggregation	\$ 3.6 million
CMP Standard Offer	\$ 2.5 million
TXU/Reliant – Stranded Cost Case	\$ 2.3 million
FirstEnergy Market Support Generation	\$ 1.3 million
EPMI – PSE&G Gas Storage Deal	\$ 1.0 million
SPP-ERCOT DC Tie	\$ 0.9 million
Transredes Supreme Decree, Bolivia	\$ 25.0 million
Resolution 109/2001 – Argentina	\$ 1.1 million
<b>Total</b>	<b>\$190.4 million</b>

EC 000124011

**Representative Example of Risk Managed by EGA**  
 (Retail Risk, Nominal GWh, Nov. 2001, by NERC Region)



Total of 103.8 TWh, \$1 per MWh of price change = \$ 103.8 million.

UNITED STATES DISTRICT COURT  
 SOUTHERN DISTRICT OF TEXAS  
 HOUSTON DIVISION

Committee on Governmental Affairs  
**EXHIBIT #A-5**

UNITED STATES SECURITIES  
 AND EXCHANGE COMMISSION,

Plaintiff,

Civil Action No. H-02-3127

v.

COMPLAINT

MICHAEL J. KOPPER,

Defendant.

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

**SUMMARY**

1. The defendant Michael J. Kopper, a former employee of Enron Corp., engaged, along with others, in a self-enriching scheme to defraud Enron's security holders through the use of certain off-balance-sheet entities.
2. By his conduct, Kopper, directly and indirectly, engaged in acts, practices, and courses of business that violated, and unless enjoined may again violate, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].
3. The Commission requests that this Court permanently enjoin Kopper from violating the foregoing federal securities laws, prohibit him permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act, order him to disgorge gains from the violations, and order such other and further relief as the Court may deem appropriate.

**JURISDICTION AND VENUE**

4. The Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d) and (e) and 78aa].
5. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] because certain acts or transactions constituting the violations occurred in this District.
6. In connection with the acts, practices, and courses of business alleged herein, Kopper, directly or indirectly, made use of the means and instruments of transportation and communication in interstate commerce, and of the mails and of the facilities of a national securities exchange.
7. Kopper, unless restrained and enjoined by this Court, will continue to engage in transactions, acts, practices, and courses of business as set forth in this Complaint or in similar illegal acts and practices.

#### DEFENDANT

8. Michael J. Kopper, age 37, resides in Houston, Texas. Kopper held various positions at Enron from approximately 1994 through July 2001. For most of that time, Kopper reported to Enron's Chief Financial Officer ("CFO"). Between January 2000 and July 2001, Kopper also was a managing director of LJM2 Capital Management. In late July 2001, Kopper left Enron to run LJM2 Co-Investments LP, an affiliate of entities that Kopper purchased from Enron's CFO for approximately \$16.5 million.

#### CORPORATIONS INVOLVED

9. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other businesses, Enron was engaged in the purchase and sale of natural gas, construction and ownership of pipelines and power facilities, provision of telecommunication services, and trading in contracts to buy and sell various commodities. Prior to December 2, 2001, Enron was reportedly the seventh largest corporation in the United States. On December 3, 2001, Enron filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code.

#### FACTUAL ALLEGATIONS

##### Enron's Use of Off-Balance-Sheet Special Purpose Entities

10. Starting in at least the early 1990's, Enron funded certain of its investments by entering into arrangements with outside third parties. These joint investments typically were structured as separate, special purpose entities ("SPEs") to which Enron and other investors contributed assets or other consideration. Enron's treatment of the entities for financial statement purposes was subject to accounting rules that governed whether an entity should be consolidated in its entirety (including its assets and liabilities) onto Enron's balance sheet, or should be treated as an investment by Enron in a separate entity not under Enron's control. With respect to certain entities, Enron management preferred the latter result - known as "off-balance-sheet" - because it enabled Enron to present itself more attractively as measured by criteria favored by Wall Street investment analysts and credit rating agencies.

11. Enron engaged in myriad SPE and other transactions that were structured to achieve off-balance-sheet treatment. Under applicable accounting rules, an SPE could receive off-balance-sheet treatment only if independent third-party investors contributed at least three percent of the SPE's capital, and the third party investment were genuinely at risk, among other things. If the third party were not truly independent, or its investment were not truly at risk, consolidation of the SPE onto Enron's balance sheet would be required.

12. Starting in at least early 1997, Kopper and others devised a scheme to defraud Enron's security holders by enriching themselves through the use of certain Enron SPEs. Some of these SPEs were not eligible for off-balance-sheet treatment because the supposedly independent third party investors were controlled by the CFO, Kopper, and others and because the third party "investment" was not at risk, since Enron, the CFO, Kopper, or others provided the funds to be invested or guaranteed the investment against risk of loss. Thus, these SPEs should have been consolidated onto Enron's balance sheet.

13. Enron nevertheless engaged in various transactions with these SPEs that were designed to improve its apparent financial results. Meanwhile, Kopper and others used their simultaneous influence over Enron's business operations and the SPEs as a means to secretly and unlawfully generate millions of dollars for themselves and others.

RADR

14. In early 1997, Enron's holdings included a number of California wind farms that were partly owned by an Enron subsidiary named ZOND. At the time, California and federal energy regulations granted substantial economic benefits to alternative energy facilities that met certain requirements, including a requirement that they not be owned by public utilities ("qualifying facilities," or "QF"). Because Enron was in the process of purchasing a public utility, Portland General Electric, its wind farms would become ineligible for QF status unless ZOND's interests were sold.

15. In approximately May 1997, Kopper and others devised a scheme to enrich themselves and to enable Enron to retain secret control over the California wind farms while appearing to maintain eligibility for QF status. Enron's CFO and Kopper caused the creation of SPEs known as "RADR ZWS, LLC," and "RADR ZWS MM, LLC" (collectively, "RADR") which purchased ZOND's interest in the wind farms. RADR was funded mainly with a \$16.4 million loan from an Enron subsidiary. Rather than seek independent third party equity investors, and to insure that Enron effectively monitored control over the wind farms, Enron's CFO and Kopper contacted several of their personal friends, including a friend of the Enron CFO's wife, Kopper's domestic partner, and a Houston real estate broker.

16. The Enron CFO arranged to fund some of the friends' "investments" by making an unsecured personal loan to Kopper, who in turn made unsecured loans to the friends, so that they could "invest" in RADR. It was understood that the friends would repay Kopper with distributions from their RADR "investments," and Kopper would in turn repay Enron's CFO. It was further understood that, at some time in the future, Enron would repurchase the RADR entities. The repurchase price would increase over time, so that the longer it took Enron to repurchase RADR, the higher the price it would have to pay. The RADR transaction was a model for later transactions, which came to be known within Enron as "Friends of Enron" deals. 17. Between August 1997 and July 2000, RADR generated approximately \$2.7 million in distributions to the investors. In July 2000, Enron repurchased the RADR entities, resulting in an additional gain of approximately \$1.8 million to the investors. Two of the investors were directed by Kopper to transfer portions of their proceeds to various individuals. Among those who received money were Enron's CFO, Kopper, several of their family members, and various Enron employees and their family members.

Chewco

18. In 1993, Enron and the California Public Employees' Retirement System ("CALPERS") entered into a joint venture investment partnership called Joint Energy Development Limited Partnership ("JEDI"). Enron was the general partner of JEDI and contributed \$250 million in Enron stock; CALPERS was the limited partner and contributed \$250 million in cash. Enron did not consolidate JEDI onto its balance sheet and did not include JEDI's debt in its financial statements.

19. In the summer of 1997, Enron began to seek a buyer for CALPERS' share of the JEDI partnership so that CALPERS would agree to invest additional funds in an even larger partnership to be called JEDI II. CALPERS imposed a deadline of November 6, 1997 for the buyout.

20. In November 1997, Enron formed Chewco, an SPE, to buy out CALPERS' JEDI interest. Enron's CFO initially sought to become Chewco's general partner, but substituted Kopper when it became clear that Enron otherwise would have to disclose publicly the CFO's participation.

21. After failing to find investors willing to provide the required 3-percent outside equity for Chewco before the November 6, 1997 deadline, Enron arranged to fund the buyout temporarily through "bridge" loans from Barclays Bank PLC ("Barclays") and Chase Manhattan Bank

("Chase"). Each bank loaned \$191.5 million to Chewco, with repayment guaranteed by Enron, and Chewco used those loan proceeds to buy CALPERS' interest in JEDI.

22. Because Chewco had no genuine outside equity investment, and because Enron guaranteed Barclays and Chase against risk of loss, Chewco did not comply with SPE rules. Enron thus planned, for financial reporting purposes, to replace the bridge financing before year end with another structure that would qualify Chewco as an SPE with sufficient outside equity.

23. Chewco's structure at year-end again failed to meet SPE requirements. Its permanent financing structure consisted of a \$240 million loan from Barclays guaranteed by Enron, a \$132 million advance from JEDI to Chewco under a revolving credit agreement, and approximately \$11.49 million as an apparent equity investment from Chewco's general and limited partners. However, Enron structured the transaction so that \$11.03 million of the supposed outside equity was actually borrowed from Barclays by various entities controlled by Kopper. The loan was secured by approximately \$6.58 million in cash that was generated by JEDI's November 1997 sale of an asset. Those funds were held in accounts that were fully pledged to Barclays, meaning that Barclays was partly protected against risk of loss. The remaining "outside equity" consisted of \$125,288 provided by Kopper and his domestic partner.

24. From December 1997 through December 2000, Kopper received various payments relating to Chewco, which he secretly shared with Enron's CFO. Kopper received a total of approximately \$1.5 million in "management fees" relating to Chewco, which he shared with Enron's CFO mainly through checks payable to members of the CFO's family. In December 1998, Enron's CFO caused Enron to pay a \$400,000 "nuisance fee" to Chewco as compensation for agreeing to amend JEDI's partnership agreement. Kopper transferred approximately \$67,224 of the nuisance fee back to Enron's CFO, again through checks written to the CFO or members of his family. In addition, Kopper paid the CFO's wife approximately \$54,000 for acting as a Chewco administrative assistant.

25. In March 2001, Enron bought Chewco's limited partnership interest in JEDI and consolidated JEDI onto its financial statements. Enron's CFO approved a purchase price of \$35 million, of which Kopper and his domestic partner received approximately \$3 million. In September 2001, Enron's CFO authorized a further \$2.6 million "tax indemnity payment" to Chewco, which Kopper subsequently transferred to an account under his control.

#### Southampton

26. Still another SPE formed by Enron was a partnership called LJM Cayman, L.P. ("LJM Cayman"). Enron's CFO invested \$1 million in LJM Cayman and was granted by Enron a limited waiver of Enron's conflict of interest rules so he could run LJM Cayman as its general partner. LJM Cayman had two limited partners, an entity owned by Credit Suisse First Boston ("CSFB") and an entity owned by National Westminster Bank ("NatWest"). Each invested \$7.5 million.

27. In June 1999, Enron entered into a transaction in which a third party assigned more than three million Enron shares to LJM Cayman. In return, Enron received promissory notes and a "put" option on shares Enron owned in Rhythms NetConnections, Inc. ("Rhythms"). The Rhythms put option was issued by LJM Cayman's subsidiary, LJM Swap Sub, L.P. ("Swap Sub"), and purported to give Enron the right to sell, or put, its Rhythms shares to Swap Sub for a set price on certain future dates. Because Swap Sub was capitalized primarily with Enron shares, it would be unable to afford to pay Enron for the put option if its Enron shares fell below ascertain price.

28. During the first quarter of 2000, both Enron and Rhythms shares increased in price, making Swap Sub's main asset (its Enron shares) more valuable while substantially decreasing its potential liability on the Rhythms put option. Thus, Swap Sub had far more value than previously. In approximately February 2000, Kopper, three NatWest bankers, and others devised and later executed a scheme to defraud Enron and others by: (i) causing Enron to pay \$30 million to buy

out, or "unwind," the banks' interests in Swap Sub; (ii) causing NatWest to accept only \$1 million for its interest in Swap Sub, while representing to Enron that NatWest was getting \$20 million, and (iii) splitting the \$19 million balance among themselves and certain Enron and LJM employees.

29. To carry out the scheme, Kopper and others caused Enron to pay \$30 million (purportedly allocated \$20 million to NatWest and \$10 million to CSFB) to unwind Swap Sub. That purchase price was based on the Enron CFO's false representation to Enron that NatWest and CSFB had agreed to sell their interests in Swap Sub for \$20 million and \$10 million, respectively. In fact, NatWest received only \$1 million and had agreed to receive this sum based on misrepresentations and fraudulent conduct of its own employees, who sought to skim profits that should have gone to NatWest.

30. As a result, the three NatWest bankers who participated in the scheme received approximately \$7.3 million. The balance of the funds went to investors in an entity called Southampton LP ("Southampton"), which Kopper created. The Southampton "investors" were Kopper, who contributed \$25,000 and caused Chewco to loan another \$750,000, and received approximately \$4.5 million, a purported charitable foundation in the name of the CFO's family, which contributed \$25,000 and received approximately \$4.5 million, and five Enron and LJM employees chosen by Kopper and the CFO, who contributed a total of less than \$20,000 and received a total of approximately \$3.3 million.

#### **CLAIM FOR RELIEF**

Violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)]  
and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]

31. Paragraphs 1 through 30 are realleged and incorporated by reference herein.

32. As set forth more fully above, Kopper, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails and of the facilities of a national securities exchange, in connection with the purchase or sale of securities: has employed devices, schemes, or artifices to defraud, has made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

33. By reason of the foregoing, Kopper violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

#### **JURY DEMAND**

34. The Commission demands a jury in this matter.

**PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that this Court:

A. Grant a Final Judgment of Permanent Injunction restraining and enjoining Kopper from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; prohibiting him permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act; and ordering him to pay disgorgement of profits described herein; and

B. Grant such other and additional relief as this Court may deem just and proper.

Dated: August \_\_\_\_, 2002

Respectfully submitted,

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Stephen M. Cutler  
Director, Enforcement Division

Linda Chatman Thomsen  
Deputy Director, Enforcement Division

Charles J. Clark  
Assistant Director, Enforcement Division

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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

Committee on Governmental Affairs  
EXHIBIT #A-6

UNITED STATES COURTS  
SOUTHERN DISTRICT OF TEXAS  
FILED  
AUG 20 2002

UNITED STATES OF AMERICA

v.

MICHAEL J. KOPPER

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§

MICHAEL N. MILBY, CLERK OF COURT

Cr. No. H-02-  
Violations: 18 U.S.C. §§ 1956(h), 1957 and  
§371 (Money Laundering Conspiracy;  
Conspiracy to Commit Wire Fraud)

INFORMATION

**H - 02-0560**

The Acting United States Attorney charges:

1. At all times relevant to this Information, Enron Corp. ("Enron") was a publicly-traded Oregon corporation with its headquarters in Houston, Texas. Among other businesses, Enron was engaged in the purchase and sale of natural gas, construction and ownership of pipelines and power facilities, provision of telecommunication services, and trading in contracts to buy and sell various commodities. Before December 2, 2001, Enron was the seventh largest corporation in the United States.

2. The defendant MICHAEL J. KOPPER was a resident of Houston, Texas and held various positions at Enron from approximately 1994 through July 2001. For much of that time, KOPPER reported to Enron's Chief Financial Officer ("Enron's CFO"). Between January 2000 and July 2001, KOPPER also was a managing director of LJM2 Capital Management. In late July 2001, KOPPER left Enron to run LJM2 Co-Investments LP, an affiliate of entities that KOPPER purchased from Enron's CFO for approximately \$16.5 million.

THE SCHEME TO DEFRAUD

A. Enron's Use of Off-Balance-Sheet Special Purpose Entities

3. Starting in at least the early 1990's, Enron funded certain of its investments by entering into arrangements with outside third parties. These joint investments typically were structured as separate entities to which Enron and other investors contributed assets or other consideration. Enron's treatment of the entities for financial statement purposes was subject to accounting rules that governed whether an entity should be consolidated in its entirety (including its assets and liabilities) onto Enron's balance sheet, or should be treated as an investment by Enron in a separate entity not under Enron's control. Enron management preferred the latter result -- known as "off-balance-sheet"-- because it enabled Enron to present itself more attractively as measured by criteria favored by Wall Street investment analysts and credit rating agencies.

4. Enron engaged in myriad transactions that were structured to achieve off-balance-sheet treatment. Many of those transactions were structured using "special purpose entities" ("SPEs"). Under applicable accounting rules, an SPE could receive off-balance-sheet treatment only if independent third-party investors contributed at least 3-percent of the SPE's capital, and the third-party investment is genuinely at risk, among other things. If the third party was not truly independent, or its investment was not truly at risk, consolidation of the SPE onto Enron's balance sheet would be required.

5. Starting in at least early 1997, Enron's CFO, KOPPER, and others devised a scheme to defraud Enron and its shareholders by enriching themselves through the use of certain Enron SPEs. Some of these SPEs were not eligible for off-balance-sheet treatment because the

supposedly independent third party investors were controlled by the CFO, KOPPER, and others and because the third party "investment" was not at risk, since Enron, the CFO, KOPPER, or others provided the funds to be invested or guaranteed the investment against risk of loss. Thus, these SPEs should have been consolidated onto Enron's balance sheet.

6. Enron nevertheless engaged in various transactions with these SPEs that were designed to improve its apparent financial results, or to circumvent regulatory requirements by having an SPE do what Enron itself could not. Meanwhile, Enron's CFO, KOPPER, and others used their simultaneous influence over Enron's business operations and the SPEs as a means to secretly and unlawfully generate millions of dollars for themselves and others.

**B. RADR**

7. In early 1997, Enron's holdings included a number of California wind farms that were partly owned by an Enron subsidiary named ZOND. At the time, California and federal energy regulations granted substantial economic benefits to alternative energy facilities that met certain requirements and were not owned by public utilities ("qualifying facilities", or "QFs"). Because Enron was in the process of purchasing a public utility, Portland General Electric, its wind farms would become ineligible for QF status unless ZOND's interests were sold.

8. In approximately May 1997, Enron's CFO, KOPPER, and others devised a scheme to enrich themselves and enable Enron to retain secret control over the California wind farms while appearing to maintain eligibility for QF status. Enron's CFO and KOPPER caused the creation of SPEs known as "RADR ZWS, LLC," and "RADR ZWS MM, LLC" (collectively, "RADR") which purchased ZOND's interest in the wind farms. RADR was funded mainly with a \$16.4 million loan from an Enron subsidiary. Rather than seek independent third party equity

investors, and to ensure that Enron effectively maintained control over the wind farms, Enron's CFO and KOPPER contacted several of their personal friends, including a friend of the Enron CFO's wife, KOPPER's domestic partner, and a Houston real estate broker.

9. As part of their scheme to enrich themselves through the use of Enron SPES, Enron's CFO arranged to fund some of the friends' "investments" by making an unsecured personal loan to KOPPER, who in turn made unsecured loans to the friends so that they could "invest" in RADR. It was understood that the friends would repay KOPPER with distributions from their RADR "investments," and KOPPER would in turn repay Enron's CFO. It was further understood that, at some time in the future, Enron would repurchase the RADR entities. The repurchase price would increase over time, so that the longer it took Enron to repurchase RADR, the higher the price it would have to pay. The RADR transaction was a model for later transactions, which came to be known within Enron as "Friends of Enron" deals.

10. Between August 1997 and July 2000, RADR generated approximately \$2.7 million in distributions to the investors. In July 2000, Enron repurchased the RADR entities, resulting in an additional gain of approximately \$1.8 million to the investors. Two of the investors were directed by KOPPER to transfer portions of their proceeds to various individuals. Among those who received money were Enron's CFO, KOPPER, several of their family members, and various Enron employees and their family members.

C. Chewco

11. In 1993, Enron and the California Public Employees' Retirement System ("CALPERS") entered into a joint venture investment partnership called Joint Energy Development Limited Partnership ("JEDLP"). Enron was the general partner of JEDI and

contributed \$250 million in Enron stock; CALPERS the limited partner and contributed \$250 million in cash. Enron did not consolidate JEDI onto its balance sheet and did not include JEDI's debt in its financial statements.

2. In the summer of 1997 Enron began to seek a buyer for CALPERS' share of the JEDI partnership that CALPERS would agree to invest additional funds in an even larger partnership to be called JEDI II. CALPERS imposed a deadline of November 6, 1997 for the buyout.

3. In November 1997 Enron formed Chewco, an SPE, to buy out CALPERS' JEDI interest. Enron CFO initially sought to become Chewco's general partner but substituted KOPPER when it became clear that Enron otherwise would have to disclose publicly the CFO participation.

4. After failing to find investors willing to provide the required 3-percent outside equity for Chewco before the November 6, 1997 deadline, Enron arranged to fund the buyout temporarily through "bridge" loans from Barclays Bank PLC ("Barclays") and Chase Manhattan Bank ("Chase"). Each bank loaned \$125 million to Chewco, with repayment guaranteed by Enron, and Chewco used those loan proceeds to buy CALPERS' interest in JEDI.

Because Chewco had no genuine outside equity investment, and because Enron guaranteed Barclays and Chase against risk of loss, Chewco did not comply with SPE rules. Enron thus planned, for financial reporting purposes, to replace the bridge financing before year-end with another structure that would qualify Chewco as an SPE with sufficient outside equity.

6. Chewco's structure at year-end again failed to meet SPE requirements. Its permanent financing structure consisted of a \$240 million loan from Barclays guaranteed by

Enron, \$32 million advance from JEDI to Chewco under revolving credit agreement, and approximately \$49 million as apparent equity investment from Chewco general and limited partners. However, Enron structured the transaction so that \$63 million of the supposed outside equity was actually borrowed from Barclays by various entities controlled by KOPPER. The loan was secured by approximately \$658 million in cash that was generated by JEDI's sale of asset. Those funds were held in accounts that were fully pledged to Barclays meaning that Barclays was partly protected against risk of loss. The remaining "outside equity" consisted of \$38 provided by KOPPER and his domestic partner.

From December 1997 through December 2000, KOPPER received various payments relating to Chewco which he secretly shared with Enron's CFO. KOPPER received a total of approximately \$1 million in "management fees" relating to Chewco, which he shared with Enron's CFO mainly through checks payable to members of the CFO's family. In December 1999, Enron's CFO caused Enron to pay \$400,000 "nuisance fee" to Chewco as compensation for agreeing to amend JEDI's partnership agreement. KOPPER transferred approximately \$67,224 of the nuisance fee back to Enron's CFO, again through checks written to the CFO or members of his family. In addition, KOPPER paid the CFO's wife approximately \$54,000 for acting as Chewco's administrative assistant.

In March 2000, Enron bought Chewco's limited partnership interest in JEDI and consolidated JEDI onto its financial statements. Enron's CFO approved a purchase price of \$33 million, of which KOPPER and his domestic partner received approximately \$3 million. In September 2000, Enron's CFO authorized a further \$2.6 million "tax indemnity payment" to Chewco, which KOPPER subsequently transferred to an account under his control.

D. Southampton

19. Still another SPE formed by Enron was a partnership called LJM Cayman, L.P. ("LJM Cayman"). Enron's CFO invested \$1 million in LJM Cayman and was granted by Enron a limited waiver of Enron's conflict of interest rules so he could run LJM Cayman as its general partner. LJM Cayman had two limited partners, an entity owned by Credit Suisse First Boston ("CSFB") and an entity owned by National Westminster Bank ("NatWest"). Each invested \$7.5 million.

20. In June 1999, Enron entered into a transaction in which a third party assigned more than three million Enron shares to LJM Cayman. In return, Enron received promissory notes and a "put" option on shares Enron owned in Rhythms NetConnections, Inc. ("Rhythms"). The Rhythms put option was issued by LJM Cayman's subsidiary, LJM Swap Sub, L.P. ("Swap Sub"), and purported to give Enron the right to sell, or put, its Rhythms shares to Swap Sub for a set price on certain future dates. Because Swap Sub was capitalized primarily with Enron shares, it would be unable to afford to pay Enron for the put option if its Enron shares fell below a certain price.

21. During the first quarter of 2000, both Enron and Rhythms shares increased in price, making Swap Sub's main asset (its Enron shares) more valuable while substantially decreasing its potential liability on the Rhythms put option. Thus, Swap Sub had far more value than previously. In approximately February 2000, Enron's CFO, KOPPER and three NatWest bankers devised and later executed a scheme to defraud Enron and others by: (i) causing Enron to pay \$30 million to buy out, or "unwind", the banks' interests in Swap Sub; (ii) causing NatWest to accept only \$1 million for its interest in Swap Sub while representing to Enron that NatWest

was getting \$20 million; and (iii) splitting the \$19 million balance among themselves and certain Enron and LJM employees.

22. To carry out the scheme, KOPPER, Enron CFO and others caused Enron to pay \$3 million to unwind Swap Sub. That purchase price was based on Enron CFO's false representation to Enron that NatWest and CSFB had agreed to sell their interests in Swap Sub for \$20 million and \$ million, respectively. In fact, NatWest received only \$ million and had agreed to receive this sum based on misrepresentations and fraudulent conduct of its employees who sought to skim profits that should have gone to NatWest.

23. As a result, the three NatWest bankers who participated in the scheme received approximately \$7.3 million. The balance of the funds went to investors in an entity called Southampton LP ("Southampton"), which KOPPER created. The Southampton investors

KOPPER, who contributed \$25,000 and caused Chewco to loan another \$ million and received approximately \$4 million; purported charitable foundation in the name of the CFO's family which contributed \$25,000 and received approximately \$4 million; and five Enron and LJM employees chosen by KOPPER and the CFO, who contributed a total of less than \$20,000 and received a total of approximately \$3 million.

COUNT ONE—Conspiracy to Commit Wire Fraud

24. Paragraphs Three through Twenty-Three of this Information are repeated and realleged as if fully set forth here.

In or about and between at least May 1997 and July 2000, both dates being

approximate and inclusive, within the Southern District of Texas and elsewhere, the defendant

MICHAEL J. KOPPER

and others, conspired to and did devise scheme and artifice and to obtain money by false and fraudulent pretenses and to deprive Enron and its shareholders of their intangible right to corporate employee honest services, and for the purpose executing such scheme and artifice transmitted and caused to be transmitted by means of wire communication interstate and foreign commerce writings, signs, signals, pictures and sounds all in violation of Title United States Code, Sections 1343 and 1346.

MEANS AND METHODS

26 Among the means and methods by which the defendant MICHAEL J. KOPPER and his co-conspirators would and did carry the conspiracy were those described paragraphs Three through Twenty-Three of this Information, well others.

OVERT ACTS

27. In furtherance of the conspiracy and to effect the objects thereof within the Southern District of Texas and elsewhere, the defendant MICHAEL KOPPER and others did commit and cause to be committed the following overt acts among others

RADR

- In about May 1997 Enron CFO wired \$4,000 to KOPPER.
- b. In about May 1997 KOPPER wired \$224,600 his domestic partner and \$204,400 to Houston real estate broker.
- In or about August 1997, KOPPER wired \$48,500 to Enron CFO.
- d. In or about July 2000 KOPPER's domestic partner and the Houston real estate

broker received wire transfers the amounts of \$65,260 and \$827,641 respectively

In about August 1997 KOPPER and Enron CFO agreed to pay portion of their RADR profits to an Enron employee who assisted them with the RADR transaction.

Chewco

f. On about December 23, 1998, KOPPER directed wire transfer the amount of \$400,000 from Chewco to account controlled by KOPPER, representing proceeds of "nuisance fee" paid by Enron to Chewco

g. On or about December 1998, KOPPER wrote checks totaling \$3,724 payable to Enron CFO wife and children

h. On about August 14, 2000, KOPPER received wire transfer from Chewco the amount of \$1,045,000

i. On about May 6, 2000 KOPPER received wire transfer from Chewco in the amount of \$2,582,064

On about May 6, 2000 KOPPER domestic partner received wire transfer from Chewco in the amount of \$4,882,222

k. On about September 2000 KOPPER received wire transfer from Chewco the amount of \$2,625,000, representing proceeds of "tax indemnity" payment made by Enron to Chewco

Southampton

On or about March 4, 2000 Enron CFO met with NatWest banker the Cayman Islands.

m. On or about March 2000 NatWest banker faxed letter from London, England

to KOPPER in Houston, Texas stating that NatWest would sell its interest in SwapSub to a company controlled by KOPPER for \$1 million.

n. On or about March 16, 2000, KOPPER met with a NatWest banker in New York.

o. On or about April 25, 2000, a NatWest banker caused a wire transfer of \$251,993 from an account in England to an account controlled by KOPPER in Houston, Texas.

p. On or about May 1, 2000, KOPPER caused a wire transfer of \$7,352,626 from Houston, Texas to an account in the Cayman Islands controlled by one of the NatWest bankers.

q. On or about May 1, 2000, KOPPER caused a wire transfer of \$1,040,744 to an account controlled by an Enron employee.

r. On or about May 1, 2000, KOPPER caused a wire transfer of \$4,466,189 to an account in the name of Enron's CFO's purported charitable foundation.

s. On or about May 1, 2000, KOPPER caused a wire transfer of \$4,466,189 into an account that he controlled.

All in violation of Title 18, United States Code, Section 371.

COUNT TWO—Money Laundering Conspiracy

28. The allegations in paragraphs Three through Twenty-Three of this Information are realleged as if fully set forth here.

29. In or about and between at least May 1997 and July 2001, within the Southern District of Texas and elsewhere, the defendant

MICHAEL J. KOPPER

and others, conspired to knowingly engage in monetary transactions, namely, deposits, withdrawals, transfers and exchanges in and affecting interstate or foreign commerce, in

criminally derived property of value greater than \$ 0,000 said property being derived from specified unlawful activity namely, wire fraud, in violation of Title 18, United States Code Section 957

30 It was part of the conspiracy that, or about and between July 1997 and September 2000 KOPPER and others engaged in monetary transactions involving criminally derived property from the RADR transaction that totaled approximately \$4.4 million.

It is further part of the conspiracy that, in or about and between November 1997 and September 2000 KOPPER and others engaged in monetary transactions involving criminally derived property relating to the Chewco transaction that totaled approximately million

It was further part of the conspiracy that, in or about May 2000 KOPPER and others engaged in monetary transactions involving criminally derived property relating to the Hampton transaction that totaled approximately \$ 19.6 million.

All in violation of Title 18, United States Code, sections 956(h) and FORFEITURE ALLEGATION 18 U. C. 98(a)(1)(C) U. C. 246 (Criminal Forfeiture)

The allegations contained in Count One of this information are hereby realleged and incorporated herein for the purpose of alleging forfeiture pursuant to the provisions of Title 18, United States Code, section 98(a)(1)(C) and Title 28, United States Code, Section 246

As a result of the offense alleged in Count One, the defendant

MICHAEL J. KOPPER

shall forfeit to the United States, pursuant to Title 18, United States Code, section 98(a)(1)(C) and Title 28, United States Code, Section 246(c), any property, real or personal, which

constitutes and is derived from proceeds traceable to the commission of said offense, including but not limited to the following:

**A. BANK ACCOUNTS**

<u>Bank Name</u>	<u>Account #</u>	<u>Amount to Restrain</u>	<u>Account Holder</u>
JPMorgan/Chase	Q65183-00-8	\$4,610,208.91	Fastow Family Foundation
Paine Webber	HS-75406-EI	\$1,374,744.00	Kristina Mordaunt
Sunlife Assurance Co. of Canada	0212524146-01	\$300,000	Kristina Mordaunt
Fidelity Spartan Municipal Money Market FSI	Acct.#UNK	\$218,326.60	Kathy Lynn
Charles Schwab	1320-9323	\$45,000	Anne Yeager
Charles Schwab	11042180	\$500,000	Peter Fastow
1st Union Security	001-HD1-9839-6161	\$916,137.00	Ben Glesan Jr.
Chase Bank	054-05023866	\$7,699,838.13	Lea W & Andrew S. Fastow
JP Morgan	340160	\$7,699,838.13	Lea W & Andrew S. Fastow
Chase Bank	Q62603-00-8	\$1,420,000	Lea W & Andrew S. Fastow
Sterling	159006385	\$6,370,000	Capital Growth Holding
Sterling	159006893	\$130,000	Capital GP Holding

**B. REAL PROPERTY**

All that lot or parcel of land, together with its buildings, appurtenances, improvements, fixtures, attachments and easements, located at the following:

<u>Property</u>	<u>Owner</u>
3005 Del Monte Houston, Texas 77019 Lt 3, Blk 31, River Oaks Sect, Harris County, Texas	Andrew and Lea Fastow

4531 W. Alabama St.  
Houston, Texas 77027  
Lt 3 Blk 4 Afton Oaks Sec 1  
Harris County, Texas Chase Bank

Kristina Mary Mordaunt and  
Robert Y. Ulsh Jr.

C. PERSONAL PROPERTY - VEHICLE

<u>Property</u>	<u>Owner</u>
2000 Lexus VIN JT6G/f10U5Y0078539	R. Vance Ulsh Jr.

35. If any of the property described herein as being subject to forfeiture, as a result of any act or omission of the defendant:

- a. cannot be located upon the exercise of due diligence;
- b. has been transferred or sold to or deposited with, a third person;
- c. has been placed beyond the jurisdiction of the Court;
- d. has been substantially diminished in value; or
- e. has been commingled with other property which cannot be subdivided without difficulty;

then any and all interest MICHAEL J. KOPPER has in other property shall be vested in the United States and forfeited to the United States pursuant to Title 18, United States Code, Section 982(b)(1), including \$4 million from Charles Schwab account number 3962-3986 in the name of LJM2 Capital Management, LP, which represents substitute assets for criminally derived property.

All in violation of United States Code, Sections 1343 and 371.

**FORFEITURE ALLEGATION:**

(18 U.S.C. § 982(a)(1)-- Criminal Forfeiture)

36. The allegations contained in Count Two of this Information are hereby realleged and incorporated herein for the purpose of alleging forfeiture pursuant to the provisions of Title 18, United States Code, Section 982(a)(1).

37. As a result of the offense alleged in Count Two, the defendant

**MICHAEL J. KOPPER**

shall forfeit to the United States, pursuant to Title 18, United States Code, Section 982(a)(1), any property, real or personal, involved in such offense, or any property traceable to such property, including but not limited to the following:

**A BANK ACCOUNTS**

<u>Bank Name</u>	<u>Account #</u>	<u>Amount to Restrain</u>	<u>Account Holder</u>
JPMorgan/Chase	Q65183-00-3	\$4,610,208.91	Fastow Family Foundation
Paine Webber	HS-75406-EJ	\$1,374,744.00	Kristina Mordaunt
SunLife Assurance Co. of Canada	0212524146-01	\$300,000	Kristina Mordaunt
Fidelity Spartan Municipal Money Market FSI	Acct.#UNK	\$218,326.60	Kathy Lynn
Charles Schwab	1320-9323	\$45,000	Anne Yeager
Charles Schwab	11042180	\$500,000	Peter Fastow
1st Union Security	001-FH01-3839-6161	\$916,137.00	Ben Clisan Jr.
Chase Bank	054-05023866	\$7,699,838.13	Lea W & Andrew S. Fastow
JP Morgan	340160	\$7,699,838.13	Lea W & Andrew S. Fastow
Chase Bank	Q62603-00-3	\$1,420,00	Lea W & Andrew S. Fastow
Sterling	159006885	\$6,370,000	Capital Growth Holding
Sterling	159006893	\$130,000	Capital GP Holding

## B. REAL PROPERTY

All that lot or parcel of land, together with its buildings, appurtenances, improvements, fixtures, attachments and easements, located at the following:

<u>Property</u>	<u>Owner</u>
3005 Del Monte Houston, Texas 77019 Lt 3, Blk 31, River Oaks Sec1, Harris County, Texas	Andrew and Lea Fastow
4531 W. Alabama St. Houston, Texas 77027 Lt 3 Blk 4 Afon Oaks Sec 1 Harris County, Texas Chase Bank	Kristina Mary Mordaunt and Robert V. Ulsh Jr.

## C. PERSONAL PROPERTY - VEHICLE

<u>Property</u>	<u>Owner</u>
2000 Lexus VIN JT6G/f10U5Y0078539	R. Vance Ulsh Jr.

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- a. cannot be located upon the exercise of due diligence;
- b. has been transferred or sold to or deposited with, a third person;
- c. has been placed beyond the jurisdiction of the Court;
- d. has been substantially diminished in value; or
- e. has been commingled with other property which cannot be subdivided without difficulty;

then any and all interest MICHAEL J. KOPPER has in other property shall be vested in the

United States and forfeited to the United States pursuant to Title 18, United States Code, Section 982(b)(1), including \$4 million from Charles Schwab account number 3962-3986 in the name of LJM2 Capital Management, LP, which represents substitute assets for criminally derived property.

All in violation of Title 18, United States Code, Sections 1956(h) and 1957.

DATED: Houston, Texas  
August 20, 2002

JOSHUA HOCHBERG  
Acting United States Attorney  
Southern District of Texas

By: Leslie R. Caldwell  
LESLIE R. CALDWELL  
Director, Enron Task Force

By: Thomas A. Manusik  
THOMAS A. MANUSIK  
Trial Attorney, Enron Task Force

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

UNITED STATES SECURITIES	:	
AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	Civil Action No.
	:	
v.	:	
	:	<b>COMPLAINT</b>
ANDREW S. FASTOW,	:	
	:	<b>JURY DEMANDED</b>
Defendant.	:	

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

**SUMMARY**

1. The defendant, Andrew S. Fastow, the former Chief Financial Officer of Enron Corp., engaged in a fraudulent scheme to defraud Enron's security holders and to enrich himself and others. Fastow's fraudulent conduct involved entering into undisclosed deals, manufacturing of earnings through sham transactions, inflating the value of Enron's investments, backdating documents, and other illegal acts.
2. The Commission requests that this Court permanently enjoin Fastow from violating the federal securities laws cited herein, prohibit him permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") or that is required to file reports pursuant to Section 15(d) of such Act, order him to disgorge all ill-gotten gains, to pay civil penalties, to have the amount of such penalties added to and become part of a disgorgement fund for the benefit of the victims of Fastow's unlawful conduct, and order such other and further relief as the Court may deem appropriate.

**JURISDICTION AND VENUE**

3. The Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d) and (e) and 78aa] and Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77(b), 77(d)(1) and 77v(a)].
4. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] and Section 22 of the Securities Act [15 U.S.C. § 77v(a)] because certain acts or transactions constituting the violations occurred in this District.
5. In connection with the acts, practices, and courses of business alleged herein, Fastow, directly or indirectly, made use of the means and instruments of transportation

and communication in interstate commerce, and of the mails and of the facilities of a national securities exchange.

6. Fastow, unless restrained and enjoined by this Court, will continue to engage in transactions, acts, practices, and courses of business as set forth in this Complaint or in similar illegal acts and practices.

#### DEFENDANT

7. Andrew S. Fastow, age 40, resides in Houston, Texas. Fastow was Enron's Chief Financial Officer from March 1998 to October 24, 2001, and was senior vice president, finance, from January 1997 to March 1998. Fastow oversaw many of Enron's financial activities and reported directly to Enron's Chief Executive Officer. Fastow, among others, was responsible for reviewing and verifying the accuracy and reliability of Enron's filings with the Commission, including its year-end financial statements. At all times relevant, Fastow, directly and indirectly, was a control person of Enron and Michael J. Kopper within the meaning of the federal securities laws. Fastow signed Enron's confidentiality agreement and certificate of compliance with Enron's code of ethics. Enron's confidentiality agreement required employees to disclose business activities outside Enron that could be considered a conflict of interest, among other things. Similarly, Enron's code of ethics prohibited employees from engaging in, among other activities, investments that could be considered to conflict with Enron's interests. Fastow's illegal gains from the fraud alleged herein include kickbacks and undisclosed fees. In addition, Fastow made millions in salary, bonuses, and through sales of Enron stock even as he was defrauding Enron, its investors, and others.

#### ENTITIES AND OTHER PERSONS INVOLVED

8. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. From 1997 to 2001, while Fastow engaged in the fraudulent conduct alleged herein, Enron raised approximately \$5 billion in the public debt and equity markets. Among other operations, Enron was the nation's largest natural gas and electric marketer with reported annual revenue of more than \$150 billion. Enron rose to number seven on the Fortune 500 list of companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped in less than a year from more than \$80 per share to less than \$1.

9. Michael J. Kopper, age 37, resides in Houston, Texas. Kopper held various executive positions at Enron from approximately 1994 through July 2001. For most of that time, Kopper reported directly to Fastow. Between January 2000 and July 2001, Kopper also was a managing director of LJM2 Capital Management. In late July 2001, Kopper left Enron to run LJM2 Co-Investments LP. Kopper purchased the general partner interest in the entity and another entity from Fastow for approximately \$16.5 million. On August 21, 2002, Kopper pleaded guilty to conspiracy to commit wire fraud and money laundering and agreed to forfeit \$4 million in criminal proceeds. The same day, the Commission filed a parallel settled action against Kopper in this district, SEC v. Kopper, Case No. H-02-3127 (Lake). Pursuant to the final judgment entered August 22, 2002, the Court ordered Kopper to pay disgorgement, including a direct payment of \$8 million, and additional disgorgement in the amount of \$4 million forfeited in the criminal case,

permanently enjoined Kopper from violating the provisions of the federal securities laws set forth in the Complaint, and barred Kopper from acting as an officer or director of public companies. Kopper's guilty plea, and the conduct alleged in the Commission's complaint, related to three fraudulent transactions he engaged in with Fastow and others, known as RADR, Chewco, and Southampton.

#### FACTUAL ALLEGATIONS

##### Enron's Use of Off-Balance-Sheet Special Purpose Entities

10. Since at least the early 1990's, Enron engaged in transactions with other entities that were designed to improve Enron's balance sheet. Enron's treatment of the entities for financial statement purposes was subject to accounting rules that governed whether the assets and liabilities of the entity should be consolidated onto Enron's balance sheet, or treated as an investment by Enron in a separate entity not under Enron's control. With respect to certain entities, Enron management preferred the latter result - known as "off-balance-sheet"- because it enabled Enron to present itself more attractively as measured by criteria favored by Wall Street investment analysts, credit rating agencies, and others.

11. Enron engaged in myriad transactions that were structured to achieve off-balance-sheet treatment. Many of those transactions were structured using special purpose entities ("SPEs"). Under applicable accounting rules, an SPE could receive off-balance-sheet treatment only if independent third-party investors made a substantive capital investment, generally at least three percent of the SPE's assets, and the third-party investment were genuinely at risk, among other things. If the third-party were not truly independent, or its investment were not truly at risk, those transactions using the SPEs were improper.

12. Starting in at least early 1997, Fastow, Kopper, and others devised a scheme to defraud Enron's security holders through transactions with certain Enron SPEs.

13. Some of these SPEs were not eligible for off-balance-sheet treatment because the SPE and supposedly independent third-party investors were controlled by Fastow, Kopper, and others, the outside equity requirement was not met, and the third-party "investment" was not truly at risk. Thus, these SPEs should have been consolidated onto Enron's balance sheet. Further, Fastow, Kopper and others used their simultaneous influence over Enron's business operations and the SPEs as a means to secretly and unlawfully generate millions of dollars for themselves and others.

##### RADR

14. In early 1997, Fastow devised a scheme to enrich himself and others while enabling Enron to maintain secret control over, and achieve off-balance-sheet treatment, of assets that it had "sold" to a supposedly independent SPE. Within Enron, these transactions came to be known as "Friends of Enron" deals because the purportedly independent investors in the SPE actually were friends or family members of Enron executives, and served as nominees under the executives' control. Fastow and Enron's other top management liked "Friends of Enron" deals because they enabled Enron to retain control over assets while shedding the burdens of legal ownership, including required public disclosure in Enron's financial statements. Another benefit to Fastow of

the "Friends of Enron" structure was that he, Kopper and others used their control over the "investors" to secretly siphon off for themselves proceeds of the SPE transactions, in violation of their duties to Enron and its shareholders.

15. One "Friends of Enron" transaction related to Enron's effort to appear to divest itself of its interest in certain wind farms in California, so that the farms could continue to receive beneficial regulatory treatment, while Enron secretly retained control over the farms. Under applicable federal and state regulations, the wind farms qualified for financial benefits conferred on alternative energy sources that met certain requirements ("qualifying facilities" or "QF"). Wind farms that were more than fifty percent owned by an electric utility or electric utility holding company, however, were ineligible for QF status. In early 1997, Fastow and others were aware that Enron's wind farms would soon lose their QF status because Enron was in the process of acquiring Portland General Electric, an electric utility based in Portland, Oregon, and would become an electric utility holding company.

16. In approximately March 1997, Fastow, Kopper, and others devised a scheme whereby Enron would "sell" a portion of its interest in the wind farms to a partnership comprised of "Friends of Enron." Fastow initially proposed the formation of a partnership SPE to be known as Alpine Investors ("Alpine"), which would buy Enron's interest in the wind farms. The proposed "investors" in Alpine were all "Friends of Enron," including relatives of Fastow's wife.

17. Alpine did not complete the proposed transaction with Enron. Rather, in May 1997, Fastow and Kopper created SPEs known as "RADR ZWS, LLC" and "RADR ZWS MM, LLC" (collectively, "RADR"), which purchased a portion of Enron's interest in the wind farms. RADR was funded mainly with a \$16.4 million loan from an Enron subsidiary. Because Fastow knew that his participation as an equity investor in RADR would require Enron to make public disclosure, he and Kopper enlisted "Friends of Enron" to serve as the supposedly independent third-party investors. These investors included a friend of Fastow's wife, Kopper's domestic partner, and a Houston real estate broker.

18. These "Friends of Enron" were Kopper's nominees and lacked sufficient funds to invest in RADR. Fastow arranged to fund some of the friends' "investments" by making an unsecured personal loan of \$419,000 to Kopper, who in turn made unsecured loans to the friends, so that they could "invest" in RADR. It was understood that the friends would repay Kopper with distributions from their RADR "investments," and Kopper would in turn repay Fastow. It was further understood that Kopper would have control over any other RADR funds the friends received.

19. RADR began making distributions to "investors" on July 1, 1997. Two of the "investors" repaid their loans from Kopper on or about August 25, 1997. The next day, Kopper wired \$481,850 to Fastow, which included the original loan amount from Fastow plus \$62,850 in interest, an approximate 15% return in four months.

20. RADR proved to be far more lucrative than initially expected, generating a "windfall" to the investors. Fastow became aware of the windfall and demanded a share, in the form of kickbacks through Kopper of investors' RADR proceeds. To disguise the nature of the payments, Fastow instructed Kopper to establish a "gifting program," whereby Kopper and his domestic partner made annual "gifts" of \$10,000 to individual Fastow family members.

21. The \$10,000 amount was chosen because IRS rules exclude from taxable income and do not require reporting of gifts of \$10,000 or less made to any one person in one year. Fastow instructed Kopper that he and his domestic partner should write checks not only to Fastow but also to Fastow's wife and two children. Fastow cautioned that no "gifts" should come directly to him from the other RADR investors or RADR, as Fastow wanted to conceal his link to the RADR deal and could think of no legitimate explanation why he would receive checks from the other RADR investors. Fastow told Kopper that, if ever asked, they could explain the checks from Kopper by saying that he and Fastow were very close friends and the checks were gifts. In all, records reflect that Kopper arranged "gift" payments totaling approximately \$125,000 to Fastow and his family between December 1997 and February 2000.

22. Because RADR was under the control of Fastow and Kopper, and the supposed investments by their friends were secretly funded by Fastow, RADR failed to qualify for off-balance-sheet treatment and should have been consolidated by Enron. By establishing RADR in this manner, Fastow caused Enron to improperly keep RADR off its books and to hide Enron's continued control over the wind farms from regulators to achieve favorable economic benefits.

#### **Chewco**

23. By late 1997, Fastow and Enron began creating SPEs that were under the direct control of Enron executives. The first such SPE was Chewco Investments, L.P. ("Chewco").

24. In 1993, Enron and the California Public Employees' Retirement System ("CALPERS") entered into a joint venture investment partnership called Joint Energy Development Investments LP ("JEDI"). Enron was the general partner of JEDI and contributed \$250 million in Enron stock; CALPERS was the limited partner and contributed \$250 million in cash. Given CALPERS' large equity investment and other factors, Enron did not consolidate JEDI onto its balance sheet and did not include JEDI's debt in its financial statements.

25. In approximately the summer of 1997, Enron began to seek a buyer for CALPERS' share of the JEDI partnership so that CALPERS would agree to invest additional funds in an even larger partnership to be called JEDI II. CALPERS imposed a deadline of November 6, 1997 for the buyout to occur at the negotiated price of \$383 million.

26. Fastow proposed the formation of Chewco to buy out CALPERS' JEDI interest. Fastow initially planned to become Chewco's outside equity investor and general partner, but substituted Kopper when it became clear that Enron would have to publicly disclose Fastow's participation, including disclosure in Enron's financial statements. Nevertheless, Fastow, directly or indirectly, controlled Chewco and Kopper, a fact not publicly disclosed.

27. Before the November 6, 1997 deadline, Fastow and others arranged to fund the buyout temporarily through "bridge" loans from Barclays Bank PLC ("Barclays") and Chase Manhattan Bank ("Chase"). Each bank loaned \$191.5 million to Chewco, with repayment guaranteed by Enron, and Chewco used those loan proceeds to buy CALPERS' interest in JEDI.

28. The bridge transaction was referred to as a "dirty close." Fastow and others knew that Chewco failed to comply with SPE non-consolidation rules because Chewco had no genuine outside equity investment, and because Enron guaranteed Barclays and Chase against risk of loss. Enron thus planned, for financial reporting purposes, to replace the bridge financing before year-end with another structure that would qualify Chewco as an SPE with sufficient outside equity.

29. Chewco's structure at year-end 1997 again failed to meet SPE non-consolidation requirements. Its purported outside "equity" investment consisted of approximately \$11.49 million from Chewco's general and limited partners. However, Enron structured the transaction so that \$11.36 million of the supposed outside equity was actually borrowed from Barclays by various entities set up and controlled by Kopper. The Barclays loans were secured by approximately \$6.58 million in cash that was generated by JEDI's November 1997 sale of an asset. Those funds were held in accounts that were fully pledged to Barclays, meaning that Barclays was partly protected against risk of loss. The remaining "outside equity" consisted of approximately \$125,000 provided by Kopper and his domestic partner.

30. Fastow's undisclosed control of Chewco and Kopper permitted him to demand a share of Chewco's profits and other Chewco related funds. From December 1997 through December 2000, Fastow directed Kopper to secretly share with him various payments received by Kopper relating to Chewco. Kopper received a total of approximately \$1.5 million in "management fees" relating to Chewco, which he shared with Fastow at his direction mainly through checks payable to members of Fastow's family. Fastow directed Kopper to pay at least \$54,000 to Fastow's wife for administrative work she did for Chewco. In December 1998, Fastow caused Enron to pay a \$400,000 "nuisance fee" to Chewco as compensation for agreeing to amend JEDI's partnership agreement, even though the amendment benefitted Chewco, not Enron. At Fastow's direction, Kopper transferred approximately \$67,224 of the nuisance fee back to Fastow, again through checks written to Fastow or members of his family.

31. In March 2001, Enron bought Chewco's limited partnership interest in JEDI. Fastow approved a purchase price of \$35 million, of which Kopper and his domestic partner received approximately \$3 million. In September 2001, Fastow authorized a further \$2.6 million "tax indemnity payment" to Chewco, which Kopper subsequently transferred to himself. The payment was not contractually required and should not have been made, according to advice from Enron's inside and outside counsel at the time. These funds were used by Kopper to partially fund his purchase of Fastow's interests in two "LJM" entities (defined below).

32. Because Chewco did not meet SPE requirements, due to, among other things, the undisclosed control by Fastow and Kopper, lack of independence, and failure to meet the outside equity requirement, the entities Chewco and JEDI should have been consolidated onto Enron's financial statements beginning the fourth quarter 1997. Fastow's formation, structuring, and use of Chewco enabled Enron to conceal millions in debt while falsely increasing income. As a result, Enron's year-end financial statements for the years 1997, 1998, 1999, and 2000 were materially false and misleading. In November 2001, in a Form 8-K filed with the Commission, Enron announced that it would consolidate Chewco and JEDI retroactive to 1997. This resulted in a massive reduction in Enron's reported net income and a massive increase in its reported debt.

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sums of money from such transactions, both in the form of management fees and skimmed deal profits.

38. Fastow and Enron representatives regularly entered into secret side agreements pursuant to which the LJM entities would not bear true economic risk when they "purchased" assets from Enron. Frequently there was an understanding with Enron that the LJM entities would hold assets only for a short period of time, and Enron guaranteed that the LJM entities would make a profit on the buyback of those assets by Enron.

#### Cuiaba

39. Enron, through a wholly-owned subsidiary, held an approximate 65% interest in a power plant and related pipelines under construction in Cuiaba, Brazil (the "Cuiaba project"). Enron was developing the project to generate and sell electricity. However, the Cuiaba project was troubled from its inception and caused Enron to incur significant costs. Enron's problems with the Cuiaba project were well known at Enron.

40. Enron did not want to consolidate the Cuiaba project's debt on its balance sheet, and attempted to sell its interest. Deconsolidating would also permit Enron to mark to market a related power supply contract, thereby recognizing earnings. However, the Cuiaba project was so problematic that no independent third-party would purchase an interest in the project.

41. Enron and Fastow solved their Cuiaba project problem by "selling" an interest in the project to Fastow-controlled LJM1. On September 30, 1999, Enron sold LJM1 a 13% interest in the project for \$11.3 million. The sale of this interest (and the board seat that went with it) was purportedly sufficient for Enron to conclude that it did not control the Cuiaba project. The "sale" enabled Enron to keep the Cuiaba project's substantial debt off its balance sheet. Furthermore, this purported sale enabled Enron to recognize a total of approximately \$65 million of income in the third and fourth quarters of 1999, when it was struggling to meet its projected financial results.

42. LJM1, through Fastow, agreed to "buy" Enron's interest in the Cuiaba project because Enron agreed in an undisclosed side deal to repurchase the interest if necessary and guarantee LJM1 a profit. Enron agreed to repurchase LJM1's interest at a higher price regardless of the actual performance of the Cuiaba project.

43. Because such a buyback agreement would have destroyed the favorable accounting treatment, the buyback agreement, originally in writing, was not set forth in the final deal documents, but continued in fact as part of an oral understanding. The buyback agreement was also not included in the written documents out of concern that Enron's auditors, Arthur Andersen LLP, would not approve the sale to LJM1 with such a provision.

44. After LJM1's purchase, the Cuiaba project continued to suffer serious cost overruns, technical, and environmental problems. Despite the ongoing problems with the Cuiaba project affecting its value, on or about March 2001, Fastow and Enron agreed upon the buyback price of LJM1's interest. For various reasons (including the fact that Fastow did not sell his interest in LJM1 to Kopper until July 2001), Fastow delayed the closing until August 15, 2001. Enron bought back LJM1's interest for \$13,752,000. This purchase

price was calculated to provide LJM1 a significant profit even though the market value for Cuiaba had decreased.

#### Nigerian Barges

45. In 1999, Fastow caused Enron to engage in a fraudulent "sale" of assets to permit Enron to record approximately \$12 million of earnings in the fourth quarter of 1999.

46. The "sale" related to three electricity-generating power barges owned by Enron. In December 1999, an Enron subsidiary entered into an agreement with certain Nigerian government entities for a three-phase energy project related in part to certain of Enron's power barges. These barges were expected to produce future revenues from an agreement for the supply of electricity to the Nigerian government.

47. After several failed attempts to sell a portion of the project, in December 1999, Enron, through Fastow and Enron's Treasurer, contacted a leading financial institution ("Financial Institution") and pressured it to purchase a \$28 million interest in the project, with 75% financed by Enron, so that Enron could book a gain at year end. Such a sale would allow Enron to record approximately \$12 million of earnings in the fourth quarter of 1999, so that Enron could meet earnings goals, and to record \$28 million in funds flow.

48. In spite of some dissension within the Financial Institution, including an internal document expressing concern that it could be viewed as aiding and abetting Enron's fraudulent manipulation of its income statement, the Financial Institution ultimately agreed to invest in the project. The Financial Institution invested \$7 million, and Enron financed the remainder of the deal with a \$21 million loan that was non-recourse to the Financial Institution. The Financial Institution never paid any interest on the loan. The Financial Institution had no real interest in investing in barge power projects in Nigeria but wanted to accommodate Enron, an important client and source of millions in fees to the Financial Institution. The Financial Institution conducted no due diligence on the barge project and did not actively monitor its investment.

49. To induce the Financial Institution to enter into the transaction, Fastow guaranteed the Financial Institution that it would not lose money and would be taken out of the deal within six months. The Financial Institution was to receive an up front fee of \$250,000 plus 15% per annum for the period the Financial Institution held the investment, or an approximately 22.5% return. Enron falsely recorded the transaction with the Financial Institution as a sale and improperly recorded approximately \$12 million of fictitious earnings in the fourth quarter of 1999.

50. Six months later, consistent with the guarantee given by Fastow to the Financial Institution, Fastow arranged for the Financial Institution to be bought out of its interest in the barges. Fastow directed Kopper to have LJM2 buy the Financial Institution's interest and on June 29, 2000, the day before the date Fastow had agreed to "take out" the Financial Institution, LJM2 bought the Financial Institution's interest for \$7,525,000. The price was not the product of negotiation. Rather, the price reflected a \$525,000 premium over the Financial Institution's original investment to account for the rate of return promised to the Financial Institution. LJM2 made the purchase to fulfill Fastow's guarantee. Further, had Enron repurchased the asset it may have had to reverse the sale, negating the favorable accounting treatment.

**Raptor I/AVICI**

51. Enron and LJM2 engaged in complex financial transactions with an entity called Raptor I. Fastow and others used Raptor I to generate profits for LJM2 and Fastow and to manipulate Enron's financial statements. Specifically, Fastow and others: (1) used Raptor I as an off balance sheet vehicle that they knew in fact did not qualify for such treatment, and therefore should have been consolidated on Enron's books; and (2) backdated documents to generate profits for Enron.

52. Enron invested in other companies, including start-up ventures that later did initial public offerings ("IPO") of their shares. At the time of an IPO, Enron often owned millions of shares of the newly public company. Following the IPO, Enron was at risk for market price fluctuations in the shares. The value of such stock was required to be recorded in Enron's financial statements at the end of each quarter. Because Enron was restricted by "lock up" agreements from selling its shares until some future date, it sought to reduce the impact on its financial results of a possible dramatic decline in the share price.

53. Raptor I was designed to protect Enron's financial statements from decreases in the value of certain Enron investments. Enron sought to use Raptor I to lock in the value of Enron's investments in stock, without actually selling its investments.

54. Raptor I was created in April 2000 through an off-balance-sheet SPE called Talon LLC ("Talon"). Talon was designed to generate accounting gains which would offset Enron's significant mark to market losses on certain investments. Talon would enter into transactions with an Enron subsidiary that would lock in the value of Enron's stock portfolio. If the price of Enron's stock portfolio increased, Talon would be entitled to the upside gain, and if the stock portfolio declined, Talon would be obligated to pay the Enron subsidiary the amount of the loss.

55. Talon was funded mainly by Enron through a promissory note and Enron's own stock. The remainder of Talon's funding, \$30 million, was from LJM2, representing the purported three percent outside equity required for Talon to be off Enron's balance sheet.

56. However, Talon should have been consolidated on Enron's financial statements because of an undisclosed side deal engineered by Fastow. Pursuant to the side deal, Enron agreed that, prior to conducting any hedging activity with Talon, Enron would return to LJM2 its full investment in Talon plus a guaranteed return. This undisclosed side deal would have "broken" the SPE, that is, it would have required Talon to be consolidated on Enron's financial statements because the supposed outside three percent equity was not at risk. Further, with the return of LJM2's capital by Talon, there was no outside equity at risk to justify Talon not being consolidated. Yet, Enron did not consolidate Talon on its financial statements filed with the Commission. In exchange for this side agreement, Fastow caused and allowed Enron employees to use Talon to manipulate Enron's financial statements. Pursuant to the undisclosed side deal, after LJM2 invested \$30 million in Talon, it received \$41 million from Talon on or about September 7, 2000, reflecting a return of its capital and \$11 million profit.

57. To conceal the side deal, Fastow and others devised a scheme to manufacture a \$41 million payment to LJM2. Fastow and others made it appear that the payment represented the premium paid on a "put option" on Enron shares that Enron purchased from Talon. Enron purchased the put option, set to expire on October 18, 2000, for a premium of \$41 million. Enron settled the put option early and Talon then distributed the \$41 million to LJM2. The transaction was unusual for several reasons, including the fact that the put option was a bet by Enron that its own stock price would decline. There was no true business purpose for the put option other than to generate funds to pay LJM2 under the undisclosed side deal.

58. One of Enron's Raptor I hedges related to its attempt to lock in substantial gains from its stock holdings in AVICI Systems, Inc., an Internet company that had recently engaged in an IPO. Because the stock price of AVICI had declined by the end of Enron's third quarter 2000, Fastow engaged in a fraudulent scheme to backdate the AVICI hedge to achieve a significant economic advantage for Enron.

59. Fastow caused the AVICI hedge to be backdated to August 3, 2000. Fastow chose this date because he knew it was the date AVICI traded at an all time high price of \$163.50. By back-dating the AVICI hedge in this manner, Fastow and Enron fraudulently locked in the recognition of a substantial gain and booked \$75 million in additional mark to market gains that they otherwise would not have recognized. To facilitate the fraud, the put option was purportedly settled early, also on August 3, 2000, so that Enron could use Raptor I for hedging purposes.

#### Southampton

60. Enron had an investment in an Internet company called Rhythms NetConnections, Inc. ("Rhythms"). Enron owned approximately 5.4 million shares of Rhythms stock, and following an IPO in April 1999, Enron was at risk for market price fluctuations in the stock. Because Enron was restricted from selling its shares until November 1999, it sought to reduce the impact on its financial results of a possible dramatic decline in the share price of Rhythms stock.

61. In June 1999, Enron devised a scheme to reduce its risk through a "hedge." As part of this hedging effort, LJM1 created a subsidiary known as LJM Swap Sub, L.P. ("Swap Sub"), which was funded with cash and Enron shares. Swap Sub thereafter entered into a series of transactions with Enron known as "derivatives." These derivatives transactions included a "put," which gave Enron the right to sell its Rhythms shares to Swap Sub for a set price on certain future dates even if the market value of the Rhythms Net shares was below the set price. In the third and fourth quarters 1999, the share price of Rhythms Net decreased significantly and Enron was able to record gains from its transaction with Swap Sub to offset losses it incurred on its Rhythms Net investment.

62. In January-February 2000, both Enron and Rhythms shares increased in price, making Swap Sub's main asset (its Enron shares) more valuable while decreasing its potential liability on the Rhythms put option. Thus, Swap Sub had significantly more value than previously. Fastow was prohibited from having any direct pecuniary interest in Enron's stock held by LJM1. Nevertheless, in approximately February 2000, Fastow, Kopper, and three NatWest bankers devised and later executed a scheme to capture the increase in Swap Sub's value for themselves and others and defraud Enron, NatWest, and others by: (i) causing Enron to pay \$30 million to buy out, or "unwind," the banks'

interests in Swap Sub; (ii) causing NatWest to accept only \$1 million for its interest in Swap Sub, while representing to Enron that NatWest was getting \$20 million, and (iii) splitting the \$19 million balance among themselves and certain Enron and LJM employees.

63. In part to conceal from Enron and NatWest the true structure of the Swap Sub transaction and the roles played by Fastow, Kopper, and the bankers, Kopper created several layers of partnerships that would buy Swap Sub. The partnership created to buy NatWest's interest in Swap Sub was Southampton, L.P., in which Fastow, Kopper, and certain other Enron and LJM employees had a financial interest. Southampton K Co. was a limited partner in and owned 50% of Southampton, L.P. Thus, after Southampton, L.P. purchased Nat West's interest in Swap Sub, Southampton K Co. would own 50% of that interest. Kopper provided the bankers with an option to buy Southampton K Co. for \$250,000. Upon exercising that option, the bankers would own 50% of Nat West's interest in Swap Sub, an ownership interest that Fastow and Kopper knew Enron was prepared to purchase for millions of dollars.

64. To carry out the scheme, Fastow, Kopper and others, on or about March 22, 2000, caused Enron to agree to pay \$30 million (purportedly allocated \$20 million to NatWest and \$10 million to CSFB) to unwind Swap Sub. That purchase price was based on Fastow's false representation to Enron that NatWest and CSFB had agreed to sell their interests in Swap Sub for \$20 million and \$10 million, respectively. In fact, NatWest received only \$1 million and had agreed to receive this sum based on misrepresentations and fraudulent conduct of its own employees, who sought to skim profits that should have gone to NatWest.

65. As a result, the three NatWest bankers who participated in the scheme received approximately \$7.3 million. The balance of the funds went to Fastow, Kopper and other investors in an entity called Southampton Place LP ("Southampton"), which Kopper created. The Southampton "investors" were a purported charitable foundation set up by Fastow for the purpose of receiving Southampton proceeds, which contributed \$25,000 and received approximately \$4.5 million; Kopper, who contributed \$25,000 and caused Chewco to loan another \$680,000, and received approximately \$4.5 million; and five Enron and LJM employees chosen by Kopper and Fastow, who contributed a total of less than \$20,000 and received a total of approximately \$3.3 million. The payments were made on approximately May 1, 2000.

66. In November 2001, in a Form 8-K filed with the Commission, Enron announced that it would consolidate Swap Sub retroactive to 1999. Enron concluded that Swap Sub did not qualify for nonconsolidation treatment because of inadequate capitalization. The consolidation had the effect of reducing Enron's reported net income by \$95 million in 1999, and by \$8 million in 2000.

#### CLAIMS FOR RELIEF

##### FIRST CLAIM

**Violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)]  
and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]**

67. Paragraphs 1 through 66 are realleged and incorporated by reference herein.

68. As set forth more fully above, Fastow, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails and of the facilities of a national securities exchange, in connection with the purchase or sale of securities: has employed devices, schemes, or artifices to defraud, has made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

69. By reason of the foregoing, Fastow violated and aided and abetted violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

70. By reason of the foregoing, Fastow was a controlling person of Enron and its executives and employees, and a controlling person of Kopper, within the meaning of Section 20(a) of the Exchange Act [15 U.S.C. § 78t(a)], and by virtue of that control violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

#### SECOND CLAIM

##### Violations of Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)]

71. Paragraphs 1 through 70 are realleged and incorporated by reference herein.

72. Fastow, by engaging in the conduct described above, directly or indirectly, in connection with the offer or sale of securities, by the use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails: with scienter, employed devices, schemes, or artifices to defraud, obtained money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon the purchasers of such securities.

73. By reason of the foregoing, Fastow violated Section 17(a) of the Securities Act.

#### THIRD CLAIM

##### Violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, & 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13]

74. Paragraphs 1 through 73 are realleged and incorporated by reference herein.

75. By engaging in the conduct described above, Fastow knowingly and substantially caused Enron to file materially false and misleading annual reports on Form 10-K and materially false and misleading quarterly reports on Form 10-Q with the Commission during the period 1997 through at least September 2001.

76. By reason of the foregoing, Fastow aided and abetted violations by Enron of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

77. By reason of the foregoing, Fastow was a controlling person of Enron and its executives and employees, and a controlling person of Kopper, within the meaning of Section 20(a) of the Exchange Act [15 U.S.C. § 78t(a)], and by virtue of that control violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

#### FOURTH CLAIM

**Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B)] and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1]**

78. Paragraphs 1 through 77 are realleged and incorporated by reference herein.

79. By engaging in the conduct described above, Fastow aided and abetted Enron's failures to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflected Enron's transactions and dispositions of its assets, in violation of Section 13(b)(2)(A) of the Exchange Act, and further aided and abetted failures to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that Enron's corporate transactions were executed in accordance with management's authorization and in a manner to permit the preparation of financial statements in conformity with generally accepted accounting principles in violation of Section 13(b)(2)(B) of the Exchange Act.

80. By engaging in the conduct described above, Fastow, directly or indirectly, falsified and caused to be falsified Enron's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act in violation of Rule 13b2-1 thereunder.

81. By reason of the foregoing, Fastow aided and abetted violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and violated Rule 13b2-1 thereunder.

82. By reason of the foregoing, Fastow was a controlling person of Enron and its executives and employees and a controlling person of Kopper, within the meaning of Section 20(a) of the Exchange Act [15 U.S.C. § 78t(a)], and by virtue of that control violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder.

#### FIFTH CLAIM

**Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)]**

83. Paragraphs 1 through 82 are realleged and incorporated by reference herein.

84. By engaging in the conduct described above, Fastow knowingly circumvented or knowingly failed to implement a system of internal financial controls at Enron.

85. By reason of the foregoing, defendant Fastow violated Section 13(b)(5) of the Exchange Act.

86. By reason of the foregoing, Fastow was a controlling person of Enron and its executives and employees within the meaning of Section 20(a) of the Exchange Act [15 U.S.C. § 78t(a)], and by virtue of that control violated Section 13(b)(5) of the Exchange Act.

**SIXTH CLAIM**

**Violations of the Exchange Act Rule 13b2-2 thereunder [17 C.F.R. § 240.13b2-2]**

87. Paragraphs 1 through 86 are realleged and incorporated by reference herein.

88. By engaging in the conduct described above, in connection with the Cuiaba transaction described above, Fastow, directly or indirectly, made or caused to be made false and misleading statements or omitted or caused others to omit to state material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to Enron's independent accountants and Enron's auditors in connection with audits and examinations of Enron's required financial statements and in connection with the preparation and filing of documents and reports required to be filed with the Commission, in violation of Exchange Act Rule 13b2-2.

89. By reason of the foregoing, defendant Fastow violated and aided and abetted violations of the Exchange Act Rule 13b2-2.

90. By reason of the foregoing, Fastow was a controlling person of Enron and its executives and employees, and a controlling person of Kopper, within the meaning of Section 20(a) of the Exchange Act [15 U.S.C. § 78t(a)], and by virtue of that control violated Exchange Act Rule 13b2-2.

**JURY DEMAND**

91. The Commission demands a jury in this matter.

**PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that this Court:

A. Grant a Permanent Injunction restraining and enjoining Fastow from violating the statutory provisions set forth herein; prohibiting him permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act; and ordering him to pay disgorgement of illegal gains, and civil penalties;

B. Pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, enter an order providing that the amount of civil penalties ordered against Fastow be added to and become part of a disgorgement fund for the benefit of the victims of the violations alleged herein; and

C. Grant such other and additional relief as this Court may deem just and proper.



Dated: October \_\_\_\_, 2002

Respectfully submitted,

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Stephen M. Cutler  
Director, Enforcement Division

Linda Chatman Thomsen  
Deputy Director, Enforcement Division

Charles J. Clark  
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SOUTHERN DISTRICT OF TEXAS  
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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

OCT 31 2002

MICHAEL N. MILBY, CLERK OF COURT

H- 02-0665

Cr. No. H-02-

UNITED STATES OF AMERICA

§  
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§

v.

ANDREW S. FASTOW

Violations 18 U.S.C. §§ 1343 (Wire Fraud);  
1956(a), 1956(b), 1957 (Money  
Laundering); 1512 (Obstruction of Justice);  
371 (Conspiracy); and 2 (Aiding and  
Abetting).

INDICTMENT

Committee on Governmental Affairs

EXHIBIT #A-8

The Grand Jury charges:

1. At all times relevant to this indictment, Enron Corp. ("Enron") was an Oregon corporation with its headquarters in Houston, Texas. Among other businesses, Enron was engaged in the purchase and sale of natural gas, construction and ownership of pipelines and power facilities, provision of telecommunication services, and trading in contracts to buy and sell various commodities. Before it filed for bankruptcy on December 2, 2001, Enron was the seventh largest corporation in the United States.
2. Enron was a publicly traded company whose shares were listed on the New York Stock Exchange. As a public company, Enron was required to comply with regulations of the United States Securities and Exchange Commission ("SEC"). Those regulations protect members of the investing public by, among other things, ensuring that a company's financial information is accurately recorded and disclosed to the public.
3. Under SEC regulations, Enron and its officers had a duty to make and keep books, records and accounts that fairly and accurately reflected Enron's business transactions, and file

with the SEC reliable quarterly and annual reports.

4. The defendant ANDREW S. FASTOW, a resident of Houston, Texas, was Enron's Chief Financial Officer ("CFO") from March 1998 to October 24, 2001. Prior to serving as CFO, FASTOW served as a Managing Director at Enron. As CFO, FASTOW had oversight over many of Enron's financial activities. FASTOW reported directly to Enron's Chief Executive Officer ("CEO"). During the time that he served as Enron's CFO, FASTOW also served as the general partner and otherwise was in control of certain special purpose entities ("SPEs") with which Enron did business.

5. FASTOW as an Enron employee and executive officer owed a duty to Enron and its shareholders to provide the company with his honest services.

THE SCHEMES TO DEFRAUD

6. Between at least 1997 and October 24, 2001, FASTOW and others devised schemes to defraud Enron and its shareholders, the investing public, the SEC, and others. The goals of the schemes included:

- (a) fabrication of Enron's reported financial results so that Enron would appear more successful than it was;
- (b) artificial manipulation of the share price of Enron stock;
- (c) circumvention of federal regulations so that Enron could obtain benefits to which it was not entitled;
- (d) illusion of business skill and success on the part of FASTOW and other Enron senior management; and
- (e) personal enrichment of FASTOW and others at the expense of Enron, its

shareholders, and others to whom they owed a duty of honest services.

7. The means by which FASTOW and others achieved, and conspired and attempted to achieve, the goals of the schemes included:

- (a) Enron's engaging in fraudulent transactions with SPEs;
- (b) Enron's filing materially false and misleading financial statements with the SEC;
- (c) Enron's making false and misleading public statements about Enron's financial performance; and
- (d) FASTOW's and others' taking advantage of their simultaneous control over SPEs and Enron's business operations.

Enron's Use of Special Purpose Entities

8. Since at least the early 1990's, Enron engaged in transactions with SPEs that were designed to improve Enron's reported financial results. Enron's treatment of its transactions with these SPEs for financial statement purposes was subject to accounting rules that governed whether an SPE should be consolidated onto Enron's balance sheet, or treated as a separate entity not under Enron's control. Enron's management, including FASTOW, preferred the latter result, known as "off-balance-sheet," because it enabled Enron to (a) book earnings and record cash flow and (b) avoid inclusion of unfavorable information in its reported financial statements, thereby presenting itself more attractively to Wall Street investment analysts, credit rating agencies, the investing public, and others.

9. Under applicable accounting rules, an SPE properly could receive off-balance-sheet treatment only if independent third-party equity investors contributed at least 3% of the SPE's capital, and the third-party investment was genuinely at risk, among other requirements. If

the third party was not truly independent, or its equity not truly at risk, consolidation of the SPE onto Enron's balance sheet was required.

The RADR Transaction

10. In early 1997, Enron owned interests in certain California wind farms which qualified for government financial benefits conferred on alternative energy sources. Such energy facilities were known as "qualifying facilities" or "QFs." Under applicable federal regulations, wind farms that were more than fifty percent owned by an electric utility holding company were ineligible for QF status, and accordingly were not entitled to the associated financial benefits. By at least early 1997, FASTOW knew that Enron's wind farms were about to lose their QF status because Enron was in the process of acquiring Portland General Electric, and as a consequence Enron would become an electric utility holding company.

11. In approximately March 1997, FASTOW and others devised a scheme enabling them to reap the proceeds from the wind farms, without the farms losing their valuable QF status. As part of the scheme, Enron appeared to partially divest itself of its interest in the wind farms through a sale to an SPE known as RADR. In reality, Enron illegally and secretly retained control over the farms and the purported independent 3% equity in the SPE. Although FASTOW at first planned to serve as the SPE's outside equity investor and general partner, nominees were substituted after FASTOW learned that his own involvement or that of his relatives would have prevented the desired QF status. FASTOW provided funding for the nominees' "investment" in RADR through a loan from his personal checking account. The nominees remained under the concealed control of FASTOW and another Enron finance executive, Michael Koppen.

12. On approximately May 31, 1997, RADR purchased Enron's interest in the wind

farms for \$17 million.<sup>1</sup> Enron funded 97% of the purchase price with a \$16.49 million loan to RADR. The supposedly independent 3% equity investors in RADR contributed the remaining \$510,000. FASTOW contributed \$419,000 of that sum through concealed loans.

13. Although he did not appear as a partner or investor in RADR, FASTOW directed the distribution of RADR proceeds. Indeed, FASTOW personally benefited from the RADR transaction, in violation of FASTOW's duty to provide Enron with his honest services. For instance, RADR began making distributions to the nominees on July 1, 1997. On or about August 26, 1997, at FASTOW's direction, FASTOW received from the nominees \$481,850 in RADR proceeds, which represented \$62,850 more than the sum he had fronted the nominees. And between approximately December 1997 and February 2000, FASTOW received an additional \$126,000 in RADR proceeds. So that his concealed interest in RADR would not be revealed, at FASTOW's direction the payments were disguised as "gifts" from Kopper and others to FASTOW, his wife and two children.

The Chewco Transaction

14. In 1995 Enron and the California Public Employees Retirement System ("CALPERS") entered into a \$500 million joint venture known as Joint Energy Development Investments ("JEDI"), which made various energy investments. Given CALPERS' 50% equity investment and other factors, Enron was able to treat JEDI for accounting purposes as an equity investment in an off-balance-sheet entity.

15. In approximately the summer of 1997, CALPERS decided to liquidate its investment in JEDI, and later agreed to do so for \$383 million. FASTOW proposed the creation

<sup>1/</sup> Numbers referred to herein are approximate.

of an SPE known as Chewco to buy CALPERS' interest in JEDI. Although FASTOW at first planned to serve as Chewco's outside equity investor and general partner, Kopper was substituted when FASTOW learned that his own involvement would trigger financial disclosure obligations for Enron.

16. While FASTOW was precluded from serving in an official role at Chewco, he nevertheless directed that he receive a portion of Chewco's proceeds from Kopper, in violation of FASTOW's duty to provide honest services to Enron and its shareholders. For example, in December 1998, FASTOW improperly authorized Enron to pay a \$400,000 "nuisance/arrangement fee" to Chewco to obtain its consent to amend the JEDI partnership agreement, even though the amendment was for the benefit of Chewco, not Enron. In December 1998 and January 1999, FASTOW received kickbacks from that payment totaling \$67,224, in the form of checks from Kopper to FASTOW and FASTOW's family.

17. FASTOW authorized other payments from Enron to Chewco that were against Enron's interest. For example, on March 26, 2001, Enron repurchased Chewco's limited partnership interest in JEDI for \$35 million. On behalf of Chewco, Kopper requested an additional payment from Enron to Chewco of \$2.625 million under a purported tax indemnity agreement executed in 1997. Against the advice of both inside and outside counsel at Enron, FASTOW approved the payment to Chewco.

The LJM EntitiesOverview

18. By 1999, Enron was increasingly dependent on transactions with SPEs to meet its financial reporting goals. By June 1999, in order to have an off-balance-sheet SPE to which Enron regularly could turn, Enron's Board agreed to permit FASTOW to create and serve as the managing partner of a new SPE known as LJM1. The Board later approved FASTOW's participation in another SPE, known as LJM2 (the LJM entities hereafter collectively will be referred to as "LJM" unless otherwise noted). The vast majority of LJM's business involved transactions with Enron and its affiliates.

19. From approximately July 1999 through October 2001, Enron entered into transactions with LJM that defrauded Enron, its shareholders, the SEC, and others. The transactions with LJM enabled Enron to: (a) manipulate its reported financial results by moving poorly performing assets off balance sheet, when in fact such off-balance-sheet treatment was improper; (b) manufacture earnings through sham transactions with LJM when Enron was having trouble otherwise meeting its goals for a quarter; and (c) improperly inflate the value of Enron's investments by backdating transaction documents to dates advantageous to Enron.

20. Enron's dealings with LJM also ensured that: (a) as CFO, FASTOW readily could rid Enron of poorly performing assets and thereby improve Enron's reported financial results, which in turn would enable FASTOW to earn continued prestige, salary, bonuses, and other benefits from Enron; (b) LJM would meet its predicted rate of return, as Enron management secretly agreed that LJM losses would be made up in future deals; and (c) FASTOW and others at LJM personally reaped huge sums of money from such transactions, both in the form of

management fees and skimmed deal profits.

False Representations to Enron's Board

21. FASTOW and others made various false representations to Enron's Board of Directors (the "Board") to obtain its approval for FASTOW's participation in LJM. Specifically, the Board was assured that: (a) Enron's Chief Accounting Officer ("CAO") and Chief Risk Officer would review transactions with LJM to ensure their fairness to Enron; (b) the Board would be informed of all Enron transactions with LJM; (c) the purpose of LJM was to buy assets from Enron; and (d) although FASTOW would be compensated by LJM, he would not profit from any appreciation in the value of Enron stock held by LJM or its affiliates.

22. In fact, as FASTOW knew, far from reviewing transactions with LJM to ensure their fairness to Enron, Enron's CAO and others had an undisclosed agreement with FASTOW that ensured that, over time, LJM would not lose money in its dealings with Enron.

23. As FASTOW further knew, although the Board was told that LJM was a vehicle to which Enron could sell assets, and that it would be informed of all transactions with LJM, the Board was not informed that Enron would from time to time repurchase assets from LJM, or find another buyer, so as to provide a profit to LJM.

24. Finally, as described more fully below in connection with a transaction known as Southampton, FASTOW violated his own representation to the Board that he would not personally profit from any appreciation in the value of Enron shares held by LJM.

Use of LJM to Manipulate Enron's Financial Results

25. Several transactions between Enron and LJM were mere "parking" or "warehousing" deals in which Enron "sold" assets to LJM so that it could book earnings and

record cash flows. Enron secretly agreed that LJM would hold the asset only for a short time, after which Enron would arrange a repurchase of the assets at a profit to LJM.

The Cuiaba Transaction

26. One parking transaction involved LJM's "purchase" of part of Enron's interest in a company that was building a power plant in Cuiaba, Brazil (the "Cuiaba project"). The Cuiaba project had caused Enron to incur significant costs and by 2000 was approximately \$120 million over budget.

27. When no true third-party buyer could be found, FASTOW and others arranged on September 30, 1999 to "sell" a portion of Enron's interest in the Cuiaba project to LJM for \$11.5 million. This purported sale enabled Enron to recognize a total of approximately \$65 million of income in the third and fourth quarter of 1999, when it was struggling to meet its projected financial results.

28. LJM agreed to "buy" Enron's interest in the Cuiaba project despite its problems only because Enron and FASTOW in an undisclosed oral side deal agreed that Enron would buy back the interest if necessary at a profit to LJM. That secret buy-back agreement was concealed from Enron's outside auditors and Enron's Board by FASTOW and others.

29. After the LJM "purchase," the Cuiaba project continued to encounter serious problems. Despite these problems, in August 2001 FASTOW caused Enron to buy back LJM's Cuiaba interest at a considerable profit to LJM.

The Nigerian Barge Transaction

30. Another example of asset parking involved Enron's interest in electricity-generating power barges moored off the coast of Nigeria. In 1999, Enron made unsuccessful

efforts to sell an interest in the barges to a third party. When Enron failed to sell the project by December 1999, Enron through FASTOW and others arranged for a major financial institution (the "Financial Institution") to "buy" a \$28 million interest in the project. The Financial Institution agreed to "purchase" the interest only because: (a) FASTOW promised in an oral "handshake" deal that the Financial Institution would receive a fixed 15% interest rate and would not have to hold the barge interest for more than six months and (b) Enron would finance 75% of the purchase price and only require the Financial Institution to put up \$7 million. The Financial Institution's "purchase" allowed Enron to record improperly \$12 million in earnings and \$28 million in funds flow in the fourth quarter of 1999.

31. With no true third-party purchaser available to buy the Financial Institution's interest as the six-month deadline loomed, on June 29, 2000, FASTOW had LJM purchase the Financial Institution's interest. LJM paid \$7,525,000 for the Financial Institution's interest, which represented a \$525,000 premium over the Financial Institution's original investment to account for the rate of return promised by Enron. FASTOW caused Enron to provide financing for LJM's purchase, and for Enron to pay LJM a substantial undisclosed fee for entering into the deal with the Financial Institution. Enron subsequently arranged for a third party to purchase LJM's interest in the barges, again at a profit to LJM.

Manipulation of Enron's Books Through Hedging Transactions

Talon

32. Beginning in the spring of 2003, Enron and LJM engaged in a complex scheme to manipulate artificially Enron's financial statements. LJM enabled Enron to falsify its financial picture; in return, LJM profited handsomely. Specifically, FASTOW, Enron's CAO, Enron's

Treasurer, and others used an SPE known as Talon to engage in illegal transactions, namely: (1) the use of Talon as an off-balance-sheet vehicle that FASTOW and others knew in fact did not qualify for such treatment and should have been included on Enron's books; (2) the backdating of documents to manipulate Enron's financial statements; and (3) the manufacture of guaranteed earnings for LJM.

33. Enron invested in other companies, including start-up ventures that later did initial public offerings ("IPO") of their shares. At the time of an IPO, Enron often owned substantial shares of the company. The value of such stock was required to be recorded at the prevailing market price in Enron's financial statements at the end of each quarter. Following an IPO, Enron was at risk for market price fluctuations in the shares, many of which were extremely volatile. Because Enron was restricted by "lock up" agreements from selling these shares until some future date, it sought to reduce the impact on its financial results of a possible dramatic decline in the share price.

34. Talon, which was created in April 2000, was designed by FASTOW and others to protect Enron's balance sheet from decreases in value of certain of these investments. Talon would enter into "hedging" transactions with an Enron subsidiary that would lock in the value of Enron's stock portfolio: if the price of Enron's stock increased, Talon would reap the upside gain, and if the stock declined, Talon would pay the Enron subsidiary the amount of the loss.

35. Talon was funded mainly by Enron through a promissory note and Enron's own stock. The remainder of Talon's funding came from a \$30 million investment from LJM. This alleged third party funding served as the supposed 3% outside equity required for Talon not to be reflected in Enron's financial statements.

36. As FASTOW and others knew, however, Talon was not properly off balance sheet. Enron and FASTOW entered into a side agreement whereby Enron guaranteed that it would pay \$41 million to LJM before Talon would be allowed to engage in the hedging transactions for which it was created. In exchange, FASTOW allowed Enron to use Talon to manipulate Enron's balance sheet. As a result of this secret side deal, LJM's investment was never truly at risk.

37. In order to mask the side deal, FASTOW, Enron's CAO, and others devised a scheme to manufacture a \$41 million payment from Enron to LJM. To do so, Enron and Talon entered into a "put," that is, a transaction that ostensibly served to hedge Enron against a decline in its own stock value. That "put" option was purchased by Enron for \$41 million. The \$41 million was paid to Talon and then transferred to LJM on September 7, 2000.

Back-Dating Documents In Order to Manipulate Enron's Financial Statements

38. After agreeing to make the \$41 million payment to LJM, Enron began to use Talon to hedge Enron's investments. FASTOW and others allowed Enron to record inflated values for its investment portfolio by back-dating Talon hedge documents to dates when Enron's stocks were trading at prices higher than those in effect on the date the hedge was actually entered into. Specifically, Enron used back-dating to inflate the value of its investment in 1.09 million shares of AVICI stock. While Enron hedged its AVICI investment through Talon in late August 2000, FASTOW and others caused documents related to the hedge to be backdated to August 3, 2000. At the close of business on that day, the price of AVICI was at an all time high of \$163.50, while the share price by the actual date of the hedge had declined significantly. By backdating the hedge transaction to August 3, 2000, Enron avoided having to report the decline

in value that actually had occurred by the true date of the hedge.

FASTOW's Use of LJM to Enrich Himself and Others

39. Enron owned approximately 5.4 million shares of Rhythms NetConnections, Inc. ("Rhythms Net"), an internet company. In approximately April 1999, Rhythms Net conducted an IPO of its shares. Following the IPO, Enron was at risk for market price fluctuations in Rhythms Net shares. Because Enron was restricted from selling its shares until November 1999, it sought to reduce the impact on its financial results of a possible dramatic decline in the share price of Rhythms Net stock.

40. In approximately June 1999, FASTOW devised a means for Enron to reduce the risk of its investment in Rhythms Net through a hedge. As part of this hedging effort, FASTOW and others caused the creation of an LJM subsidiary known as LJM Swap Sub, L.P. ("Swap Sub"). Credit Suisse First Boston ("CSFB") and National Westminster Bank ("NatWest") invested and became limited partners in Swap Sub, which held both Enron shares and cash. Swap Sub thereafter entered into a series of transactions with Enron, including a "put" that gave Enron the right to sell its Rhythms Net shares to Swap Sub for a set price on certain future dates even if the market value of the Rhythms Net shares was below the set price.

41. By early 2000, Enron's and Rhythms Net's share prices had increased; consequently, so had the value of Swap Sub. Even though FASTOW was prohibited by Enron's Board from having any direct pecuniary interest in Enron's stock held by LJM, FASTOW, Kopper, and three bankers employed by NatWest devised a scheme to defraud Enron and NatWest by capturing a substantial portion of the increased value of Swap Sub's Enron shares for themselves and others.

42. It was part of the scheme that FASTOW, Kopper, and the NatWest bankers fraudulently induced NatWest to sell its interest in Swap Sub for \$1 million, at a time when they knew the interest was worth millions more. Indeed, on or about March 22, 2000, FASTOW finalized an agreement with Enron to pay Swap Sub \$30 million to unwind Enron's transactions with Swap Sub. FASTOW represented to Enron that CSFB would receive \$10 million, and falsely represented that NatWest would receive \$20 million. In fact, as FASTOW and his co-conspirators knew, NatWest received only \$1 million.

43. The \$19 million of illegal proceeds was divided among the conspirators. The NatWest bankers received approximately \$7.3 million. The remaining balance of the funds went to "investors" in a partnership known as Southampton. These "investors" included FASTOW, Kopper, Enron's Treasurer, various LJM employees, and an Enron in-house attorney. Specifically, on approximately May 1, 2000, the "investors" in Southampton received the following payout: the FASTOW Family Foundation \$4.5 million, Kopper \$4.5 million, and the five Enron and LJM employees received a total of approximately \$3.3 million.

Sale of the LJM Entities

44. In July 2001, Enron determined that FASTOW's continued role in LJM would require disclosure in Enron's financial statements. To avoid such disclosure while keeping LJM available for use by Enron, FASTOW sold his interest in LJM to Kopper.

COUNT ONE

(Conspiracy to Commit Wire Fraud: Self-Dealing by FASTOW)

45. The allegations of paragraphs 1 through 17 and 39 through 44 are realleged as if fully set forth here.

46. In or about and between at least 1997 and October 2001, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others conspired to devise a scheme and artifice to defraud, including to deprive Enron and its shareholders and NatWest of their intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and for the purpose of executing such scheme and artifice would transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, all in violation of Title 18, United States Code, Section 1343.

OVERT ACTS

47. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did commit and cause to be committed the following overt acts, among others:

RADR

- a. In or about May 1997, FASTOW wired \$419,000 to Kopper.
- b. In or about August 1997, FASTOW received a \$481,350 wire transfer from Kopper.
- c. In or about December 1997 through February 2000, FASTOW and Kopper directed the payment of RADR proceeds to FASTOW, his wife and two children.

Chewco

- d. In or about December 1998, FASTOW caused Enron to pay \$400,000 to Chewco as a "nuisance/arrangement fee."
- e. On or about and between December 31, 1998 and January, 1999, FASTOW, his wife

and children received checks from Kopper totaling \$67,224.

Southern

f. On or about March 4, 2000, FASTOW met with a NatWest banker in the Cayman Islands.

g. On or about March 10, 2000, a NatWest banker faxed a letter from London, England to Houston, Texas stating that NatWest would sell its interest in Swap Sub for \$1 million.

h. On or about April 25, 2000, a NatWest banker caused a wire transfer of \$251,993 from an account in England to an account in Houston, Texas.

i. On or about May 1, 2000, \$7,352,626 was wire transferred from Houston, Texas to an account in the Cayman Islands controlled by one of the NatWest bankers.

j. On or about May 1, 2000, \$1,040,744 was wire transferred to an account controlled by an Enron employee.

k. On or about May 1, 2000, \$4,466,189 was wire transferred to an account in the name of the FASTOW Family Foundation.

( Title 18, United States Code, Sections 371 and 3551 et seq.)

COUNT TWO

(Conspiracy to Commit Wire Fraud – Nigerian Barges)

48. The allegations of paragraphs 1 through 9, 18 through 25, and 30 and 31 are realleged as if fully set forth here.

49. In or about and between December 1999 and December 2000, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendant ANDREW S. EASTOW and others conspired to devise a scheme and artifice to defraud,

including to deprive Enron and its shareholders of their intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses and representations, and for the purpose of executing such scheme and artifice would transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, all in violation of Title 18, United States Code, Section 1343.

OVERT ACTS

50. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did commit and cause to be committed the following overt acts, among others:

- a. In or about December 1999, FASTOW spoke with representatives of the Financial Institution regarding its investing in the barges.
- b. In or about December 1999, FASTOW committed to the Financial Institution that Enron would take the Financial Institution out of the barge transaction within six months.
- c. In or about December 1999, Enron made false representations to its outside auditors regarding the agreement between the Financial Institution and Enron.
- d. In or about June 2000, FASTOW caused LJM to purchase the Financial Institution's interest in the barges.
- e. In or about June 2000, FASTOW caused Enron to pay LJM a fee for purchasing the Financial Institution's interest in the barges.
- f. In or about June 2000, Enron made false representations to its outside auditors

regarding the agreement between the Financial Institution, Enron and LJM.

( Title 18, United States Code, Sections 371 and 3551 et seq.)

COUNT THREE

(Conspiracy to Commit Wire and Securities Fraud – Talon Off-Balance-Sheet Conspiracy)

51. The allegations of paragraphs 1 through 9, 18 through 25, and 32 through 38 are realleged as if fully set forth here.

52. In or about and between spring 2000 and December 2000, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did knowingly and intentionally conspire (a) willfully and unlawfully to use and employ manipulative and deceptive devices and contrivances and directly and indirectly (i) to employ devices, schemes and artifices to defraud; (ii) to make untrue statements of material facts and omit to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (iii) to engage in acts, practices, and courses of conduct which would and did operate as a fraud and ~~substantially~~ *in connection with purchases and sales of Enron* stock and by the use of the instruments of communication in interstate commerce and the mails, in violation of Title 15, United States Code, Section 78j(b) and Rule 10b-5 of the SEC, Title 17, Code of Federal Regulations, Section 240.10b-5, and (b) to devise a scheme and artifice to defraud, including to deprive Enron and its shareholders of their intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations, promises, and, for the purpose of executing such scheme and artifice, to cause interstate wire communications in violation of Title 18, United States Code, Section 1343.

OVERT ACTS

53. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did commit and cause to be committed the following overt acts, among others:

- a. In or about April 2000, FASTOW caused Enron to enter into a put with Talon.
- b. On or about September 2000, FASTOW caused LJM to obtain \$41 million from

Enron.

( Title 18, United States Code, Sections 371 and 3551 *et seq.* )

COUNT FOUR

(Conspiracy to Commit Wire and Securities Fraud – AVICI Hedge Conspiracy)

54. The allegations of paragraphs 1 through 9, 18 through 25, and 32 through 38 are recited as if fully set forth here.

55. In or about and between August 2000 and September 2000, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did knowingly and intentionally conspire (a) willfully and unlawfully to use and employ manipulative and deceptive devices and contrivances and directly and indirectly (i) to employ devices, schemes and artifices to defraud; (ii) to make untrue statements of material facts and omit to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (iii) to engage in acts, practices, and courses of conduct which would and did operate as a fraud and deceit upon members of the investing public, in connection with purchases and sales of Enron stock and by the use of the instruments of communication in interstate commerce and the mails,

in violation of Title 15, United States Code, Section 78j(b) and Rule 10b-5 of the SEC, Title 17, Code of Federal Regulations, Section 240.10b-5, and (b) to devise a scheme and artifice to defraud, including to deprive Enron and its shareholders of their intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations, promises, and, for the purpose of executing such scheme and artifice, to cause interstate wire communications in violation of Title 18, United States Code, Section 1343.

OVERT ACTS

56. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did commit and cause to be committed the following overt act, among others:

a. In or about late August 2000, FASTOW met with an LJM employee and instructed the employee to permit Enron to enter into a back-dated hedge of the AVICI stock.

b. In or about late August 2000, LJM caused Talon to enter into a hedge with Enron of its AVICI stock, back-dated to August 3, 2000.

( Title 18, United States Code, Sections 371 and 3551 et seq.)

COUNTS FIVE THROUGH THIRTY-THREE  
(Wire Fraud --RADR)

57. The allegations of paragraphs 1 through 13 are realleged as if fully set forth here.

58. On or about the dates specified below, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did devise a scheme and artifice to defraud, including to deprive Enron and its shareholders of their intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses,

representations and promises, and for the purpose of executing such scheme and artifice did transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, as follows:

Count	Date	From	To	Description
5	12/23/97	New York, NY	Houston, TX	wire transfer: \$55,820.04
6	12/23/97	New York, NY	Houston, TX	wire transfer: \$65,835.62
7	2/4/98	New York, NY	Houston, TX	wire transfer: \$75,091.94
8	2/4/98	New York, NY	Houston, TX	wire transfer: \$31,808.22
9	3/31/98	New York, NY	Houston, TX	wire transfer: \$40,684.93
10	4/13/98	New York, NY	Houston, TX	wire transfer: \$9,292.00
11	6/25/98	New York, NY	Houston, TX	wire transfer: \$19,733.78
12	6/25/98	New York, NY	Houston, TX	wire transfer: \$63,616.44
13	8/5/98	New York, NY	Houston, TX	wire transfer: \$94,780.06
14	8/5/98	New York, NY	Houston, TX	wire transfer: \$30,328.77
15	9/30/98	New York, NY	Houston, TX	wire transfer: \$10,178.77
16	9/30/98	New York, NY	Houston, TX	wire transfer: \$41,424.66
17	12/23/98	New York, NY	Houston, TX	wire transfer: \$42,740.07
18	12/23/98	New York, NY	Houston, TX	wire transfer: \$62,136.99
19	2/4/99	New York, NY	Houston, TX	wire transfer: \$18,665.99
20	2/4/99	New York, NY	Houston, TX	wire transfer: \$31,808.22
21	7/1/99	New York, NY	Houston, TX	wire transfer: \$32,669.59
22	7/1/99	New York, NY	Houston, TX	wire transfer: \$108,000.00
23	8/6/99	New York, NY	Houston, TX	wire transfer: \$45,357.84
24	8/6/99	New York, NY	Houston, TX	wire transfer: \$27,369.86
25	10/19/99	New York, NY	Houston, TX	wire transfer: \$12,263.01
26	10/29/99	New York, NY	Houston, TX	wire transfer: \$54,739.73

27	12/23/99	New York, NY	Houston, TX	wire transfer: \$18,217.07
28	12/23/99	New York, NY	Houston, TX	wire transfer: \$48,082.19
29	2/15/00	New York, NY	Houston, TX	wire transfer: \$845,241.59
30	2/15/00	New York, NY	Houston, TX	wire transfer: \$39,945.21
31	3/27/00	New York, NY	Houston, TX	wire transfer: \$98,383.56
32	6/27/00	New York, NY	Houston, TX	wire transfer: \$256,616.47
33	7/24/00	New York, NY	Houston, TX	wire transfer: \$2,000,000.00

(Title 18, United States Code, Sections 1343, 2 and 3551 et seq.)

COUNTS THIRTY-FOUR THROUGH FORTY  
(Wire Fraud -Southampton)

59. The allegations of paragraphs 1 through 9 and 39 through 44 are recited as if fully set forth here.

60. On or about the dates set forth below, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did devise a scheme and artifice to defraud, including to deprive Enron and its shareholders of their intangible right of honest services, and to obtain money and property by means of false and fraudulent pretenses, representations and promises, and for the purpose of executing such scheme and artifice did transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, as follows:

Count	Date	From/To	Description
34	3/6/00	Houston/London	Fax: offer to purchase Swap Sub interest
35	3/10/00	London/Houston	Fax: re sale of Swap Sub interest
36	3/16/00	London/Houston	Email: signature needed for Swap Sub sale documents

Count	Date	From/To	Description
37	3/17/00	London/Houston	Email final Swap Sub sale documents
38	4/21/00	London/Houston	Fax signed notice of option exercise
39	4/26/00	England/Houston	Wire transfer of \$251,993 to exercise option
40	5/1/00	Houston/Cayman Islands	Wire transfer of \$7,352,626

(Title 18, United States Code, Sections 1343, 2 and 3551 *et seq.*)

COUNT FORTY-ONE

(Obstruction of Justice)

61. The allegations in paragraphs 1 through 9 and 39 through 44 are realleged as if fully set forth here.

62. In or about August and September 2001, within the Southern District of Texas, the defendant ANDREW S. FASTOW did knowingly, intentionally and corruptly persuade and attempt to persuade another person, namely, Michael J. Kopper, with intent to cause and induce Kopper to (a) withhold records, documents and other objects from official proceedings, namely: governmental proceedings and investigations, and (b) alter, destroy, mutilate and conceal objects, namely, laptop and desktop computers and information contained therein, with intent to impair the objects' integrity and availability for use in such official proceedings.

(Title 18, United States Code, Sections 1512(b)(2)(A) and (B) and 3551 *et seq.*)

COUNT FORTY-TWO

(Money Laundering Conspiracy)

63. The allegations in paragraphs 1 through 44 are realleged as if fully set forth here.

64. From in or about July, 1997 through December 2001, in the Southern District of

Texas and elsewhere, the defendant ANDREW S. FASTOW and others did knowingly conspire:

(a) knowingly to conduct and attempt to conduct financial transactions affecting interstate commerce and foreign commerce, which transactions involved the proceeds of specified unlawful activity, that is, wire fraud, in violation of Title 18, United States Code, Section 1343, and securities fraud, in violation of Title 15, United States Code, Sections 78j(b), 78ff and 17 C.F.R. 240.10b-5, knowing that the transactions were designed in whole or in part to conceal and disguise the nature, location, source, ownership, and control of the proceeds of specified unlawful activity, and that while conducting and attempting to conduct such financial transactions, knew that the property involved in the financial transactions represented the proceeds of some form of unlawful activity, in violation of Title 18, United States Code, Section 1956(a)(1)(B)(i); and

(b) knowingly to engage and attempt to engage, in monetary transactions by, through or to a financial institution, affecting interstate and foreign commerce, in criminally derived property of a value greater than \$10,000, that is the deposit, withdrawal, or transfer of funds, such property having been derived from a specified unlawful activity, that is, wire fraud and securities fraud, in violation of the provisions of Title 18, United States Code, Section 1957.

#### OVERT ACTS

65. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendant ANDREW S. FASTOW and others did commit and cause to be committed the following overt acts, among others:

Overt Act	Date	Transaction
a	08/27/1997	Transfer of \$481,850 from Bank One account number 1883757583 in the name of Michael Kopper to JP Morgan Chase account number 054-06029219 in the name of Lea and Andrew Fastow
b	5/2/2002	Transfer of \$6,500,000 from FASTOW JP Morgan Chase Account 054-05023866 to Capital Growth Holding, LP account number 0159006385 at Sterling Bank

(Title 18, United States Code, Sections 1956(b) and 3551 et seq.)

COUNTS FORTY-THREE THROUGH FORTY-NINE  
(Money Laundering)

66. The allegations in paragraphs 1 through 13 are realleged as if fully set forth here.

67. On or about the dates listed in the chart below, in the Southern District of Texas and elsewhere, defendant ANDREW S. FASTOW, knowing that the property involved in the financial transaction represented the proceeds of some form of unlawful activity, did knowingly conduct and attempt to conduct, such a financial transaction affecting interstate and foreign commerce which in fact involved the proceeds of specified unlawful activity, that is, wire fraud, in violation of Title 18, United States Code, Section 1343, and securities fraud, in violation of Title 15, United States Code, Sections 78j(b), 78ff and 17 C.F.R. 240.10b-5, knowing that the transaction was designed in whole or in part to conceal and disguise the source, ownership, and control of the proceeds of specified unlawful activity, to wit:

Count	Date	Transaction
43	08/27/1997	Transfer of \$481,850 from Bank One account number 1883757583 in the name of Michael Kopper to JP Morgan Chase account number 054-06029219 in the name of Lea and Andrew Fastow

44	12/30/1998	Transfer of \$10,000 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 766-09061417 in the name of Jeffrey T. Fastow, UGTA
45	12/30/1998	Transfer of \$10,000 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 766-09061227 in the name of Matthew Fastow, UTMA
46	12/30/1998	Transfer of \$6,333.10 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 054-05023866 in the name of Lea and Andrew Fastow
47	3/16/2000	Transfer of \$10,000 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 766-09061227 in the name of Matthew Fastow, UTMA
48	3/16/2000	Transfer of \$10,000 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 054-05023866 in the name of Lea and Andrew Fastow
49	3/16/2000	Transfer of \$10,000 from Charles Schwab account number 2883-7706 in the name of William Dodson to JP Morgan Chase account number 054-05023866 in the name of Lea and Andrew Fastow

(Title 18, United States Code, Sections 1956(a)(1)(B)(i), 2 and 3551 et seq.)

COUNTS FIFTY THROUGH SEVENTY-EIGHT  
(Money Laundering)

68. The allegations in paragraphs 1 through 9, 13 through 25, and 39 through 44 are realleged as if fully set forth here.

69. On or about the dates listed in the chart below, in the Southern District of Texas, and elsewhere, defendant FASTOW did knowingly engage and attempt to engage, and did aid, abet, counsel, command, induce, procure and cause the engaging and attempting to engage in the following monetary transaction by, through or to a financial institution, affecting interstate commerce, in criminally derived property of a value greater than \$10,000, which funds were derived from a specified unlawful activity, that is, wire fraud in violation of Title 18, United

State Code, Section 13-43, and securities fraud in violation of Title 15, United State Code,

Sections 78j(b), 78ff and 17 C.F.R. 240.10b-5, to wit:

Count	Date	Transaction
50	5/1/2000	Transfer of \$1,040,744 from Southampton Place, LP's Chase Bank account number 323-905781 to Ben Glisan's Charles Schwab account number 3714-9242
51	5/1/2000	Transfer of \$416,298 from Southampton Place, LP's Chase Bank account number 323-905781 to Kathy Lynn's Bank One account number 1883761874
52	5/1/2000	Transfer of \$1,040,744 from Southampton Place, LP's Chase Bank account number 323-905781 to Kristina Mordant's UBS Paine Webber account number HS 75406 EJ
53	5/1/2000	Transfer of \$520,372 from Southampton Place, LP's Chase Bank account number 323-905781 to Anne Yaeger Patel's Enron Credit Union share account number 618571
54	5/1/2000	Transfer of \$416,298 from Southampton Place, LP's Chase Bank account number 323-905781 to Michael Hinds' Merrill Lynch account number 728-17139
55	10/13/2000	Purchase of 1,000,000 shares of City of Austin fnp municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
56	7/2/2001	Transfer of \$750,000 from a Salomon Smith Barney, account number 719-02658-12-125 to Kristina Mordant's UBS Paine Webber account number HS 75406 EJ
57	8/06/2001	Purchase of 500,000 shares of Texas A & M Univ Revs Financing municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
58	8/07/2001	Purchase of 500,000 shares of Katy Independent School District Tex Penn Sch Fund municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
59	8/30/2001	Purchase of 1,050,000 shares of San Antonio Independent School District municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8

60	9/13/2001	Purchase of 1,000,000 shares of Irving Independent School district municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
61	9/18/2001	Purchase of 500,000 shares of Hays County Tax Goal Purpose Fund municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
62	9/24/2001	Purchase of 1,000,000 shares of Comal Independent School District municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
63	10/02/2001	Purchase of 500,000 shares of University of Texas Univ Rev Financing Sys municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
64	10/02/2001	Purchase of 500,000 shares of University of Texas Univ Rev Financing Sys municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
65	10/02/2001	Purchase of 500,000 shares of University of Texas Univ Rev Financing Sys municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
66	11/01/2001	Purchase of 1,110,000 shares of Carrollton Farmers Branch Independent School District municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
67	11/29/2001	Purchase of 500,000 shares of Port of Houston Auth Tex Harris County Port municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
68	11/29/2001	Purchase of 1,000,000 shares of Port of Houston Auth Tex Harris County Port municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
69	11/29/2001	Purchase of 500,000 shares of Port of Houston Auth Tex Harris County Port municipal bonds with funds from FASTOW JP Morgan Chase Account Q62603-00-8
70	12/20/01	Purchase of 1,000,000 shares of City of Austin Tex Wtr & Water Sys Revs Ref municipal bonds with funds from FASTOW JP Morgan Chase Account: Q62603-00-8
71	9/13/2001	Transfer of \$60,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866

72	9/21/2001	Transfer of \$1,020,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
73	12/19/2001	Transfer of \$5,000,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
74	2/22/2002	Transfer of \$1,000,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
75	4/9/2002	Transfer of \$1,000,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
76	4/16/2002	Transfer of \$2,000,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
77	5/2/2002	Transfer of \$4,000,000 from FASTOW JP Morgan Chase Account Q62603-00-8 to FASTOW JP Morgan Chase Account 054-05023866
78	5/2/2002	Transfer of \$6,500,000 from FASTOW JP Morgan Chase Account 054-05023866 to Capital Growth Holding, LP account number 0159006885 at Sterling Bank

(Title 18, United States Code, Sections 1957, 2 and 3551 *et seq.*)

FORFEITURE ALLEGATIONS

70. Upon conviction of one or more of the offenses alleged in Counts 1 through 40, FASTOW shall forfeit to the United States pursuant to 18 U.S.C. § 981(a)(1)(C) and 23 U.S.C. § 2461(c) any property constituting or derived from proceeds obtained directly or indirectly as a result of the said violations, including but not limited to the properties listed in paragraph 72 below.

71. Upon conviction of one or more of the offenses alleged in Counts 42 through 78, FASTOW shall forfeit to the United States pursuant to 18 U.S.C. § 982(a)(1) the following

property:

- (a) all right, title, and interest in any and all property involved in each offense in violation of 18 U.S.C. §§ 1956 and 1957, or conspiracy to commit such offense, for which the defendant is convicted, and all property traceable to such property, including the following: 1) all money or other property that was the subject of each transaction, transportation, transmission, or transfer in violation of Sections 1956 and 1957, including but not limited to the properties listed in paragraph 72 below; 2) all commissions, fees and other property constituting proceeds obtained as a result of those violations; and 3) all property used in any manner or part to commit or to facilitate the commission of these violations.
- (b) A sum of money equal to the total amount of money involved in each offense, or conspiracy to commit such offense, for which the defendant is convicted. If more than one defendant is convicted of an offense, the defendants so convicted are jointly and severally liable for the amount involved in such offense.

72. The United States intends to forfeit property of the defendant including, but not limited to, the following:

- (a) the contents of JP Morgan Chase account no. 054-05023866, in the name of Lea and Andrew Fastow;
- (b) the contents of JP Morgan Chase account no. Q62603-00-8, in the name of Andrew S. and Lea W. Fastow;
- (c) the contents of JP Morgan Chase account no. 340160, in the name of Lea and Andrew Fastow;

(d) the contents of J.P. Morgan Chase account no. Q65183-03-8, in the name of the Fastow Family Foundation;

(e) real property known as 3005 Del Monte Dr., Houston, Texas.

73. Pursuant to Title 21, United States Code, Section 853(p), as incorporated by Title 18, United States Code, Section 982(b), the defendant shall forfeit substitute property if, by any act or omission of the defendant, the property described above:

(a) cannot be located upon the exercise of due diligence;

(b) has been transferred, sold to or deposited with a third party;

(c) has been placed beyond the jurisdiction of the court;

(d) has been substantially diminished in value; or

(e) has been commingled with other property which cannot be divided without difficulty;

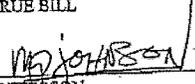
up to the value of the amount described in subparagraphs 73(a)-(e).

(Title 18, United States Code, Sections 981 and 982; Title 28, United States Code, Section 2461; Rule 32.2(a) of the Federal Rules of Criminal Procedure)

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Dated: Houston, Texas  
October 31, 2002

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FOREPERSON

LESLIE R. CALDWELL  
Director, Enron Task Force

By:   
ANDREW WEISSMANN  
Deputy Director, Enron Task Force

LAUREL LOOMIS  
Trial Attorney, Enron Task Force

Committee on Governmental Affairs  
EXHIBIT #A-9

# FINANCE COMMITTEE MEETING

MAY 5, 1997



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- ✓ Herbert S. Winokur, Jr., Chairman
- ✓ Robert A. Belfer
- ✓ Norman P. Blake, Jr.
- Ronnie C. Chan — A
- John A. Urquhart — A
- ✓ Charls E. Walker

*V. Thirumala*  
*S. Gadd*  
*A. Gattew*  
*D. Skelton*  
*E. Sogner*  
*J. Lindholm*  
*R. O'Leary*  
*M. Koenig*  
*B. Gathmann*  
*Don K. Lay*  
*Dir 9* *Reman*

**AGENDA**  
**Meeting of the Finance Committee of the**  
**Board of Directors**  
**Enron Corp.**

**3:00 p.m., May 5, 1997**  
**Enron Corp. 50M Dining Conference Room**  
**Houston, Texas**

- ✓ 1. Approval of minutes from meeting of the Finance Committee held on February 10, 1997 -- Mr. Winokur. *Blake, Belfer, Caried*
- ✓ 2. *Discussion on financial + earnings reports.*
- ✓ 3. Overview of Enron Capital Management, capital books and capital expenditure policy -- Mr. Fastow. *Carried*  
*to next meeting*
- ✓ 4. Review of asset/liability management -- Mr. Fastow.
- ✓ 5. Review of 1997 financing needs -- Mr. Gathmann.
- ✓ 6. Approval of indemnities associated with sale of Zond-related qualifying facilities for recommendation to the Board of Directors -- Ms. Hodge.
- ✓ 7. Review and approval of incremental Dabhol financings for recommendation to the Board of Directors -- Mr. Gathmann.
- ✓ 8. Approval of guarantee and sublease of new Hawker aircraft for recommendation to the Board of Directors -- Mr. Gathmann.
- 9. Review of foreign exchange exposure in Latin America -- Mr. Gathmann. *Carryover to next meeting*
- 10. Review of guarantee exposure -- Mr. Gathmann.
- 11. Other business.
- 12. Adjournment. @ 4:30 pm

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**APPENDICES:**

- 1. Guarantee and Letter of Credit Report**
- 2. Summary of Liquidity and Interest Rate Risk**

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## REVIEW OF 1997 FINANCING NEEDS

- \$1 billion Enron Corp. revolving credit facility and a \$600 million accounts receivable sales facility are sufficient for short-term liquidity requirements
- Expect to issue \$100-\$300 million of long-term debt:
  - Potentially \$100 million by Northern Natural Gas for rate purposes
  - Potentially £100 million by Enron Corp. to establish European name recognition
- Contingent funding requirements (e.g., J-Block settlement) would require additional financing

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Agenda Item 3

EC 000025724



**Enron Renewable Energy Corp.**

*Zond*

**Divestiture of California QF Assets**



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## Overview

- ◆ Zond Qualifying Facilities (QFs) owned 50% by EREC (Enron) and 50% by ESI
- ◆ Upon Enron merger with Portland General, three QFs will lose QF status if owned more than 50% by utilities as defined by PUHCA
- ◆ Enron must divest its ownership in the facilities

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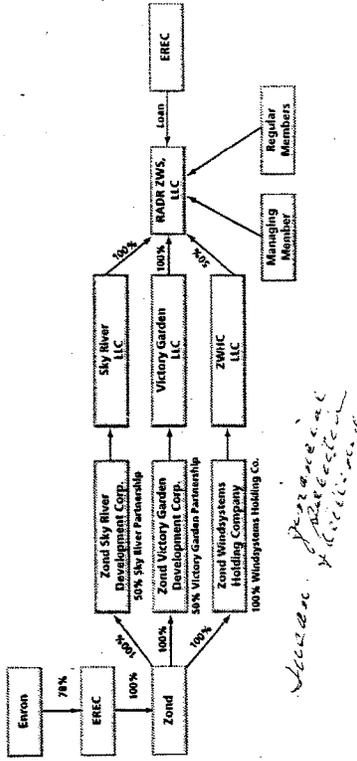
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*Enron*

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# Transaction Overview

- ◆ Facilitate establishment of non-Enron investment vehicle (RADR ZWS, LLC) to purchase QFs
- ◆ RADR ZWS to be capitalized with 97% loan from EREC and with 3% outside equity
- ◆ QFs to be sold to RADR ZWS for \$12.5MM
- ◆ Enron provides certain indemnifications (described later)
- ◆ EREC retains right to repurchase the assets



## **Seller Financing**

- ◆ EREC loan to RADR ZWS, LLC, funded by Enron Corp.
- ◆ 97% of purchase price - \$12,125,000
- ◆ Tenor: 13 years
- ◆ Rate: 7.75%
- ◆ Repayment: 75% of available semi-annual cash flow after fees and taxes

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# Approval of Indemnifications Requested

	Approximate Amounts	Indemnifier	Mitigants
◇ ESI (Regulatory and Tax)	\$150MM	Enron Corp.	<ul style="list-style-type: none"> <li>• FERC informal approval</li> <li>• Case precedents</li> <li>• Legal opinions</li> <li>• Cap on indemnification</li> </ul>
◇ RADR ZWS (Purchase Agreement Reqs and Covenants)	\$0.5MM	Enron Corp.	<ul style="list-style-type: none"> <li>• Same as current risk</li> </ul>
◇ RADR ZWS (Environmental)	Uncapped	Zond Systems, Inc.	<ul style="list-style-type: none"> <li>• Capped at RADR level; uncapped at individual investor level</li> <li>• Wind projects</li> </ul>
◇ RADR ZWS (Tax)	\$20.0MM	Enron Corp.	<ul style="list-style-type: none"> <li>• Cap on indemnification</li> <li>• Current risk assumed</li> </ul>
◇ Project Banks (Regulatory)	\$143.6MM	Enron Corp.	<ul style="list-style-type: none"> <li>• Same as above mitigants</li> </ul>

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## Conclusions

- ◆ Satisfies FERC for transfer of ownership
- ◆ Not a sale for book purposes; thus, continued recognition of project revenues
- ◆ Installment sale treatment for tax purposes; thus, amortization of taxes on gain on sale
- ◆ Call option to repurchase the assets in future and sell in "non-fire sale" environment
- ◆ Low allocation of purchase price to assets
- ◆ Low transaction cost (financing 3% equity)
- ◆ Seller financing and indemnifications result in minimal increased risk for Enron



*Moved by  
M. Lopez  
M. Lopez  
C. Lopez*

**Agenda Item 5  
(Suggested Form of Resolution)**

RESOLVED, that the formation by the Company's indirect subsidiaries, Zond Systems, Inc., a California corporation ("ZSI") and Zond Mesa VGIV Corporation, a California corporation ("ZVG"), of three single-member Delaware limited liability companies to be known as Sky River, LLC ("Sky River LLC"), Victory Garden, LLC ("Victory Garden LLC") and ZWHC, LLC ("ZWHC LLC") is hereby approved and that the execution and delivery by an officer of ZSI or ZVG of a Limited Liability Company Agreement for each such limited liability company in the form approved by such officer is hereby approved; and

RESOLVED, that in connection with the formation of each such limited liability company, the officers of the Company are hereby authorized to take such action as may be necessary to cause the officers of ZSI and ZVG to execute a Certificate of Formation in the form required by applicable law and cause same to be filed with the Secretary of State for the State of Delaware.

*MERGER OF CERTAIN COMPANIES INTO NEW LLCs*

RESOLVED, that the merger of Zond Sky River Development Corp., a California corporation and an indirect subsidiary of the Company ("Sky River DevCo"), with and into Sky River LLC is hereby approved;

RESOLVED, that the merger of Zond Victory Garden Phase IV Development Corp., a California corporation and an indirect subsidiary of the Company ("Victory Garden DevCo"), with and into Victory Garden LLC is hereby approved;

RESOLVED, that the merger of Zond Windsystems Holding Company, a California corporation and indirect wholly-owned subsidiary of the Company ("ZWHC"), with and into ZWHC LLC is hereby approved; and

RESOLVED, that the officers of the Company are authorized and instructed to take such action as may be necessary to cause the appropriate officers or authorized representatives of Sky River DevCo, Victory Garden

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**Project Storm**

Draft Report  
July 6, 2001

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Committee on Governmental Affairs  
**EXHIBIT #A-10**



PricewaterhouseCoopers LLP  
177 Avenue of the Americas  
New York, NY 10036  
United States  
Telephone: (212) 875-1000  
Facsimile: (212) 875-1400

July 6, 2001

Ms. Kathy M. Lynn  
Managing Director  
LJM Investments  
333 Clay Street, Suite 1203  
Houston, TX 77002-7361

Dear Ms. Lynn:

As you requested, we have performed the initial dataroom analysis as well as next stage analysis of certain historical and prospective financial information and various financial, operating and other data for Enron Renewable Energy Corporation ("EREC" or the "Company"), solely to assist you in your evaluation of the Company ("Project Storm"). According to your instructions, our services have been limited to the work described in our engagement letter dated May 2, 2001.

Information with respect to the Company's operations, account balances and accounting and operating procedures purported to be in effect and described in our report was obtained through discussions with certain officers and employees of the Company, discussions with the Company's independent accountants, and observations and analysis made by us during the course of our work.

Our work did not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA"). Accordingly, we do not express an opinion or any other form of assurance on the financial statements of the Company or any financial or other information, or operating and internal controls of the Company.

With respect to prospective financial information relative to the Company referenced throughout this report, we did not examine, compile or apply agreed-upon procedures to such information in accordance with standards established by the AICPA, and we express no assurance of any kind on such information. There will usually be differences between estimated and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We take no responsibility for the achievability of the expected results anticipated by the management of the Company.

We make no representation regarding the sufficiency of our work either for purposes for which this report has been requested or for any other purpose. The sufficiency of the work we performed is solely the responsibility of LJM Investments, as are any decisions with respect to the proposed transaction. Had we been requested to perform additional work, additional matters might have come to our attention that would have been reported to you.

It is understood that this report is solely for the information of LJM Investments. This report, or portions thereof, should not be referred or distributed to any other persons or entity, other than LJM Investment's legal counsel on this transaction. It is not to be referred to or quoted, in whole or in part, in any registration statement, prospectus, public filing, loan agreement, or other agreement or document without our prior written approval, which may require that we perform additional work.

We appreciate the opportunity to assist you in connection with your due diligence review of the Company. Should you require clarification of any of the matters contained in our report or any further information, we would be pleased to extend our work as you consider necessary.

Yours very truly,

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**Limits on Report Access and Distribution**

This report has been prepared exclusively for LJM Investments ("LJM") sole benefit and use pursuant to terms of arrangement dated May 2, 2001 between PricewaterhouseCoopers LLP and LJM. Distribution of this report to person's other than LJM is prohibited. This report is not to be referred to or quoted, in whole or in part, in any registration statement, prospectus, public filing, loan agreement, or other agreement or document without our prior written approval.

Access to this report by a party other than LJM or their attorneys on the transaction requires the express consent of PricewaterhouseCoopers LLP and each recipient must sign a Standard Release Letter that is returned to PricewaterhouseCoopers LLP prior to obtaining a copy of this report.

Notwithstanding whether or not the Standard Release Letter is signed and returned to PricewaterhouseCoopers LLP each person (other than LJM) that should obtain a copy of and or reads this report agrees that by obtaining or reading this report that person agrees to the following terms:

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2. The reader of this report acknowledges that this report was prepared at the direction of LJM and may not include all procedures deemed necessary for the purposes of the reader.
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## 1 - Background & Organizational Structure

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## ***EWC in its current state was formed through Zond Systems' acquisition of Tacke in October 1997***

Enron Wind Corp. ("EWC") designs, manufactures, sells, installs and maintains wind turbines; in addition, in the US, EWC also develops and manages wind power projects. Currently, EWC is considered one of the leading wind power companies that, according to management, enjoys high market share and a reputation for technological innovation. As explained in more detail on the following slide, EWC is a wholly-owned subsidiary of Enron Renewable Energy Corp. ("EREC" or the "Company") which is in turn a wholly-owned subsidiary of Enron Corp. ("Enron").

EWC was formed through the combination of two predecessor companies: Zond Energy Systems ("Zond") in the US and Tacke, Windenergie ("Tacke") in Germany. Prior to 1994, Zond was predominantly a wind project developer, utilizing Vestas as its wind turbine supplier. Wishing to release themselves from dependency on Vestas, in 1994, Zond undertook to design and manufacture its own wind turbines by hiring, research and development professionals as well as build their own manufacturing operations.

Zond's first product on the market was the 550 kW turbine introduced in late 1995. The wind turbines were sold into wind projects that Zond had developed; at that time, all projects that were developed by Zond had a buyer in place before the start of the project. In early 1996, development of the 750 kW turbine began and the first 750 kW was installed in a project in late 1997. In early 1997, in conjunction with the acquisition of Zond by EREC, a new philosophy for wind projects began whereby all wind projects were financed internally and the equity interests sold subsequent to completion of the project.

In late 1997, Zond was considering expansion into the European market and did so through the acquisition of Tacke in October. EWC management does not disclose the terms of the acquisition of Zond and Tacke from the best way to maximize the value of the transaction and therefore, both companies operate relatively autonomously. EWC manages its business by analyzing the "America" (all Zond and project related activity) and "Europe" (all overseas activity regardless of location of the entity) which are categorizations utilized throughout this report.

By late 2000, the engineering groups of both companies had been organized under one manager; however, this is the only functional area that has been fully integrated. Manufacturing heads in each operation report to the commercial head of either the Americas or Europe. Central procurement has been established in Germany for the top 20 components for turbine manufacture while local procurement is in place for all other purchases. The financial infrastructure and operations have not yet been integrated.

Tacke's product portfolio at the time of acquisition included the 600 kW turbine and product development for a 1.5 MW turbine. The first 1.5 MW turbine was sold and installed in Europe during 1999 and the technology was brought to the US in 2000; the first 1.5 MW turbine was sold in the US during April 2001. Currently, the combined engineering group is working on a 3.5 MW turbine and hopes to have a prototype available in late 2001 or early 2002.

During mid-2000, another change in EWC's approach toward wind projects was made. Management determined EWC would no longer finance the entire cost of wind projects and instead focus on the opportunistic development of suitable land. EWC would then bundle the land and the sale of wind turbines together with their project management expertise and sell that to a buyer, thereby, management hopes, significantly reducing the balance sheet exposure to EWC.

Mr. Adam Umanoff was named President & CEO of EWC in early 2001.

### **Organization of Report**

This portion of the report provides background information about the Company which the executive here highlights the significant issues identified through the course of our due diligence in each of the areas of service detailed in our engagement letter. Separate sections including the detailed analysis conducted in all areas of service follow the summary of significant issues.

All amounts are presented in thousands of US dollars unless otherwise stated.

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### EWC utilizes a complicated system of companies and partnerships to manage its current operations

As shown in the chart to the right, the organizational structure of EWC, which also dictates its financial consolidation, is very complicated. Due to diligence conducted through the date of this report was focused, according to your instructions on the Americas (i.e. the Zond entities). Only limited due diligence, including high level financial, risk management and human resource reviews have been conducted on the European operations.

#### Zond Energy Systems, Inc.

Zond is both an operating as well as a holding company for the manufacturing and sales operations in California and certain companies established for wind projects.

#### Euron Wind Holding GmbH

This entity is the holding company for the two Tacke operating companies, one dedicated to accounting for manufacturing activities and one established to account for service activities. This organizational structure is considered typical in Germany.

#### Spain

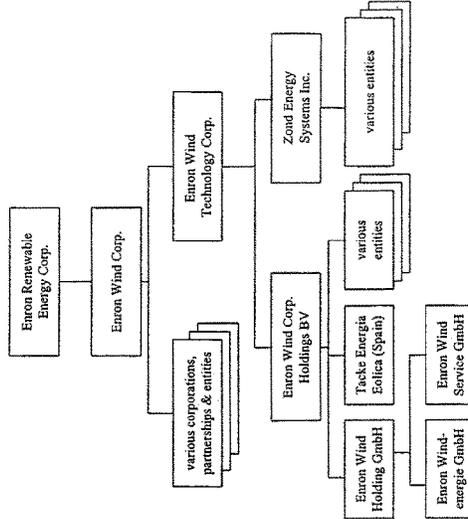
This entity was established in order to account for the activity of the Spanish manufacturing facility in Noliejas.

#### Other

Other than these entities, there are over 50 entities included in the consolidation of EWC. These other entities consist mainly of partnerships and other corporate entities established relative to the wind development projects developed, managed and/or owned by EWC. In brief, EWC's policy has been to establish a new series of entities each time a development project was undertaken.

#### Integration and Consolidation

Generally, Zond, Tacke and Spain operate on a stand-alone basis with little intercompany activity beyond financing. The accounting related to the other entities is performed by employees at Zond.



**The Americas represents 36% of EREC's consolidated EBITDA reported for 2000**

The table to the right presents the consolidated EREC results for the year ended December 31, 2000 and the portion of that total generated by the Americas. As of the date of this report, due diligence field work was conducted through a dataroom review and site visit to the Americas operations. As shown in the table, the Americas only accounted for 39% and 36% of reported revenues and EBITDA in 2000, respectively.

In addition to operational results, the table also presents reported net assets and amounts due to Enron at December 31, 2000 and April 30, 2001. These unadjusted amounts indicate the Americas comprises slightly over 60% of consolidated net assets at both dates. In addition, the amounts due to Enron should be carefully considered for their size and growing balance and the impact this will have on the purchase price adjustment mechanism included in the draft purchase and sale agreement.

It is recommended additional due diligence procedures be performed on the European operations as well as EREC's stand-alone results to allow for a complete understanding of EREC's consolidated operations and financial results.

	Reported		Due Diligence Coverage
	Consolidated EREC	Americas	
Revenues	\$ 450,555	\$ 174,647	39%
Cost of sales	348,057	141,266	41%
Gross margin %	102,498	33,661	32%
	22.7%	18.9%	
Operating expenses	61,737	25,785	42%
Operating income	40,761	7,276	
Operating income %	9.0%	4.2%	
Equity/IV income	11,603	11,603	100%
Other income (expenses)	25	(245)	nil
EBITDA, per mgmt	52,389	18,634	36%
Depreciation and amort	15,143	11,312	75%
Interest expense, net	10,875	9,833	90%
Pre-tax income	\$ 26,371	\$ (2,511)	
	December 31, 2000		
Net Assets	\$ 294,260	\$ 183,686	62%
Due to Enron	\$ 195,200	\$ 113,843	
	April 30, 2000		
Net Assets	\$ 284,120	\$ 180,256	63%
Due to Enron	\$ 241,780	\$ 184,693	



**Summary of abbreviations utilized in this report**

Americas - US operations of EWC  
EBITDA - Earnings before interest, taxes, depreciation and amortization  
Enron - Enron Corporation  
EREC - Enron Renewable Energy Corporation  
ESEI - Enron Solar Energy Inc.  
Europe - International operations of EWC  
EWC - Enron Wind Corporation  
kW - Kilowatt  
MW - Megawatt  
NREL - United States Department of Energy's National Renewable Energy Laboratory  
OFL - Overall Foreign Loss  
PAYG - Pay as you go warranty contract  
PG&E - Pacific Gas & Electric  
PTC - Production Tax Credit in the US  
SCE - Southern California Electric Company  
Tacke - Tacke Windenergie (German operations of EWC)  
US GAAP - United States generally accepted accounting principles  
Zond - Zond Energy Systems

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2 - Executive  
Summary

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**2 - Executive Summary**

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### ***During 2000, the Americas shifted its focus to pre-development and manufacturing from complete project development and ownership***

Prior to 2000, the Americas primarily developed wind projects which included the identification and certification of suitable land, negotiating power purchase agreements with the local utility, manufacturing and installing wind turbines and completing certification testing on the installed turbines. The Americas' revenue was primarily derived from the sale of wind projects it had developed; secondarily the Americas generated revenue through the maintenance and management of the wind projects it sold. Sales of wind turbines to third parties were primarily one-off transactions made for marketing and/or customer awareness.

During 2000, the Americas' management determined to change this business strategy. Instead of developing full-scale wind projects (which required significant up-front financial investment) the Americas' strategy would be to focus on

- the pre-development of wind projects (identification and certification of suitable land as well as negotiation of the power purchase agreements) and
- manufacturing turbines for sale to third parties.

While management expects the manufacture of turbines will be the primary revenue driver, they believe these select pre-development activities will enhance third party sales as the Americas will be able to offer potential customers the convenience of land and turbines together. This new strategy will require the Americas to consider revenue recognition policies relative to the bundling of land sales and turbine production/installation. This strategy will also significantly decrease the financial investment required by the Americas at any given time.

Concurrent with this shift in strategy, the Americas switched from the production of the Z750 to the EW 1.5 MW. Due to the confluence of these factors as well as the expiration of the PTC in June 1999, there were no turbines produced at the Tehachapi facility between July 1999 and October 2000.

These factors are critical to understanding the environment in which the Americas operated and the related impact on the financial results. Our review covered 1998, 1999 and 2000, all periods during which the Americas was focused on the development and sale of completed wind projects. The four months ended April 30, 2001 is the only period covered by our review in which the Americas was operating under its new strategy.

It is critical for the information provided in this report, including the quality of earnings and net assets analysis, be assessed in light of the underlying operational environment. A majority of the adjustments proposed to reported EBITDA and net assets related to US GAAP, period/revenue recognition and run-rate issues that arose when the Americas was operating under the "old" strategy. It is unclear whether the Americas' financial accounting will change under the "new" strategy.

**Quality of Earnings**  
 "Proposed adjustments" represent those items noted during the course of diligence considered to be important in the analysis of the Americas' EBITDA. The adjustments have been categorized according to their nature as follows:

**GAAP Adjustments** - These items adjust for the Americas' inappropriate application of US GAAP to various transactions.  
**Period Issues / Revenue Recognition** - These adjustments account for the Americas recognizing revenue incorrectly or recording amounts in the improper period.

**Run-Rate / True-Up Adjustments** - These items adjust for one-time or non-recurring transactions recorded by the Americas. In addition, certain pro-forma estimates of future costs have been included in order to better reflect ongoing operations.

**1. EREC push-down income/(expense)** - Enron allocates certain costs to EREC primarily related to financial, human resources and administrative functions performed by Enron. In addition to these allocations, EREC incurs other operating costs for which no detail has been supplied to date. As a holding company (EREC holds 100% of the stock of EWVC) whose two employees work for the benefit of EWVC, all costs incurred by EREC should be pushed down to EWVC in order to both appropriately account for these costs under US GAAP and properly reflect the full cost of the Americas' operations. The adjustment represents the full amount of operating expenses, excluding depreciation and amortization (of approximately \$1,000 in each of the periods presented). For purposes of this analysis, it is assumed all EREC costs would be pushed down to the Americas. The impact of this adjustment is to include EREC's expenses in the costs required to operate this business thereby reducing EBITDA. These costs will need to be considered in the modeling of future costs; see also adjustment #10, stand-alone costs.

Quality of Earnings		Year Ended	Four Mos. Ended
		December 31,	April 30,
		1999	2001
	(\$ in thousands)		
	Reported EBITDA	\$ 18,614	\$ 534
	Proposed adjustments:		
	GAAP Adjustments		
1	EREC push-down expenses	(5,550)	(1,160)
2	Warranty expenses	(17,900)	700
3	Reversal of bonus accrual	780	(780)
4	Purchase price variance release	-	1,100
5	Revenue- 3rd party sales	-	440
6	Manfort land sale	-	(165)
	Total of GAAP adjustments	(22,370)	(11,280)
	Period Issues/Revenue Rec.		
7	Lake Benton Inv. recognition	-	(6,100)
8	Lake Benton I reserve reversal	2,900	(2,900)
9	Strom Lake II refund	160	(160)
	Total of Period Issues/Rev. Rec. adjs	3,060	(9,160)
	Run-Rate/True-Up Adjustments		
10	Stand-alone costs	-	(1,000)
11	Purchase note interest income	-	(1,810)
12	Equity income, net of distributions	(8,944)	(1,794)
13	ParAero settlement, net	460	(765)
14	Bad debt expense	-	(350)
15	BRP/UP/G&E settlement income	-	(275)
16	Excess property tax accrual	-	1,390
17	Obsolescence reserve increase	(100)	100
18	President's salary differential	1,300	290
19	Unreconciled differences	-	-
	Total of Run-Rate/True-Up adjs	(7,284)	(6,399)
	Adjusted EBITDA	\$ 7,643	\$ (8,395)
			\$ (149)

Source: General ledger, information provided by management and PwC analysis

Quality of Earnings

	Year Ended		Four Mos. Ended
	1999	2000	April 30, 2001
Reported EBITDA	\$ 34,227	\$ 18,634	\$ 534
Proposed adjustments:			
GAAP Adjustments			
1. EREC push-down expenses	(5,240)	(5,550)	(1,160)
2. Warranty expenses	(17,900)	(4,930)	700
3. Reversal of bonus accrual	780	(780)	-
4. Purchase price variance release	-	-	1,100
5. Revenue-3rd party sale	-	-	440
6. Montfort land sale	-	-	-
Total of GAAP adjustments	(22,370)	(11,280)	(165)
Period Issues/Revenue Rec.			
7. Lake Benton Inv. recognition	-	(6,100)	-
8. Lake Benton I reserve reversal	2,900	(2,900)	-
9. Storm Lake II refund	100	(100)	-
Total of Period Issues/Rev. Rec. adjs	3,000	(9,100)	-
Run-rate/Fix-up Adjustments			
10. Stand-alone costs	-	(2,185)	(1,060)
11. Purchase note interest income	-	(1,810)	-
12. Equity income, net of distributions	(8,944)	(1,794)	267
13. PanAero settlement, net	460	(765)	-
14. Bad debt expense	-	(330)	-
15. BRP/PT&GE settlement income	-	(275)	-
16. Excess property tax accrual	-	1,309	(800)
17. Obsolete reserve increase	(100)	100	-
18. President's salary differential	1,300	290	-
19. Unaccrued differences	-	-	-
Total of Run-Rate/Fix-Up adjs	(7,284)	(6,379)	(1,933)
Adjusted EBITDA	\$ 7,643	\$ (8,205)	\$ (144)

Source: General Ledger, information provided by management and PwC analysts

- Quality of Earnings, continued
- Warranty expenses. Based on reviews of the supporting documentation and discussions with management, the Americas has not recorded warranty expenses for products covered by its warranty arrangements in compliance with US GAAP, especially related to serial defects identified in the Z750 turbines. The net adjustments to reported EBITDA have been proposed to reflect the proper application of US GAAP versus amounts currently recorded in the Americas' financial statements for the periods presented. These significant adjustments would not be expected to continue if the Americas (a) no longer builds and installs the Z750; (b) does not identify serial defects in the EWP 1.5 MW; and (c) begins to calculate its warranty costs according to US GAAP.
  - Reversal of bonus accrual. During 2000, an adjustment was recorded to reverse a bonus accrual established during 1999. The adjustment reverses the income recorded in 2000 into 1999.
  - Purchase price variance release. During 2001, the Americas capitalized all purchase price variances related to materials purchased from Germany. Through April 30, 2001, the amount capitalized into inventory was a credit of nearly \$3,300 due to the favorable exchange rate between the US dollar and Deutsche Mark. However, based on discussions with management and a review of revenue recognized on turbine sales through April 30, 2001, a portion of this credit should have been released as the inventory was used/sold. The two sales in process, Trent Mesa and Montfort, are an average of 35% complete; therefore, we have proposed an adjustment of \$1,100 to account for the release of the related variances. This increase to EBITDA is the result of favorable exchange rates and the Americas not changing production standards to reflect the most current information. If standards were updated properly, similar adjustments would not be expected in the future. In addition, in periods of unfavorable exchange rate changes, the Americas' margins will be negatively impacted as sales prices with customers are fixed and the Americas does not hedge its exposures.

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Section 2 - Executive Summary

Quality of Earnings

5. Revenue on third party sales. - The Americas is recognizing revenue and costs on third party sales in 2001 using the percentage of completion method. The amounts recognized though, are reduced by a percentage to reflect the amount being withheld by the buyer for the final installment (retention). As the timing of payments does not affect the percentage of completion for recognition purposes, an addback is proposed for the YTD April 2001 period for net gain amounts previously not recognized due to the holdback. There were no third party sales in 2000 and those in 1999 were completed prior to year end. A similar adjustment will be required in future periods to the extent that the Americas has future third party sales and continues to apply this incorrect accounting.

6. Montfort land sale. - In January 2001, the Americas recorded revenue of \$2,050 from the sale of land options related to Montfort, a third party sale in Wisconsin to PPL. PPL had difficulty in securing land rights in the Wisconsin area, resulting in the Americas selling its land rights to PPL in conjunction with the turbine sale. As the Americas has begun to focus on pre-development activities, an adjustment to treat this sale as non-recurring has not been proposed, as it is assumed future land sales will occur. However, US GAAP requires the revenue from the sale of the land be recognized over the life of the turbine sale contract. As the turbine sale is not yet complete, an adjustment to reduce EBITDA by \$165 for the four months ended April 30, 2001 has been proposed. Future adjustments related to land and turbine combination sales to spread the land revenue over the turbine delivery period will be required and should be taken into consideration to the extent that future land sales are projected.

	Year Ended		Four Mos. Ended April 30, 2001
	1999	December 31, 2000	
(\$ in thousands)			
<b>Reported EBITDA</b>	<b>\$ 34,237</b>	<b>\$ 18,634</b>	<b>\$ 534</b>
<b>Proposed adjustments:</b>			
<b>GAAP adjustments</b>			
1. EREC push-down expenses	(5,250)	(5,350)	(1,160)
2. Warranty expenses	(17,900)	(4,950)	700
3. Reversal of bonus accrual	780	(780)	-
4. Purchase price variance release	-	-	1,100
5. Revenue- 3rd party sales	-	-	440
6. Montfort land sale	-	-	(165)
<b>Total of GAAP adjustments</b>	<b>(22,370)</b>	<b>(11,230)</b>	<b>915</b>
<b>Period Issues/Revenue Rec.</b>			
7. Late Pension Tax recognition	-	(6,100)	-
8. Late Pension Tax reserve reversal	2,900	(2,900)	-
9. Storm Lake II refund	180	(160)	-
10. Storm Lake II refund	3,060	(3,160)	-
<b>Total of Period Issues/Revenue Rec. adjustments</b>	<b>6,140</b>	<b>(3,160)</b>	<b>(1,060)</b>
<b>Adjusted EBITDA</b>	<b>\$ 17,907</b>	<b>\$ 7,244</b>	<b>\$ (625)</b>
<b>Adjusted EBITDA</b>	<b>\$ 7,643</b>	<b>\$ (8,205)</b>	<b>\$ (1,441)</b>

Source: General Ledger, information provided by management and ProC analysis

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Quality of Earnings

	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	December 31, 2001	April 30, 2001
	\$ 34,237	\$ 18,634	\$	\$ 534
<b>Reported EBITDA</b>				
<b>Proposed adjustments:</b>				
<b>GAAP Adjustments:</b>				
1 EECF push-down expenses	(2,250)	(5,530)	(1,160)	
2 Warranty expenses	(1,700)	(4,750)	700	
3 Reversal of bonus accrual	780	(780)		
4 Purchase price variance release	-	-	1,100	
5 Revenue- 3rd party sales	-	-	440	
6 Mountain land sale	-	-	(165)	
<b>Total of GAAP adjustments</b>	<b>(22,370)</b>	<b>(11,280)</b>	<b>915</b>	
<b>Period Issues/Revenue Rec.</b>				
7 Lake Benton I rev. recognition	-	(6,100)	-	
8 Lake Benton I reserve reversal	2,900	(2,900)	-	
9 Storm Lake II refund	160	(160)	-	
<b>Total of Period Issues/Rev. Rec. adjustments</b>	<b>3,060</b>	<b>(9,160)</b>	<b>-</b>	
<b>Run-rate/True-up Adjustments</b>				
10 Stand-alone costs	-	(3,185)	(1,660)	
11 Purchase note interest income	-	(1,810)	-	
12 Equity income, net of distributions	(8,944)	(1,794)	267	
13 Partners settlement, net	460	(765)	-	
14 Bad debt expense	-	(390)	-	
15 BROPC&E settlement income	-	(275)	-	
16 Excess property tax accrual	-	1,390	-	
17 Obsolescence reserve increase	(100)	100	(800)	
18 President's salary differential	1,300	230	-	
19 Unreconciled differences	-	-	-	
<b>Total of Run-Rate/True-Up adj's</b>	<b>(7,284)</b>	<b>(6,399)</b>	<b>(1,593)</b>	
<b>Adjusted EBITDA</b>	<b>\$ 7,643</b>	<b>\$ (8,285)</b>	<b>\$ (1,441)</b>	

Source: General Ledger, information provided by management and PwC analysis

7. **Lake Benton I revenue recognition** - Lake Benton I was sold in 1998 for a combination of cash and notes receivable. At that time, the Americas recognized all costs related to the project and all revenues except for \$6,900 which related to a holdback required by the financing sources and accrued. In 2000, the \$6,900 was released by the financing sources and recorded as revenue by the Americas. Had the Americas properly followed the installment sales method of revenue recognition on this sale (as it typically has in similar situations), along with recognizing the revenue when cash was received, the costs associated with that revenue should have also been recorded. The proposed adjustment with their revenue related costs, assuming a 12% margin, the impact of the adjustment is to reduce 2000 EBITDA by \$6,100, had 1998 been included in our analysis, a corresponding increase in EBITDA would have been included.

8. **Lake Benton I reserve reversal** - When Lake Benton I was sold in 1998, \$2,900 of the sales proceeds were retained until certain project engineering checks had been completed (this amount is separate from the \$6,900 noted above). As this portion of the sales proceeds was also funded, the Americas included this amount in the revenue recognized in 1998. However, when the retained amount had still not been released in 1999, the Americas recorded a reserve in project reserves for this amount. In December 2000, the engineering checks were completed and the restricted cash was released resulting in the Americas reversing the reserve recorded in 1999 to 2000 revenue. The proposed adjustment eliminates the impact of the reserve in 1999 and 2000.

9. **Storm Lake II refund** - Miscellaneous revenue recorded in 2000 related to Storm Lake II includes a refund of \$161 from the sale of the project in 1999 (miscellaneous escrow fees). This amount has been deducted from 2000 EBITDA and added back to 1999 EBITDA.

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Section 2 - Executive Summary

Quality of Earnings, continued

10. **Stand-alone costs.** The Americas is currently allocated certain corporate overhead costs from Enron. In addition, costs allocated to EREC from Enron have been included in the Americas costs through adjustment #1. Post-acquisition, the Americas will most likely incur costs greater than these allocations and other amounts currently included in the Americas' financial statements. (i.e., increased insurance premiums, audit fees, etc.) An adjustment has been proposed to reflect the difference between current amounts and estimated stand-alone costs post-acquisition. The adjustment has been applied only to 2000 and the four months ended April 30, 2001 (one-third of the 2000 estimated amount). These estimated additional costs of doing business should be taken into consideration when modeling the future costs and cash flows of the Americas.

11. **Purchase note interest income.** Adjustment represents interest income on notes receivable and funded hedges primarily relating to Lake Benton I and Storm Lake II. We have excluded these amounts from EBITDA as it represents non-operational interest income. The majority of income (\$1,260) relates to the interest on the deferred income from the sale of Lake Benton I discussed in adjustment #7. To the extent the Americas continues to include interest income in its actual or forecasted revenues similar adjustments will be required in the future.

12. **Equity income, net of distributions.** Management includes equity and joint venture income as a component of EBITDA due to the Americas' history as a project developer. As the strategic business focus is to transition away from start-to-finish project development and ownership in developed projects, we have excluded equity income, net of cash distributions, in the calculation of adjusted EBITDA. Included in the amounts is an adjustment to add back amortization related to the write-down of goodwill related to the Sky River and Victory Garden IV projects. Similar adjustments to exclude equity income net of cash distributions will be required in the future as long as the Americas continues to present its financial statements as if it were a project developer and include these amounts as a component of EBITDA. Given the Americas stated intent to sell down the interests it currently holds, equity income as well as the related cash distributions are expected to decrease over time.

Quality of Earnings

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	December 31,	April 30,
Reported EBITDA	\$ 34,237	\$ 18,634	\$	\$ 534
Proposed Adjustments:				
GAAP Adjustments				
1 EREC push-down expenses	(5,250)	(5,550)		(1,160)
2 Warranty expenses	(17,900)	(4,950)		700
3 Reversal of bonus accrual	780	(780)		-
4 Purchase price variance release	-	-		1,100
5 Revenue, 5th party sales	-	-		440
6 Monitor fund sale	-	-		(165)
Total of GAAP adjustments	(22,370)	(11,280)		915
7 Lake Benton I rev. recognition	-	(6,100)		-
8 Lake Benton I reserve reversal	2,900	(2,900)		-
9 Storm Lake II refund	160	(160)		-
Total of Period Issues/Rev. Adj.	3,060	(9,160)		-
Run-rate/True-up Adjustments				
10 Stand-alone costs	-	(3,185)		(1,460)
11 Purchase note interest income	-	(1,810)		-
12 Equity income, net of distributions	(8,944)	(1,794)		267
13 PwAeros settlement, net	460	(765)		-
14 Bad debt expense	-	(330)		-
15 BRP/PG&E settlement income	-	(275)		-
16 Excess property, tax accrual	-	1,390		-
17 Obsolete/inventories increase	(100)	100		(400)
18 President's salary differential	1,300	290		-
19 Unaccounted differences	-	-		-
Total of Run-Rate/True-Up Adj.	(7,284)	(6,392)		(1,593)
Adjusted EBITDA	\$ 7,643	\$ (8,209)	\$	\$ (144)

Source: General ledger, information provided by management and PwC analysts.

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Section 2 - Executive Summary

Quality of Earnings, continued

13. **PanAero settlement.** - PanAero sued the Americas in 1998 claiming improper allocation of expenses to two partnerships. The courts ruled in favor of the Americas for a total of \$2,925 and required PanAero to pay court costs and legal fees. The Americas recorded \$1,700 in 1998 as a reduction to legal expenses and \$1,225 in 2000 as a component of revenue. Legal expenses of approximately \$460 were recorded in both 1999 and 2000 related to this case. The adjustment in 2000 represents the reversal of the \$1,225 net of related legal expenses. The 1999 adjustment adds back the expenses incurred relative to this litigation. All income and expenses related to this case are considered non-recurring and no similar adjustments would be anticipated in the future as management believes it is unlikely there would be another lawsuit of this magnitude against the Americas.

14. **Bad debt expense.** - During 2000, the Americas recorded a receivable and reduced warranty expense for \$3,300 related to lightning strike insurance, of which \$700 has yet to be received. Management indicated the insurance companies disagreed on who was responsible for the remaining amount, but did not provide any supporting documentation. This adjustment assumes collectibility of approximately 50% of the amount outstanding. No similar adjustments would be anticipated in the future.

However, the Americas currently does not utilize a general reserve policy for accounts receivable; instead, it uses specific identification of bad debts. As the customer base grows and credit is extended to new customers, it is likely that bad debts may grow in the future. This anticipated shift in customers should be considered when modeling the future costs of the business.

15. **BRP/PG&E settlement income.** - Adjustment represents amounts recorded as revenue in 2000 related to the settlement received by the Americas for the cancellation of the power purchase contract by PG&E. Management was not able to provide information related to lost revenues, if any, as a result of this contract cancellation. As this represents non-recurring and non-operational revenue, it has been deducted from 2000 EBITDA.

16. **Excess property tax accrual.** - Adjustment represents an addback related to an excess accrual for property taxes which was established during 2000. The reversal of this over accrual is considered non-recurring.

Quality of Earnings

	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	April 30, 2001	2001
(\$ in thousands)	\$ 34,237	\$ 18,634	\$	\$ 534
Reported EBITDA				
Proposed adjustments:				
GAAP Adjustments				
1 EREC push-down expenses	(5,240)	(5,530)		(1,160)
2 Warranty expenses	(17,900)	(4,930)		700
3 Reversal of bonus accrual	780	(780)		-
4 Purchase price variance release	-	-		1,100
5 Revenue 3rd party sales	-	-		440
6 Nonfort load sale	-	-		(165)
Total of GAAP adjustments	(22,370)	(11,280)		915
Period Income/Revenue Rat.				
7 Lake Benton 1 rev. recognition	2,900	(6,100)		-
8 Lake Benton 1 reserve reversal	180	(2,900)		-
9 Storm Lake II refund	3,860	(160)		-
Total of Period Issuance Rec. adjs				
Non-rep/rev-up Adjustments				
10 Stand-alone costs	-	(3,183)		(1,660)
11 Purchase note interest income	-	(1,810)		-
12 Equity income, net of distributions	(8,944)	(1,794)		267
13 PanAero settlement, net	460	(765)		-
14 Bad debt expense	-	(340)		-
15 BRP/PG&E settlement income	-	(275)		-
16 Excess property tax accrual	-	1,390		-
17 Obsolescence reserve increase	(100)	100		(800)
18 President's salary differential	1,300	200		-
19 Unreconciled differences	-	-		-
Total of Non-Rep/rev-up adjs	(7,284)	(6,359)		(1,252)
Adjusted EBITDA	\$ 7,643	\$ (8,285)		\$ (144)

Sources: General Ledger, information provided by management and PwC analysis

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Section 2 - Executive Summary

Quality of Earnings, continued

17. **Obsolescence reserve increase.** Based on discussions with management and review of documentation provided, the Americas' inventory reserve for obsolete and slow moving spare parts and lattice steel inventory is considered inadequate. The director of inventory management indicated most of the excess spare parts relate to materials purchased for the Z750 prior to 1999. Therefore, we have not included a quality of earnings adjustment for the cost of increasing the spare parts and lattice steel reserve.

However, management indicated beginning in July 2001, to account for future obsolescence issues, the Americas will record a monthly adjustment to bring the inventory reserve to 3% of the gross inventory balance. This proposed treatment will result in significant charges and credits flowing through the income statement monthly based on changes in total gross inventory. We have proposed an adjustment to increase the inventory reserve, with the related charge to earnings, had this policy been in place during the periods under review. The quality of earnings adjustments take the reserves recorded for specifically identified excess parts into account.

Given the inventory reserve will be tied to the gross inventory balance, when modeling the future costs of this business, this reserve policy must be taken into account.

18. **President's salary differential.** During 2001, a new president of the Americas began full time employment in that position. An adjustment has been proposed related to the differential in the current salary and bonus for the president and the amounts expensed for individuals who held the position during 1999 and 2000. No similar adjustment would be anticipated in the future unless there was a significant change in senior management or compensation structure.

19. **Unreconciled differences.** Management provided supporting documentation for management and maintenance revenue that did not reconcile to the general ledger. The impact of these unreconciled difference was an overstatement of revenue in the general ledger by approximately \$300. An adjustment related to these amounts has not been proposed, as it is unclear why the amounts do not reconcile. See the discussion regarding the Americas' lack of internal controls in the executive summary section of this report.

Quality of Earnings		Year Ended December 31,	Four Mos. Ended April 30,
		1999	2001
		\$ 34,237	\$ 18,634
(\$ in thousands)			
Reported EBITDA			\$ 534
Proposed adjustments:			
GAAP Adjustments			
1	EBEC push-down expenses	(5,250)	(1,169)
2	Warranty expenses	(17,900)	780
3	Reversal of bonus accrual	780	(780)
4	Purchase price variance release	-	1,100
5	Revenue-3rd party sales	-	440
6	Monfort land sale	-	(165)
Total of GAAP adjustments		(22,370)	915
Period Issues/Revenue Rez.			
7	Lake Benton Inv. recognition	-	(6,100)
8	Lake Benton I reserve excess	2,910	(2,900)
9	Strom Late II refund	160	(160)
Total of Period Issues/Rev. Res. adj's		3,070	(9,160)
Revenue/True-up Adjustments			
10	Stand-alone costs	-	(3,185)
11	Purchase note interest income	(8,944)	(1,810)
12	Equity income, net of distributions	460	(794)
13	ParAveto settlement, net	-	(765)
14	Bad debt expense	-	(330)
15	DRP/UP/G&E settlement income	-	(215)
16	Excess property tax accrual	-	1,390
17	Obsolescence reserve increase	(100)	100
18	President's salary differential	1,300	299
19	Unreconciled differences	-	-
Total of Revenue/True-Up adj's		(7,284)	(6,399)
Adjusted EBITDA		\$ 7,643	\$ (8,205)

Source: General ledger, information provided by management and PwC analysis

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**Quality of Net Assets**

During the course of our analysis, we noted various items affecting the collectibility and/or reasonableness of certain assets and liabilities and therefore, the quality of stated net assets. These adjustments should be carefully considered in light of the value of net assets being acquired in the proposed transaction especially because of the proposed purchase price adjustment mechanism. These items are detailed in the table to the right and described below:

1. **Inventory reserve.** - As noted in the quality of earnings analysis, the Americas' inventory reserve for obsolete and slow moving inventory is considered inadequate as a result of excess parts for the Z750 and excess lattice steel for towers. In addition, the Americas is changing its reserve policy to increase the reserve to 3% of gross inventory (excluding items specifically identified and reserved). An adjustment to net assets as of April 30, 2001 has been proposed in order to increase the inventory reserve to account for these items. A summary of the reserve adjustment is as follows:

3% of obsolescence reserve (new policy effective July 2001) on gross inventory	\$ 1,900
Z 750 spare parts	3,000
Lattice steel deemed obsolete	500
Subtotal	5,400
Less current reserve	(800)
<b>Total</b>	<b>\$ 4,600</b>

2. **Warranty reserve.** - As discussed in the quality of earnings analysis, the Americas has not recorded warranty expense and related changes in warranty reserves in compliance with US GAAP. An adjustment to reported net assets as of April 30, 2001 has been proposed to reflect the proper implementation of US GAAP related to warranty costs.

**Analysis of Net Assets**

(\$ in thousands)	
Reported Net Assets, December 31, 2000	\$ 183,686
Net income, four months ended April 30, 2001	(3,391)
Unreconciled difference	(39)
<b>Net assets, April 30, 2001</b>	<b>180,256</b>
<b>Potential adjustments:</b>	
1 Inventory reserve	(4,600)
2 Warranty reserve	(4,420)
3 Electricity A/R reserve	(1,700)
4 Retention accrual	(1,400)
5 A/R reserve	(725)
6 Project reserves	1,610
7 Reserve for property taxes	1,394
8 Purchase price variance	1,100
9 General reserve accrual	1,080
10 Z-350 and Z-750 loading equipment	777
<b>Adjusted net assets, April 30, 2001</b>	<b>\$ 172,591</b>

Source: General Ledger and PwC analysis

Quality of Net Assets, continued

3. **Electricity accounts receivable reserve.** - The proposed adjustment reflects a decrease of \$1,700 related to receivables from SCE for electricity sold to them. SCE made no payments to the Americas from November 1, 2000 to March 31, 2001. Based on the terms of a settlement agreement reached with SCE, the Americas will receive a total of 20% of the outstanding amount in two installments with the remainder to be paid at some point in the future. We have proposed an adjustment to net assets to increase the accounts receivable reserve for the 80% of the non-reserved electricity receivables. A related quality of earnings adjustment has not been proposed as the write-off of these amounts is considered non-recurring in nature. However, in the future, the financial viability of the utilities to whom the Americas sells electricity must be closely monitored.

4. **Retention accrual.** - Agreements entered into in 2000 indicate certain US employees are entitled to a retention bonus payable in two installments: 30% at December 31, 2001 and 30% at December 31, 2002. An adjustment to reported net assets as of April 30, 2001 has been proposed to accrue for the amount of retention bonuses payable to US employees. A related quality of earnings adjustment has not been proposed as the amounts are considered non-recurring in nature.

5. **Accounts receivable reserve.** - An adjustment to net assets has been proposed for \$725 to reflect an increase in the allowance for doubtful accounts for items whose collectibility appears doubtful based on a review of the accounts receivable aging and discussions with management. A quality of earnings adjustment has been proposed for only the 2000 activity (\$350), as the remaining amounts (\$375) relate to pre-1999 activity. As noted earlier, as the Americas' customer base grows and credit is extended to new customers, it is likely bad debts and the accounts receivable reserve will grow.

Analysis of Net Assets

(\$ in thousands)	
Reported Net Assets, December 31, 2000	\$ 183,686
Net income, four months ended April 30, 2001	(3,391)
Unreconciled difference	(39)
Net assets, April 30, 2001	<u>180,256</u>
Potential adjustments:	
1 Inventory reserve	(4,600)
2 Warranty reserve	(4,420)
3 Electricity A/R reserve	(1,700)
4 Retention accrual	(1,400)
5 A/R reserve	(725)
6 Project reserves	1,616
7 Reserve for property taxes	1,290
8 Purchase price variance	1,100
9 General reserve accrual	1,080
10 Z 550 and Z 750 tooling equipment	771
Adjusted net assets, April 30, 2001	<u>\$ 172,591</u>

Source: General ledger and PwC analysis

Quality of Net Assets, continued

6. **Project reserves** - When the construction of a project is nearing its end, Americas records specific reserves to estimate the total costs to completion. At April 30, 2001, \$1,610 of specific project reserves was deemed by management to be no longer required yet these reserves remained as liabilities in the balance sheet. These reserves are predominantly comprised of reserves for construction and legal costs for projects Cabazon, Green Power, Delaware Mountain, Lake Benton II, Storm Lake I, Storm Lake II and VG Power Partners. A related quality of earnings adjustment has not been proposed, as the majority of these accruals were established prior to 1999. As the Americas is shifting its strategic focus away from project development, it is not anticipated that project reserves will continue to be a significant component of accrued liabilities in the future.

7. **Reserve for property taxes** - The Americas recorded a \$7,000 reserve related to property taxes owed on the Lake Benton I project during 2000. Management represented approximately \$1,590 of this accrual represents caution and is not deemed necessary. An adjustment to increase net assets by this amount has been proposed as of April 30, 2001.

8. **Purchase price variance** - As described in the quality of earnings analysis, at April 30, 2001, the Americas had purchase price variances capitalized related to inventory that had been sold. This adjustment reflects the release of these variances.

Analysis of Net Assets

(\$ in thousands)	
Reported Net Assets, December 31, 2000	\$ 183,686
Net income, four months ended April 30, 2001	(3,391)
Unreconciled difference	(39)
<b>Net assets, April 30, 2001</b>	<b>180,256</b>
Potential adjustments:	
1 Inventory reserve	(4,600)
2 Warranty reserve	(4,420)
3 Electricity A/R reserve	(1,700)
4 Retention accrual	(1,400)
5 A/R reserve	(725)
6 Project reserves	1,610
7 Reserve for property taxes	1,390
8 Purchase price variance	1,100
9 General reserve accrual	1,080
10 Z-550 and Z-750 tooling equipment	777
<b>Adjusted net assets, April 30, 2001</b>	<b>\$ 172,591</b>

Source: General Ledger and PwC analysis

Quality of Net Assets, continued

9. **General Reserve accrual.** - Included within accrued professional fees is a \$1,080 general reserve related to unidentified potential future claims. As management has deemed this reserve as unnecessary, an adjustment has been proposed to add back the amount to net assets as of April 30, 2001. A related quality of earnings adjustment has not been proposed as the accrual was recorded prior to 1999.

10. **Z 550 and Z 750 tooling equipment.** - As of April 30, 2001, the Americas maintained certain tooling equipment related to the Z550 and Z750 which is being depreciated over ten years. These two turbine types have ceased production in the US and the related tooling equipment may need to be written off. Management was unable to provide the net book value of this equipment. Accordingly, no adjustment has been proposed; however, further work would need to be performed to ascertain the net book value of this equipment.

Analysis of Net Assets

(\$ in thousands)	
Reported Net Assets, December 31, 2000	\$ 183,686
Net income, four months ended April 30, 2001	(3,391)
Unreconciled difference	(39)
Net assets, April 30, 2001	180,256
Potential adjustments:	
1 Inventory reserve	(4,600)
2 Warranty reserve	(4,420)
3 Electricity A/R reserve	(1,700)
4 Retention accrual	(1,400)
5 A/R reserve	(723)
6 Project reserves	1,610
7 Reserve for property taxes	1,396
8 Purchase price variance	1,100
9 General reserve accrual	1,080
10 Z 550 and Z 750 tooling equipment	???
Adjusted net assets, April 30, 2001	\$ 172,591

Source: General Ledger and PwC analysis

### **Lacking a financial accounting software system, all consolidation and analysis work is performed in Excel greatly increasing the potential for error**

Throughout the course of our due diligence, we encountered significant difficulties in attaining information required to perform our diligence procedures. Based on our discussions with management as well as the knowledge gained regarding the financial accounting systems in place in the Americas, we identified several key causes for these difficulties which are summarized below.

#### **No comprehensive financial accounting package utilized**

Currently, all significant financial consolidation and analysis work for the Americas is performed in Excel. The Americas utilizes DataWorks as its general ledger system to record the day-to-day accounting activity at each of the various operating entities. However, at the end of each period, data from DataWorks is uploaded into Excel for further work and manipulation by the accounting department.

Management records "top-side," other overall and consolidation adjustments in the determination of the final income statement and balance sheet account balances. There is an inherent lack of internal control in this manual system as there is no underlying mechanism in place to ensure that standards of double-entry bookkeeping are followed (i.e. there could potentially be one-sided adjustments recorded). Mr. Washfield indicated the Americas did not utilize a financial accounting software package because, in his opinion, there was not a package available on the market that could handle the Americas' numerous entities and related consolidation. Our information technology team does not agree with this assessment.

Due to the lack of a financial accounting software package, all supporting detail for account balances is maintained on an ad-hoc basis in Excel; in addition, what information was available was primarily only available as of the current date as historical records are not maintained. During the course of our review, we were told on numerous occasions supporting documentation did not exist for certain account balances:

#### **Income Statement**

- No breakdown of cost of sales amounts (especially for third party sales) was available for any period
- Lack of information regarding the allocation of overhead costs to inventory
- Unreconciled differences exist between the detail provided by management and the general ledger for numerous accounts and periods (especially maintenance revenues, general and administrative, business development and research and development expenses)

#### **Balance Sheet**

- No accounts receivable agings were available for December 31, 1998 and 1999; agings for December 31, 2000 and April 30, 2001 were prepared manually
- No inventory sub-ledgers were available for any period
- No fixed asset registers were available at any historical date; accumulated depreciation could not be identified by asset type
- No supporting detail was available for numerous prepaid and other asset accounts including deferred insurance
- No accounts payable sub-ledgers were available for any period
- No accrued liabilities sub-ledgers were available for any period

In addition to these items related to the Americas, very little information was available relative to EREC's income statement and balance sheet account balances. Frequently, financial management was unable to answer questions, had a liberal interpretation of accuracy and admitted to errors in their Excel spreadsheets used to maintain the financial records when brought to their attention.

Given the size and complexity of the Americas' operations, these manual systems pose significant risks for maintaining accurate and complete financial accounting records. In the future, as the Americas continues to grow, this manual system will be a hindrance to the accurate and efficient record keeping of operational results as well as to maintaining sufficient records for financing requirements.

### Numerous other factors contributed to the Americas' difficulty in providing information required for due diligence

In addition to the lack of a financial accounting software package, other factors described below contributed to the difficulties we encountered in attaining information required for our diligence procedures.

#### Changes in senior management and strategy

During the past several years there have been significant personnel changes at the senior management level including senior financial personnel. Along with these changes there have been shifts in strategy and related procedures including accounting for certain transactions and the overall financial statement consolidation. For instance, management indicated certain transactions were entered into or "pushed" into periods by previous managers in order to help meet targeted revenue or income amounts. In addition, the responsibility for the overall consolidation moved from Techahepi to Houston during 2000 and is currently being performed by individuals not involved in the day-to-day operations of the business. The consolidation is scheduled to return to Techahepi later in 2001.

The impact of these changes presents itself in the financial statements through the lack of consistency in how various transactions, especially related to projects, have been recorded as well as errors included in the overall EREC consolidation. The Americas will need to develop and implement a standard consulting policies and procedures manual to help ensure consistency and accuracy in the recording of transactions. In addition, the consolidation will need to be performed by someone knowledgeable in consolidation accounting and someone familiar with the underlying business.

It is not possible for us to evaluate the impact, if any, the change in strategy from project development and ownership to pre-development and manufacturing will have on the Americas' financial record keeping ability.

#### Concentration of accounting knowledge in few individuals

During the course of our due diligence, we had opportunity to have significant interaction with Mr. Tony Schoen, assistant controller, as well as several discussions with Mr. Mike Westfeld, controller. Through our discussions and by Mr. Westfeld's own admission, Mr. Schoen is the individual with the most detailed knowledge of the Americas' financial information. In fact, all information we obtained during the diligence process was filtered through Mr. Schoen. He indicated that over the past several years he had taken minimum amounts of vacation.

This concentration of knowledge could lead to potential issues arising from a lack of segregation of duties.

#### High materiality level in Andersen audit

During the course of our due diligence, we reviewed the audit workpapers made available to us by Arthur Andersen, the Americas' external auditor, for 1998, 1999 and 2000. Very few workpapers were available to us and those that were included mostly descriptions of various accounting processes. Through discussions with Mr. David Larkin, audit manager, we learned Andersen utilized a materiality level of \$1,600 in its determination of items for proposed adjustment. He did not indicate how Andersen had determined this amount. Mr. Larkin also noted in its assessment of financial controls at the Americas it relied heavily on Mr. Westfeld and Mr. Schoen and their longevity and experience with the business.

The use of the \$1,600 materiality threshold (22% of 2000 operating income) for the 2000 audit and the reliance placed on Mr. Westfeld's and Mr. Schoen's experience could have led to a number of the issues identified through this due diligence not being identified during the audit. Also, had we been provided with all requested information, additional items might have come to our attention that would have impacted the quality of earnings or net assets analysis.

**Inventory levels could be reduced by an estimated \$36,000 through more effective management of the supply chain; throughput and lead time of the production process is hampered by poor manufacturing standards and constraints on material handling**

**Supply Chain Management**

Tehachapi's current supply chain management environment is causing several inventory imbalances resulting in excess inventories. Key contributors include:

- present start-up mode for production of EW 1.5 MW turbines
- central procurement of key components from Germany
- sourcing of key items from Europe and Brazil
- lack of visibility into the production scheduling and inventory management processes
- ineffective use of the ERP system's (DataFlo) materials management capabilities

Opportunities exist to reduce the Americas' average 2001 inventories by up to approximately \$36,000 (a 36% improvement from the April 30, 2001 balance) through more effective management of its supply chain. These substantial inventory reductions should be realized through more effective use of DataFlo's materials management capabilities, enhanced supplier communications, and, when advantageous, local sourcing of key components.

**Manufacturing Operations**

**Performance of US-built EW 1.5 MW Turbines**

Inefficient data exists to determine the performance levels of the US built EW 1.5 MW turbines:

- Currently, there are only twenty EW 1.5 MW turbines operating in the field. The longest exposure period for a US built EW 1.5 MW turbine is approximately two months. Current estimated machine availability for these twenty EW 1.5 MW turbines is 60% which is well below the average of 96.2% for the remainder of the fleet (Z750s and Z550s).
- Two major quality issues are affecting machine availability on the EW 1.5 MW turbines. One issue is hydrogen embrittlement of T-bolts and the other relates to a hydraulic oil leak. These issues have been identified on 50% of the operational turbines. The T-bolt problem is currently delaying the commissioning of the turbines and is indicative of a lack of control over supplier manufacturing processes.

**Production Goals**

- Production throughput and lead-times are hampered by poor manufacturing standards and material handling issues
- Current manufacturing productivity requires improvement of nearly 60% to reach the budgeted annual output of 215 EW 1.5 MW units for 2001. The lack of procedures to identify areas of non value-added work, a high degree of parts retrieval and constraints on material handling devices (bridge cranes) are limiting factors in achieving targeted output requirements, future growth, and flexibility.

**While current systems are not integrated nor fully implemented, they are stable and a shift to a global ERP system is not considered necessary**

**Reassessment of Global ERP System**

During 2000, EWC completed an ERP software selection, choosing SAP for the global system. However, Mr. Westfeld stated the project did not proceed past the software selection stage due to the substantial resources that were committed to the rollout of the new EW 1.5 MW turbine. In addition, the estimated required investment of \$11,000 - \$15,000 was also a concern.

EWC plans to reanalyze the viability of a global ERP system in the fourth quarter of 2001. The Americas runs as a separate business from Europe. However, the Americas utilizes Europe for central purchasing of strategic components and engineering collaboration. These shared business functions would appear to not warrant the investment in a global ERP system.

**Current IT Systems Considered Stable but not Integrated**

The Americas' business systems are a combination of DataFlo and custom developed systems. They are not integrated nor fully implemented and lack basic functionality (refer to prior comments on system efficiency and utilization by operations). However, the systems are stable and support the business in its current form.

The DataFlo system can provide additional functionality to support the business as it grows.

Off-line spreadsheets are used for financial consolidation making account analysis extremely cumbersome. Custom DataFlo reports should be developed to simplify analysis and increase the controls surrounding consolidation and financial analysis process.

In addition, Enron provides EWC with financial consolidation services, although there are no system interfaces to any of Enron's systems and no significant separation issues related to the IT function. EWC will need to select a system for financial reporting of the American and European consolidated results. The cost is estimated to be approximately \$250 - \$350 with an estimated implementation period of 3 to 4 months.

Off-line Access databases are used to manage the labor tracking and shop floor control. The DataFlo shop floor and bar coding modules should be implemented to replace the Access databases. The cost to implement these modules is approximately \$200 - \$300 with an estimated implementation period of 2-3 months.

The Unihol system is a custom developed system that manages field operations performance and maintenance.

The Americas has one major IT project for 2001: the implementation of the MP5 system that is planned to replace the Unihol system. The cost is estimated to be approximately \$1,100 with a scheduled implementation of September 2001.

### Tax incentives are critical to the Americas' operations and the existence of an OFL impacts the cost of EREC repatriating cash from foreign operations

#### Tax Incentives

##### US, IRC Section 45 Tax Credit

*Legislative Uncertainty for Important Credit* - As was reflected in the financial results the last time the renewable energy credit was suspended, the continued availability of this credit is of the utmost importance to the Americas' business prospects. Currently, the credits have an expiration date of December 31, 2001; however, the likelihood of an extension is considered high, but not certain.

*Foreign*: We understand several other non-US markets provide tax incentives relating to "Clean Energy". Further investigation is required to determine the impact of, and future prospects for, such incentives.

##### Tax Indemnification

Our tax due diligence review did not prioritize the identification of historical tax exposures because we have assumed a fairly "blanket" tax indemnification will be provided by Enron (as is the case in the draft purchase agreement provided to us).

##### Dutch Holdco Structure

Enron's tax representatives acknowledge the required "substance" of the Dutch BV may be somewhat lacking. On a going forward basis we should ensure required formalities are followed to avoid unnecessary withholding taxes from jurisdictions owned by the BV, including Germany.

#### Overall Foreign Loss

Enron's tax planning has caused EREC to inherit an Overall Foreign Loss ("OFL"). The practical impact of the OFL is to make it extremely expensive to repatriate cash from EREC's foreign subsidiaries (i.e., it effectively doubles the corporate tax upon repatriation).

We still do not know the exact magnitude of the inherited OFL EREC acquired from Enron. However, Enron's most recent estimate suggests EREC's OFL will be approximately \$18,000.

With required debt service (and other US based cash needs), the traditional mechanisms of avoiding the "double tax" (i.e., do not repatriate) may not be available to EREC post-closing.

Complicated structures are available to mitigate the OFL "double-tax". These structures were presented under separate cover and have their own negative attributes (e.g., complicating exit strategies). At an \$18,000 level, these structures may not make sense unless EREC is an ongoing OFL "producer." If requested, we can perform a preliminary analysis to determine whether EREC is likely to be an ongoing OFL "producer."

**Revenue growth of 146% is forecast for 2001 due to the sale of the Indian Mesa projects, increased third party sales and the introduction of the EW 1.5 MW turbines in the US market**

The table to the right details forecasted revenues by type for 2001 and 2002 along with the actual amounts for 2000. The assumptions utilized by management to estimate these amounts are discussed below.

**Turbine Sales**

As discussed previously, management is forecasting the sale of 193 third party turbines in 2001 as compared with zero in 2000. Third party turbine sales are forecast to grow to 375 in 2002. See further analysis on backlog and its impact on the forecast on the following slides.

**Wind Project Sales**

Management is projecting the sale of the Indian Mesa I and II projects in December 2001. The forecasted revenue and margin from the sale of these projects is \$169,100 and \$21,000, respectively.

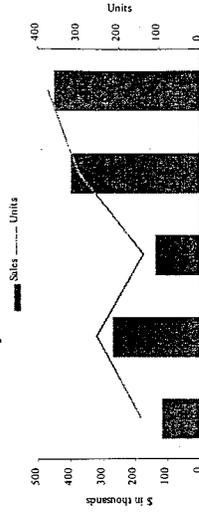
Consistent with the shift from a product developer to manufacturer, no project sales are forecast beyond 2001. However, four developed projects remain capitalized in the Americas' fixed assets (Cubazon, VG Repower, Green Power and ZWHC). Based on discussions with management, there is a plan to sell Cubazon, VG Repower and Green Power by the end of 2002; however, no formal amounts have been included in the 2002 forecast. The delay in the sale of these projects is the result of the projects consisting of Z750 turbines. As discussed previously in this report, the Z750 turbine has encountered mechanical difficulties and the Americas is in the process of retrofitting all Z750 turbines in service. The Americas has focused on the third party sales turbines first, with the developed projects scheduled to be retrofitted by the end of 2001.

Revenue Forecasts by Revenue Type

(\$ in thousands)	Year Ended December 31,	
	2000(A)	2001(F)
Turbine sales	\$ -	\$ 230,500
Wind project sales	137,447	169,100
Maintenance services	12,247	13,300
Management fees & easements	2,323	1,900
Electricity sales	16,566	14,200
Installation sales	2,810	2,000
Other	3,224	-
<b>Total revenues</b>	<b>\$ 174,647</b>	<b>\$ 431,000</b>

Source: General ledger and forecasted income statements

Turbine and Project Revenue and Units Placed in Service



Source: General ledger and unit information

**Revenue growth of 146% is forecast for 2001 due to the sale of the Indian Mesa projects, increased third party sales and the introduction of the 1.5 MW turbines in the US market**

**Wind Project Sales, continued**

Additionally, the four projects are located in California, which has created some problems in selling the projects due to the current energy environment. Management believes as the energy situation in California improves, the developed projects with look more attractive to potential buyers. However, the type of technology used in these projects (Z-550 and Z750) is older and may not be as valuable to potential buyers.

**Maintenance Services**

Maintenance services revenue is forecast to increase 8% in 2001 compared with 2000 and is forecast to increase 33% in 2002 compared with 2001. The significant increase in 2002 is the result of the projected addition of new service contracts for the new units sold in 2001 and 2002.

The forecast increase in maintenance fees in 2001 is attributable to a full year of activity for the Lake Benton I project, which was sold in June 2000 (143 units). Accordingly, 2001 will represent the first year of full maintenance activity. Further top line revenue growth will be the result of the cost plus nature of the contracts. Increases in labor and material costs would increase top line growth, however gross margin percentage would not be impacted.

**Management Fees and Easements**

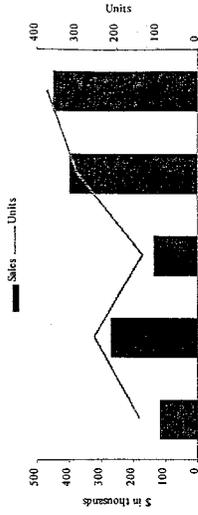
Management fees and easement revenue is forecast to decrease 18% in 2001 as compared with 2000, however are forecast to remain flat in 2002.

Revenue Forecasts by Revenue Type

(\$ in thousands)	Year Ended December 31,		
	2000(A)	2001(F)	2002(F)
Turbine sales	\$ -	\$ 230,500	\$ 451,100
Wind project sales	137,447	169,100	-
Maintenance services	12,247	13,300	19,000
Management fees & easements	2,323	1,900	1,900
Electricity sales	16,566	14,200	14,200
Installation sales	2,840	2,000	2,900
Other	3,224	-	-
<b>Total revenues</b>	<b>\$ 174,647</b>	<b>\$ 431,000</b>	<b>\$ 489,100</b>

Source: General ledger and forecasted income statements

Turbine and Project Revenue and Units Placed in Service



Source: General ledger and unit information

## Forecast electricity sales may be impacted by a recent settlement with SCE

### Electricity Sales

Electricity sales are forecast to decrease 14% during 2001 compared with 2000 and remain consistent in 2002. The Americas is forecasting increased electricity rates, however kilowatts sold is forecast to decrease.

Management indicated the forecasted SRAC rate for electricity sales for 2001 and 2002 is \$0.067 during 2000. This compares with an average kW per hour price of \$0.067 during 2000.

Based on the \$0.07 per kWh projection for 2001, kilowatts sold are forecasted to approximate 203,000 kW. This compares with approximately 250,000 kW sold during 2000. A portion of the decrease relates to the sale of the Lake Benton II project in June 2000, which generated in excess of 20,000 kW in 2000 prior to being sold. Management did not explain the other reasons for the forecasted kilowatt decrease.

As discussed in further detail in the income statement analysis section of this report, a recent settlement with SCE could result in SRAC pricing of \$0.053 per kWh for the next five years. As of the date of this report, it is uncertain as to whether the new pricing will go into effect during 2001, as certain milestones must be attained by SCE prior to the implementation of the new pricing.

### Instalment Sales

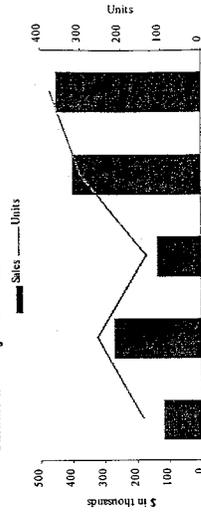
Instalment sales income relates to the Project 85 A, B and C projects.

### Revenue Forecasts by Revenue Type

65 in thousands)	Year Ended December 31,	
	2000(A)	2002(F)
Turbine sales	\$ -	\$ 230,500
Wind project sales	137,447	169,100
Maintenance services	12,247	13,300
Management fees & easements	2,223	1,900
Electricity sales	16,566	14,200
Instalment sales	2,840	2,000
Other	3,224	-
<b>Total revenues</b>	<b>\$ 174,647</b>	<b>\$ 483,000</b>

Source: General ledger and forecasted income statements

### Turbine and Project Revenue and Units Placed in Service



Source: General ledger and unit information

**Based on current production levels, units produced may be insufficient to meet the forecast for units sold in 2001 and 2002**

**2001 and 2002 Forecast Revenue for Turbine Sales**

The table to the right is a summary of forecast revenues and gross margin for wind project and wind turbine sales for 2001 and 2002 based on the production schedule for the EW 1.5 at the Tehachapi facility.

As discussed in the operational review section of the report, management believes the Tehachapi facility is currently capable of producing eight EW 1.5 MW turbines per week. Based on a 48 week production schedule, the potential annual production is 384 EW 1.5 MW turbines. As discussed previously, management is forecasting the sale of 300 and 375 units for 2001 and 2002, respectively.

However, current production for the EW 1.5 MW in Tehachapi is five per week. Based on the 48 week production schedule, the current production levels would generate 240 turbines, well below the forecasted units for 2001 and 2002.

Efficiency gains of nearly 60% would need to be attained to reach the eight turbines per production week that management believes the facility is capable of producing. For purposes of this analysis, it is assumed the Americas improved efficiency and produced 7.5 turbines per week during 2002.

Based on information provided by management, the average selling price per turbine for a third party sales is approximately \$1,200 and the average selling price per turbine for a project sale approximates \$1,600. The higher average selling price for the project sales is the result of the additional costs and risks related to project ownership. Based on current production, the Americas will not be able to supply turbines for all of the projects listed in the 2001 forecast. For purposes of this analysis, it is assumed the developed projects (Indian Mesa I and II) would be the projects that would not be fully supplied in 2001. The current production column in 2002 assumes the completion of Indian Mesa I and II and that certain third party sales would be unable to be fulfilled based on production levels.

If the current production of the EW 1.5 MW turbine remains at five per week, forecast revenues and gross margin would be significantly below estimates. A summary of the Americas backlog is presented on the following page.

**Potential Revenue and Gross Margin Based on Production**

	Night Estimates December 31,		Current Production December 31,	
	2001(F)	2002(F)	2001(F)	2002(F)
\$ in thousands				
Potential units produced per week	8	8	5	7.5
Production weeks	48	48	48	48
Potential annual production	384	384	240	360
Forecast 3rd party units	193	375	193	375
Forecast project sales units	107	-	107	60
Total forecast units	300	375	300	435
Variance based on production	84	9	(60)	(75)
3rd party sales:				
Forecast 3rd party sales (# of units)	193	375	193	300
Average selling price	\$ 1,200	\$ 1,200	\$ 1,200	\$ 1,200
Potential revenues, 3rd party	\$ 231,600	\$ 450,000	\$ 231,600	\$ 360,000
Potential CCS (\$1,000 per turbine)	193,000	375,000	193,000	300,000
Potential gross margin	\$ 38,600	\$ 75,000	\$ 38,600	\$ 60,000
Potential gross margin %	16.7%	16.7%	16.7%	16.7%
Project sales:				
Forecast project sales (# of units)	107	-	47	60
Average selling price	1,600	-	1,600	1,600
Potential revenue-Project sales	171,200	-	75,200	96,000
Potential CCS (\$1,400 per turbine)	149,800	-	65,800	84,000
Potential gross margin	\$ 21,400	\$ -	\$ 9,400	\$ 12,000
Potential gross margin %	12.5%	N/A	12.5%	12.5%
Combined revenue	\$ 402,800	\$ 450,000	\$ 306,800	\$ 456,000
Combined CCS	342,800	375,000	258,800	384,000
Combined gross margin	\$ 60,000	\$ 75,000	\$ 48,000	\$ 72,000
Combined gross margin %	14.9%	16.7%	15.6%	15.8%

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### The Americas maintains a detailed schedule that tracks opportunities based on their likelihood of completion

In order to track potential job opportunities, Mr. Gates maintains a weekly "Turbine Orders - Project List and Probability" schedule which categorizes opportunities based on their likelihood of completion. The chart to the right summarizes the schedule as at June 10, 2001 (the schedule is not maintained for prior periods).

The schedule summarizes all opportunities and attempts to assign a probability percentage based on a series of factors for each opportunity such as land availability, whether studies have been conducted, etc. Mr. Gates briefly summarized the classification system the Americas utilizes:

- "Committed" projects are those for which there is a signed contract. Note the Fenner project is included at 90% within the committed classification as the contract documentation is being finalized; according to Mr. Gates, signing is expected by June 15, 2001. As of the date of this report, the status of this contract is unclear.
- "Firm" includes projects for which the Americas has been selected as the provider by the customer, but negotiation of certain contract points is continuing.
- "Highly Likely" are those projects for which the Americas may have been selected as the provider or is on the "short list." Contract negotiations have been started, land has been secured and most permits have been obtained.
- "Probable" includes projects that are being pursued, but have a low likelihood of completion due to the number of factors that are still outstanding. Typically, initial proposals have been submitted and in certain cases, land secured and permits obtained.

Projects move through these various categories and on-and-off the list based on the facts and circumstances of each opportunity. Classification decisions are made by senior commercial management. Mr. Gates indicated the methodology for tracking projects had not changed significantly over the past two years; however there has been more formality added to the process through the creation of this schedule as well as more direct linkage between the commercial department and planning and forecasting.

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Turbine Order Pipeline & Probability

Project Name	Classification	Customer	No. of Turbines	Probability	Probability Adjusted Turbines
Mill Run	Committed	AREC	10	100%	10
Somerset	Committed	AREC	6	100%	6
Clear Sky	Committed	ABP	90	100%	90
Trent Mesa	Committed	ABP	87	100%	87
Indian Mesa I	Committed	ABP	17	100%	17
Montfort	Committed	FPL	20	100%	20
Fenner	Committed	AREC	20	98%	18
Trent Extension	Firm	ABP	13	98%	12
Colorado GP	Highly Likely	PS of CO	108	75%	81
NSP Phase IV	Highly Likely	enXco	53	75%	40
NSP All Source	Highly Likely	NAE	34	75%	26
Goldendale	Highly Likely	G. Aluminum	16	75%	12
Sims Ranch	Highly Likely	Clipper	14	75%	7
Lake Bonney	Highly Likely	Siemens	41	75%	31
Whitewater Hills	Probable	Whitewater	46	50%	23
Iowa	Probable	FPL	67	50%	34
Evanston	Probable	PacificCorp	68	50%	34
Portland Wind	Probable	Pacific Hydro	50	50%	25
various	Prospects	various	3,240	25%-0%	126
			4,000		699

Source: Commercial department

**In excess of 40% of 2001 revenue is forecast to be generated from the sale of the Indian Mesa I and II projects in December 2001**

Through April 2001, revenue of \$40,725 has been recognized on the Montfort (\$18,000) and Trent Mesa (\$22,700) project sales. Relative to Trent Mesa, 9 of a forecast 87 units have been shipped as of the end of April 2001. Mr. Miller indicated the original order for Trent Mesa was for 87 units and a change order of 13 additional units is in the process of being finalized. 17 of a forecast 20 units for the Montfort project have been shipped as of the end of April 2001. Based on the monthly forecast, the Americas is relatively on schedule for the Montfort and Trent Mesa projects.

The Americas is forecasting the sale of the Indian Mesa I and II projects in December 2001, which would account for 42% of 2001 revenue. Mr. Miller indicated the Americas is in the process of finalizing term sheets for the sale of Indian Mesa I and II with AEP. Mr. Miller anticipates a final purchase and sale agreement would be entered into by the end of July 2001. However, ownership would not transfer until the completion of the project and the testing and commissioning of the turbines is complete. Construction is forecast to be completed by the beginning of December 2001, with final approval and sale by the end of December 2001. Management acknowledged delays may result in finalizing the sale of Indian Mesa I and II and final settlement could be delayed until early 2002. Testing and commissioning can be a time consuming process, as it is conducted on a per turbine basis.

**Turbine and Wind Project Revenue Forecast for 2001**

(\$ in thousands)

Units	Jan	Feb	Mar	April	May	June	July	Sept	Oct	Nov	Dec	Total	
Wind Projects	17	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 29,200	\$ 29,200
Indian Mesa I	90	-	-	-	-	-	-	-	-	-	-	139,900	139,900
Indian Mesa II	107	-	-	-	-	-	-	-	-	-	-	189,100	189,100
Sub-total													
Turbines													
Montfort	20	2,100	2,900	7,500	6,300	7,200	-	-	-	-	-	-	26,000
Mill Run	10	-	-	-	-	-	3,100	9,000	-	-	-	-	12,100
Trent Mesa	100	-	-	17,900	11,200	14,500	26,800	23,700	-	-	-	-	117,600
Fanner	20	-	-	-	-	-	-	5,200	12,000	7,000	-	-	24,200
Somerset	6	-	-	-	-	-	-	1,700	3,500	1,800	-	-	7,000
Great River	20	-	-	-	-	-	-	-	14,200	8,800	-	-	23,000
Goldendale	17	-	-	-	-	-	-	-	-	3,300	16,300	-	19,600
Land rights	-	-	-	-	-	-	-	-	-	-	1,000	-	1,000
Sub-total	193	2,100	2,900	25,400	17,500	21,700	23,500	29,900	39,600	29,700	20,900	17,300	230,500
	300	\$ 2,100	\$ 2,900	\$ 25,400	\$ 17,500	\$ 21,700	\$ 23,500	\$ 29,900	\$ 39,600	\$ 29,700	\$ 20,900	\$ 186,400	\$ 399,600

Source: Forecasted financial information provided by management

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### Actual third party and wind project turbine sales for 2001 could range from 270 to 310 units

Management indicated the Great River sale will not be completed during 2001, however another project would most likely replace the anticipated revenue from this project. Management was unable to provide specific details regarding a potential candidate to replace the delayed revenue from the Great River project. Management indicated the actual number of units sold in 2001 (including third party and wind project sales) may range from 270 to 310 depending on market conditions (delay in extension of PTC or in securing a PPA) and production schedule. As the average turbine sale approximates \$1,200, a decrease in the number of units sold in 2001 could significantly impact 2001 forecast revenue and EBITDA.

Based on information provided by management, the 9 forecasted projects listed below are projected to generate \$38,400 in gross margin resulting in a gross margin percentage of 14.6% for 2001. Wind project sales (Indian Mesa I and II) are forecast to generate a gross margin percentage of 12% as compared to gross margin percentage of 16% for the turbine sales (remaining 7 projects).

Turbine and Wind Project Revenue Forecast for 2001

(\$ in thousands)	Units	Jan	Feb	Mar	Apr	May	June	July	Sept	Oct	Nov	Dec	Total
Wind Projects	17	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 29,200
Indian Mesa I	90	-	-	-	-	-	-	-	-	-	-	-	139,900
Indian Mesa II	107	-	-	-	-	-	-	-	-	-	-	-	169,100
Turbines													
Montfort	20	2,100	2,900	7,500	6,300	7,200	-	-	-	-	-	-	26,000
Mill Run	10	-	-	-	-	-	-	3,100	9,000	-	-	-	12,100
Trent Mesa	100	-	-	17,900	11,200	14,500	23,500	26,800	23,700	-	-	-	117,600
Fenner	20	-	-	-	-	-	-	-	5,200	12,000	7,000	-	24,200
Somerset	6	-	-	-	-	-	-	-	1,700	3,500	1,800	-	7,000
Great River	20	-	-	-	-	-	-	-	-	14,200	8,800	-	23,000
Goldendale	17	-	-	-	-	-	-	-	-	-	3,300	-	19,600
Land rights	-	-	-	-	-	-	-	-	-	-	-	1,000	1,000
Sub-total	193	2,100	2,900	23,400	17,500	21,700	23,500	29,900	39,600	29,700	20,900	17,300	230,300
	300	\$ 2,100	\$ 2,900	\$ 25,400	\$ 17,500	\$ 21,700	\$ 23,500	\$ 29,900	\$ 39,600	\$ 29,700	\$ 20,900	\$ 186,400	\$ 399,600

Source: Forecasted financial information provided by management

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**Third party units sold are forecast to grow from zero in 2000 to 375 in 2002**

Revenue by project for 2002 is based on the sale of turbines to third parties as management does not forecast the sale of any projects during 2002.

Unit growth is forecast to increase to 375 units in 2002 from zero in 2000 and a forecasted amount of 300 for 2001. All 2002 sales are forecast to be the EW 1.5 MW unit.

- Average selling price per unit is forecast to be \$1.2 million in 2002 as compared with \$1.3 million in 2001.

Management provided only a forecast of 2002 project revenue and cost and did not provide a forecast for other revenue streams.

2002 forecast gross margin percentage of approximately 16% is higher than the approximate 15% forecast for 2001 as the result of only third party turbines sales forecast for 2002. In 2001, the Americas is projecting the sale of the Indian Mesa I and II projects which is forecast to generate gross margin percentages below that of third party sales.

**Turbines Revenue Forecast for 2002**

(\$ in thousands)

Project	Units	Revenue	COS	Margin	Margin %
Rudnick	109	\$ 126,400	\$ 105,100	\$ 21,300	16.9%
Evanston Site	67	80,000	66,800	13,200	16.5%
NSP Phase IV	53	63,900	53,400	10,500	16.4%
Backbone Min.	34	41,700	35,000	6,700	16.1%
NSP All Source	34	39,200	32,500	6,700	17.1%
Oklahoma Wind	34	39,800	33,100	6,700	16.8%
Whitewater Hills	30	44,100	37,700	6,400	14.5%
Sims Ranch	14	16,000	13,300	2,700	16.9%
	<b>375</b>	<b>\$ 451,100</b>	<b>\$ 376,900</b>	<b>\$ 74,200</b>	<b>16.4%</b>

Source: Forecasted financial information

## Historical revenues were dependent on project sales that were influenced by the Production Tax Credit

### General

The income statements presented to the right were obtained from general ledgers for each of the periods. Revenue is earned from activity solely in the United States.

### Historical Performance

The Americas' revenues have fluctuated significantly during the periods under review starting at \$140,000 in 1998, rising to \$329,400 in 1999 (135% increase) and falling to \$174,600 in 2000 (47% decline). These significant fluctuations are due to the Americas' focus on the development and sale of wind projects during this period. In 1999, the Americas sold two wind projects as compared to one project during 2000. Project revenues are dependent on the availability of the PTC; the delay in the extension of this credit adversely impacted the financial results during 2000. In addition to wind projects, revenue is derived from the sale of wind turbines to third parties, management and maintenance services and the sale of electricity from majority-owned projects.

During 2001, the Americas has focused on transitioning from a project developer to a manufacturer of wind turbines. Beginning in 2001, the Americas introduced the EW 1.5 MW turbine into the US market. During the first four months of 2001, the Americas have completed the sale of 35 EW 1.5 MW units to third parties, which accounts for nearly all the revenues in that period.

Gross margins have remained relatively flat for the Americas as a whole during the period under review. Due to the numerous revenue streams and related costs that individually fluctuate during the periods presented, it is difficult to pinpoint exact drivers of margin shifts. Obviously, margins on large project sales significantly influence overall margins for a particular period. It appears the 30.3% gross margin percentage for the four months ended April 30, 2000 is the result of having only higher margin electricity, maintenance and management fee revenue, as no project or turbine sales were completed during that period.

### Income Statements

	Year Ended		Four Mths. Ended	
	1999	2000	2000	April 30,
	December 31,			
	1998	1999	2000	2000
(\$ in thousands)				
Revenue	\$ 140,116	\$ 329,424	\$ 174,647	\$ 40,470
Cost of sales	120,953	281,982	141,586	40,163
Gross margin	19,163	47,442	33,061	3,307
Gross margin %	13.7%	14.5%	18.9%	30.3%
G&A expense	9,554	15,926	12,742	4,154
R&D expense	3,594	3,741	5,716	818
Business development	4,682	5,540	7,327	2,016
Operating income	1,413	22,235	7,276	(3,647)
Operating income %	1.0%	6.9%	4.2%	-33.1%
Equity/IV income	9,306	11,271	11,603	1,196
Other income (expense)	2,590	(699)	(245)	(34)
EBITDA per mgmt	13,309	34,237	18,634	(2,485)
Depreciation and amort	7,740	10,216	11,312	2,954
Interest expense, net	4,623	7,066	9,833	2,292
Pre-tax income	\$ 946	\$ 16,955	\$ (2,311)	\$ (7,751)
				\$ (6,402)

Source: General Ledger

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## Operating expenses fluctuate significantly due to the large variances in annual revenue

Operating expenses in total and as a percentage of revenue have also fluctuated significantly during the periods presented. A large portion of the fluctuations are attributable to salaries and wages; however, there are numerous other costs included in these accounts contributing to the movement.

General and administrative costs fluctuated from 6.8% to 4.8% to 7.2% of revenues from 1998 to 1999 and 2000, respectively. These changes were primarily the result of special non-recurring bonus amounts paid to the former president in 1999, a slight headcount reduction in 2000 (5 employees) and an increasing headcount during 2001 as the Americas gears up for increased processing activity as a result of EW 1.5 MW sales. Research and development and business development costs remained relatively flat during the period but increased in 2000 and 2001 mainly as a result of spending on the introduction of the EW 1.5 MW.

The Americas earns joint venture income from its equity stake in 14 joint ventures. Other income (expense) is comprised mainly of gain on the sale of fixed assets, bank charges and political contributions.

### Other

Detailed information on revenues by type as well as cost of sales, general and administrative, research and development and business development components is included in the following pages.

Adjustments to reported EBITDA are identified in each section with applicable detail and are summarized in the quality of earnings analysis in the executive summary of this report.

### Income Statements

	Year Ended		Four Mos. Ended	
	1999	2000	2000	April 30,
	December 31,			
	1999			
	(\$ in thousands)			
Revenue	\$ 140,116	\$ 328,424	\$ 176,647	\$ 49,470
Cost of sales	120,963	281,582	141,586	40,163
Gross margin	19,153	47,842	35,061	9,307
Gross margin %	13.7%	14.5%	18.9%	18.8%
R&D expense	9,554	15,926	12,742	3,804
R&D expense	3,594	3,741	5,716	1,333
Business development	4,682	5,440	7,327	3,418
Operating income	1,413	22,735	7,276	(3,637)
Operating income %	1.0%	6.9%	4.2%	1.5%
Equity/IV income	9,306	11,971	11,603	1,196
Other income (expense)	2,590	(469)	(245)	(34)
EBITDA per night	13,309	34,237	18,634	(2,485)
Depreciation and amort	7,740	10,216	11,312	2,954
Interest expense, net	4,023	7,066	9,833	2,292
Pre-tax income	\$ 346	\$ 16,955	\$ (2,511)	\$ (7,511)
				\$ (6,402)

Source: General Ledger

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## The Americas revenues have historically depended on the ability to build and sell completed wind farms

### General

The table to the right presents a breakdown of the revenue components for the periods under review. Below is a brief description of each component; more detailed information on each component follows this overview.

### Turbine Sales (to third parties)

This category includes turbine sales made to third parties. See Appendix 5, for a list of the projects that make up the third party sales in 1999 and the four months ended April 2001; there were no third party sales in 2000.

### Wind Project Sales

Prior to 1997, the Americas typically proceeded with construction of projects only when external funding was in place. However, following its acquisition of the Americas by Enron, in 1998, after realizing PTCs could be potentially ending in June 1999, Enron extended a bridge loan of \$455,000 to accelerate the completion of projects in the pipeline.

This bridge loan was to be used for funding seven projects: Lake Benton I, Lake Benton II, Storm Lake I, Storm Lake II, Cabazon, Green Power and the Greece Project. Between 1998 and mid 1999, approximately 650 turbines were built and installed in these projects. Of these seven projects, three were sold in 1999 and 2000 as shown in the table. The amounts relating to Storm Lake II and Lake Benton I in 2000 represent various adjustments and deferred revenue relating to the original sale of these projects in 1998 and 1999 respectively. The other projects continue to be owned by the Americas.

Revenue by Type

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	April 10, 2001	2001
Turbine sales	\$ 32,290	\$ -	\$ 3,061	\$ 40,723
Wind project sales:				
Storm Lake II	164,000	161	-	-
Lake Benton I	106,000	9,800	5,6	-
Lake Benton II	-	172,300	729	-
Sub-total	270,000	183,161	5,327	3,441
Maintenance services	10,083	3,0	-	7
Electricity credits	10,305	0,9	2,323	531
Electricity sales	2,464	3,1	1,390	4,386
Installation sales	35	0,0	2,840	0,1
Other	-	3,410	2,0	4,0
<b>Total Revenues</b>	<b>\$ 329,424</b>	<b>100%</b>	<b>\$ 174,647</b>	<b>100%</b>
			<b>\$ 11,034</b>	<b>\$ 49,470</b>
			<b>100%</b>	<b>100%</b>

Sources: General Ledger and Information provided by Mr. Tony Stovene

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### Electricity sales for 2001 and future periods will be impacted by a recent settlement with SCE

Electricity is sold from the Americas owned projects primarily to Southern California Edison Company ("SCE") under a power purchase agreement that provides for pricing based on the short run avoided cost ("SRAC") established from time to time by the California Public Utilities Commission. The average price per kWh sold during the periods under review are presented in the table to the bottom right. The table to the right is a summary of electricity sales by project for the periods presented.

Electricity sales increased from \$10,305 to \$16,566, an increase of \$6,261 (61%) during 2000. Total kilowatt hours sold increased approximately 38% during 2000 compared with 1999 (accounting for approximately \$4,000 of the increase) due to the Green Power project that became operational in June 1999, the VG Repower project that became operational in July 1999 and capacity from the Lake Benton II project prior to its sale in July 2000. In addition to the increase in kilowatt hours sold, the average selling price increased from approximately \$0.057 in 1999 to \$0.067 in 2000, an increase of 17.5% which accounted for the remainder of the increase.

During the four months ended April 30, 2001, the average selling price per kilowatt hour increased to approximately \$0.105. The increase is the result of the higher prices caused by the energy crisis in California.

During 2000 and the four months ended April 30, 2001, the Americas recorded reversals related to amounts due from SCE directly to electricity sales, rather than as bad debt expense. It is unclear as to why management accounted for these reversals in this manner. Through April 30, 2001, the cumulative reversal of electricity sales from the November 2000-March 2001 period was approximately \$4,100. The impact of the reversals in 2001 results in an adjusted effective average selling price of \$0.060 for the four months ended April 30, 2001.

As described in the balance sheet analysis section, the Americas reached a settlement agreement with SCE regarding the amounts due (not including amounts written-off). Although a settlement agreement was reached, the risk of a bankruptcy filing by SCE still remains. As a result, current and future collection of fees due from the sale of electricity may be in doubt.

#### Electricity Sales by Project

(\$ in thousands)

	Year Ended December 31,		Four Mos. Ended April 30,	
	1999	2000	2000	2001
Cabazon	\$ 5,853	\$ 8,365	\$ -	\$ 2,339
ZWHC	2,991	3,495	530	760
ZSI	1,160	71	207	237
Green Power	901	2,322	653	681
VG Repower	-	1,344	-	369
Lake Benton II	-	969	-	-
Total	\$ 10,305	\$ 16,566	\$ 1,390	\$ 4,386

Source: General Ledger

#### kWh Sold and ASP by Project

	Year Ended December 31,		2000		Four Mos. Ended April 30,	
	1999	2000	kWh Sold	ASP	kWh Sold	ASP
Cabazon	100,500	\$ 70,859	104,800	\$ 0.078	33,600	\$ 0.123
ZWHC	41,600	0.059	43,200	0.077	12,500	0.127
ZSI	17,000	0.055	12,400	0.070	4,000	0.129
Green Power	19,300	0.047	53,900	0.045	17,100	0.039
VG Repower	5,600	0.069	17,600	0.072	6,200	0.128
Lake Benton II	-	-	21,600	0.045	-	-
Total	184,000	\$ 0.057	253,500	\$ 0.067	73,400	\$ 0.105

Source: Management provided electricity production schedules

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**Maintenance revenue is increasing while management & easement revenue is in decline.**

**Maintenance Services**

Maintenance revenue is derived from eleven projects sold prior to the period of review and three projects sold in 1999 and 2000. Management indicated the majority of maintenance agreements are long-term in nature (20-30 years) and are on a cost plus basis. Expenses for direct labor, materials and indirect costs are typically marked up 15%-20%.

**Management and Easement Fees**

Management fees are received for services provided to projects in which the Americas does not maintain a controlling interest. Management fees include services for accounting, tax preparation and the preparation of management reports and are generally a fixed fee payable on a quarterly or yearly basis. Revenue is recognized monthly on a straight line basis. Easement fees relate to revenue earned from recharging project companies in which the Americas does not have a controlling interest, for easement fees paid to land owners on behalf of each of these respective projects.

**Electricity Sales**

Electricity sales represent revenue generated from the sale of electricity by projects owned by the Americas. These projects currently include Cabazon, Green Power, ZWHC and YG Repower. Electricity is sold under long-term power purchase agreements.

**Revenue by Type**

	Year Ended		Four Mos. Ended	
	December 31,	2000	April 30,	2001
	1999	2000	2000	2001
(\$ in thousands)				
Turbine sales	\$ 31,990	\$ -	\$ 3,661	\$ 40,725
Wind project sales:				
Strom Lake I	165,000	59.1	-	-
Strom Lake II	106,000	31.2	161	-
Lake Benton	-	-	9,859	5.6
Lake Benton II	-	-	127,300	77.9
Sub-total	271,000	90.3	137,261	83.5
Maintenance services	10,038	3.0	12,237	46.3
Mgmt & easements	2,292	0.9	2,223	7.1
Electricity sales	1,264	0.7	1,366	4.9
Other	35	0.0	3,410	11.9
Total Revenues	\$ 328,224	100%	\$ 176,697	100%
			\$ 11,624	100%
			\$ 49,470	100%

Source: General Ledger and information provided by Mr. Tony Schwan

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**Installment sales revenue is increasing as more of the principal payments are received towards the end of the payment period**

**Installment Sales**

Revenue from installment sales is primarily generated from three projects sold in the mid 1980's (Project 85A, B and C) which were sold for 50% cash and 50% notes. Revenue and costs are recognized on an installment basis as cash is received. There are no installment sales in the four months ended April 2001 since the repayments on the Project 85 A, B & C notes are only received in May/June and November/December.

**Other**

Other revenue includes the following items for the year ended December 31, 2000:

**Purchase note interest - \$1,813** - This primarily relates to the interest on the notes receivable from the sale of Lake Benton I and Storm Lake II as well as the interest on a funded hold back for Storm Lake I. An adjustment has been proposed to deduct this amount from the Americas' 2000 EBITDA as it relates to non-operational income.

**ParAero settlement - \$1,225** - The ParAero settlement related to litigation with ParAero over maintenance fees for a project in which the parties were joint venture partners. The Americas was awarded a \$2,900 settlement, of which \$1,200 was recorded as revenue in 2000. The remaining \$1,700 was recorded as an offset to legal expenses during 1998. We have proposed a quality of earnings adjustment to exclude this 2000 revenue as non-recurring.

**BRPU - PG&E settlement - \$275** - This amount represents the settlement for the cancellation of the power purchase contract awarded to the Americas by PG&E. As this represents non-recurring and non-operational revenue, an adjustment has been proposed to deduct this amount from 2000 EBITDA. No information over lost revenues, if any, from this cancellation was provided by management.

Revenue by Type

	Year Ended		Four Mos. Ended	
	December 31,	2000	April 30,	2001
(In thousands)	1999	2000	2000	2001
Turbine sales	\$ 32,590	9.9	\$ 3,061	27.7
Wind project sales:				
Storm Lake II	164,000	10.1	-	-
Storm Lake I	104,000	32.2	161	0.1
Lake Benton I	-	-	9,800	5.6
Lake Benton II	-	-	127,300	72.9
Sub-total	271,000	42.3	137,261	88.6
Maintenance services	10,000	3.0	12,207	7.9
Right of easements	10,305	3.1	15,565	9.5
Installation sales	2,464	0.7	2,840	1.6
Other	35	0.0	3,410	2.0
Total Revenues	\$ 329,434	100%	\$ 174,647	100%

Source: General Ledger and information provided by Mr. Tony Shivers

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### Third Party Sales in 1999 resulted in a gross loss of approximately \$4,000

Appendix 5 to this report details each third party sale during 1999 and the four months ended April 30, 2001 including the relevant terms of the agreements. The table on the right summarizes these sales.

According to Mr. Gates, Vice President of Commercial Operations, third party sales in 1999 were priced competitively to enable the Americas to obtain a foothold in many key markets. The average selling price was approximately 30% less in 1999 than in the four months to April 2001. The average gross margin on 2001 sales was 20% compared to an average gross margin of -2.4% on third party sales in 1999 (or -12.2% using sales amounts included in the financials). Each third party sale is discussed in more detail below:

#### 1999 Third party sales

**Delaware Mountain, TX** - This was a sale of turbines to National Wind Power. During the bidding process the Americas was directly competing with NEG Micon, who was known to be undercutting. As a result, according to Mr. Gates, the Americas was compelled to price competitively.

**Waverly, IA and NPPD, NE** - Both these sales were part of the Americas' efforts to install turbines in non-commercial markets as both were to municipalities as part of the "turbine verification program" of the Department of Energy. It was also an effort to advertise the Americas' superior power electronics through which its turbines can directly connect to local distribution lines. According to Mr. Gates, the Americas' turbines are more suited to voltage controlled power and therefore smaller utilities that have local distribution lines would be able to recognize the value of such turbines.

**Western Resources, KS** - This was a sale to a utility in Kansas City. The sale was competitively priced to obtain a foothold into a potentially large market (i.e. strong winds in Kansas).

#### Third Party Sales

(\$ in thousands)  
(except ASB)

	Turbines	# units	Average unit prices		Total contract price		Average price per turbine
			Turbines	Towers	Installation	Price	
<b>2000</b>							
Mountain	BW 1.5	20	\$ 870	\$ 130	100	\$ 22,000	\$ 1,100
Trent Mesa	BW 1.5	87	905	188	130	102,227	1,176
Subtotal of 2001 sales		107	\$ 1,775	\$ 268	\$ 230	\$ 128,227	\$ 1,181

Note: Both projects above were under construction at April 30, 2001 and only part of the revenue indicated above has been recognized in this period.

<b>1999</b>							
Delaware Mt	Z150	40	NA	NA	NA	\$ 31,135	\$ 778
NPPD	Z150	2	NA	NA	NA	1,910	778
Waverly	Z150	2	NA	NA	NA	1,300	850
Western Resources	Z150	2	NA	NA	NA	1,300	850
Subtotal 1999 sales		260				\$ 33,992	\$ 3,307

Breakout by component of revenue not available for 1999 projects

Note: Total third party sales in 1999 according to the financial statements is \$12,500. The table reflects information included in the contracts. Management was unable to explain the difference.

Source: Project analysis provided by Mr. Schwan

Profit and loss account relating to these third party sales:

	1999	2000	4M April 2001
Third party sales	\$ 33,874	NA	\$ 40,725
Third party cost of sales	36,874	NA	32,594
Gross profit/(loss)	\$ (3,000)	NA	\$ 8,131
Margin	-12.2%		20.0%

Source: General Ledger

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## Revenue has been recognized for two third party sales which are partly completed as at April 30, 2001

### 2001 Third Party Sales

The Americas has recognized approximately \$41,000 of revenue relating to third party sales to Montfort and Trent Mesa in the four months to April 2001. The Americas is recognizing revenue and costs based on a percentage completion basis which is based on units delivered.

#### Project Montfort

The table to the right shows the project status at April 30, 2001 and the revenue and costs recognized in the four months ended April 2001 as a percentage of total revenue and total costs expected to be incurred. This third party sale was a unit price contract. Revenue and costs are recognized based on the number of units delivered multiplied by the unit price reduced by 3% (which represents the final installment due on the completion of the project). As this reduction should not be included in the calculation of costs under the percentage of completion method of accounting in US GAAP, an adjustment has been proposed to eliminate the impact of this reduction. This results in a proposed increase in 2001 EBITDA of \$115 (included as part of the \$440 adjustment related to third party sales for the four months ended April 30, 2001).

As the project is near completion, management is confident the future costs to be incurred would not significantly differ from current estimated costs to completion. Subsequent to the period under review, the buyer has ordered three additional turbines. Management indicated the sales terms for these additional units are the same as those of the original contract (same sales price and profit margins) and therefore should not impact the amount of EBITDA recognized for the four months ended April 30, 2001.

#### Transfer of risks and rewards

Progress payments are made as each unit is delivered, and once the buyer has inspected the turbines. At April 30, 2001, 17 units had been delivered and paid for. The cancellation clause in the sale contract for this project specifies that if the buyer cancels the contract, payments for all the units delivered as well as 20% of the then unpaid portion of the total contract price, needs to be made to the supplier.

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### Montfort Project

(\$ in thousands)

Components Description	Total Project	Number Of Units	Per Unit	Units Shipped	Value/cost of units shipped	
					At 95%	At 100%
<b>Revenues</b>						
Turbines	14,790	17	870	17	14,051	14,790
Towers	2,210	17	130	17	2,100	2,210
Installation	1,700	17	100	-	-	-
	<u>18,700</u>		<u>1,100</u>		<u>16,150</u>	<u>17,000</u>
Lead rights	-	-	-	-	2,050	2,050
Subtotal revenues	<u>18,700</u>		<u>1,100</u>		<u>18,200</u>	<u>19,050</u>
<b>Costs</b>						
Turbines	12,490	17	735	17	11,865	12,490
Towers	2,224	17	131	17	2,112	2,224
Installation	1,298	17	76	-	-	-
Subtotal costs	<u>16,012</u>		<u>942</u>		<u>13,978</u>	<u>14,714</u>
Net profit	\$ 2,688		\$ 158		\$ 4,222	\$ 4,337
Percentage completion using units delivered					87.3%	91.9%

However, the warranty period only begins once the entire project is completed and the turbines have been commissioned. The start of the warranty period has no impact on expected costs as these are "pay-as-you-go" warranty arrangements. Refer to the warranty discussion included in the accrued liabilities section of this report.

**2000 EBITDA includes \$2,050 for sale of land rights for project Montfort**

**Transfer of risks and rewards, continued**

Therefore, it appears title has passed to the buyer for the 17 units delivered, making it appropriate to recognize revenue relating to this project using a percentage of completion method.

**Land sales**

Included in the \$18,700 revenue from Project Montfort is \$2,100 relating to the sale of land rights. Each year the Americas negotiates options to purchase land rights from farmers. These options typically cost between \$500 and \$700 (actual dollars) per acre of land and are expensed through business development costs. If a buyer requires land owned by the Americas, the Americas will negotiate a sale price which is then included in the overall turbine contract.

The Americas recognized all of the Montfort land sale proceeds in January 2001. Since this sale of land rights included a clause that required the buyer to purchase turbines from Americas, the sales proceeds should be recognized over the life of the project. As the project was 91.9% complete at April 30, 2001, the Americas should have recognized \$1,885 of this revenue. The difference of \$165 is a proposed adjustment in the quality of earnings section that decreases EBITDA for the four months ended April 30, 2001.

**Montfort Project**

(\$ in thousands)

Components Description	Total Project	Number Of Units	Per Unit	Value/cost of units shipped	
				At 95%	At 100%
<b>Revenues</b>					
Turbines	14,790	17	870	17	14,790
Towers	2,210	17	130	17	2,210
Installation	1,700	17	100	-	-
	<u>18,700</u>		<u>1,100</u>		<u>17,000</u>
<b>Land rights</b>					
Subtotal revenues	18,700		1,100		2,050
					<u>19,050</u>
<b>Costs</b>					
Turbines	12,490	17	735	17	12,490
Towers	2,224	17	131	17	2,224
Installation	1,298	17	76	-	-
Subtotal costs	<u>16,012</u>		<u>942</u>		<u>14,714</u>
Net profit	\$ 2,688	\$ 158		\$ 4,222	\$ 4,337
Percentage completion using units delivered				87.3%	91.9%

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**Revenue has been recognized for two third party sales which are partly completed at April 30, 2001**

**Trent Mesa**

The table to the right shows the project status and the amount of revenue and costs recognized for the four months ended April 30, 2001 as a percentage of total revenue and total costs expected to be incurred.

Progress payments are only made when the turbines and other installations are delivered to the project site, and when they have passed the buyer's inspection. The termination clause in the Trent Mesa wind turbine sale and installation contract, specifies the termination fee for canceling the contract any time after April 1, 2001, as the entire contract price (\$102,000). Therefore, it appears title has passed to the buyer, making it appropriate to recognize revenue relating to this project using a percentage of completion method.

Subsequent to April 30, 2001, the buyer ordered a further 13 turbines. Management confirmed the pricing and other terms for these additional sales are identical to the original sale and therefore although the percentage completion ratio would reduce as a result of increasing the number of turbines to be delivered, the total contract price would increase proportionately and hence have no impact on gross margins.

The Americas reduces both revenue and costs recognized on the Trent Mesa third party sales by the final installment billing (which is 7.25% of total contract price). As this reduction should not be included in the calculation of costs under the percentage of completion method of accounting in US GAAP, an adjustment to eliminate the impact of this reduction has been proposed. This results in a proposed increase in 2001 EBITDA of \$327 (included as part of the \$440 adjustment related to third party sales for the four months ended April 30, 2001).

**Trent Mesa Project**

Components Description	Total Project	Number of Units	Per Unit	Value/cost of units shipped	
				Shipped	At 100%
<b>Revenues</b>					
Turbines	\$ 51,878	87	\$ 665	9	\$ 5,538
Blade Sets	20,880	87	240	31	6,682
Towers	12,004	87	138	44	5,615
Foundations completed	5,098	87	59	87	4,715
Completion & Tests	6,418	87	74	-	-
<b>Total Revenues</b>	<b>102,277</b>		<b>1,176</b>		<b>22,751</b>
<b>Costs</b>					
Turbines	\$ 47,627	87	\$ 547	9	\$ 4,557
Blade Sets	17,182	87	197	31	5,663
Towers	9,877	87	114	44	4,621
Foundations completed	4,195	87	48	87	3,880
Completion & Tests	5,281	87	61	-	-
<b>Subtotal of costs</b>	<b>84,162</b>		<b>967</b>		<b>18,721</b>
<b>Net Profit</b>	<b>\$ 18,116</b>		<b>\$ 208</b>		<b>\$ 4,030</b>
<b>Percentage completion %</b>					<b>28%</b>

Source: Project analysis provided by Tony Schoen

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**Project sales make up 82% and 73% of 1999 and 2000 revenues, respectively**

**Projects**

The table to the right details the project revenues recorded by the Americas during the period under review. In order to explain the accounting the Americas has employed for these projects as well as the projects still owned, the following items are described in detail.

**Stages of Project Development** - An internally funded project can take up to 12-18 months to complete.

**Accounting for Projects During Period Held** - In order to account for projects that are funded internally, the Americas capitalizes all associated costs until the time of sale.

**Revenue Recognition and Gain Calculations** - Revenue and gain is recognized at the time the project is sold.

**Deferred Revenue** - Deferred revenue represents income from notes receivable where all the costs of the project were recognized at the time of sale.

**Project Refunds and Reserve Reversals** - These items was improperly classified as revenue

**Project Revenues**

(\$ in thousands)  
(except ASP)

	Turbine # units	Year Ended December 31,	
		1999	2000
		Sales	ASP
<b>Project sales</b>			
Storm Lake I	2-750	150 \$ 165,000	\$ 1,070
Storm Lake II	2-750	107 106,000	1,034
Lake Benton II	2-750	138 -	-
			127,360
<b>Other revenue from project sales</b>			
Storm Lake I - reserve reversal	-	-	2,900
Storm Lake II - rebind	-	-	161
Lake Benton I - deferred revenue	-	-	6,900
		<b>395 \$ 271,000</b>	<b>2,104</b>
			<b>\$ 137,261</b>
			<b>\$ 942</b>

Source: Project analysis provided by Tony Schoen

## The Americas wrote off \$10,000 of capitalized start up costs in 1999

### Stages of Project Development

The following steps detail the process the Americas historically followed when an internally-funded project was developed:

1. The Americas surveys potential land sites suitable for wind projects and when a suitable land site is identified, it negotiates with the owner to purchase an option to lease the land and install wind turbines. Typically the lease cost ranges from \$500 to \$700 per acre (actual dollars); this cost is expensed as incurred and included in business development expenses.
2. The Americas also agrees to pay the owner between 3% and 6% of the electricity revenue generated from the project as a royalty payment for the right to set up wind turbines on the property. When the project is sold to a third party, the royalty payment owed to the owner is transferred to the buyer.
3. Transmission rights and building permits are secured.
4. The Americas negotiates with a utility to obtain a power purchase agreement for the project.
5. Once these criteria are satisfied, the external costs incurred on the project after this point are capitalized. Management has also confirmed some internal costs, such as project management overheads, are also capitalized. However management was not able to provide a breakout of capitalized internal costs.
6. The construction of the project is usually assigned to a subsidiary company under a Engineering and Procurement Contract ("EPC") which is typically priced at cost plus 20%. This profit is eliminated on consolidation. The cost of sales for each project reflects the price per the original EPC, which includes the 20% intercompany markup. Therefore, an adjustment is made in the gain calculation to reduce the cost of sales by the intercompany mark up.

7. Once the project is completed, it is commissioned and the electricity generated is sold to the utility under the terms of the power purchase contract. Typically, within a few months of operation (or less) the project is sold to a third party.

8. The Americas still has two projects that are wholly owned: Green Power and Cabazon. These projects are managed and accounted for by the Americas.

9. For most projects sold, the Americas has also contracts to provide maintenance services under a fixed price contract. In addition, for some of the projects sold the Americas provides management services, including the maintenance of the books and records.

### Accounting for Projects During Period Held

**Start-up Costs** - Prior to January 1, 1999, the Americas capitalized all project costs, including initial feasibility studies and wind studies. Beginning January 1, 1999, with the adoption of SOP 98-5, *Reporting on the Costs of Start-Up Activities*, all initial feasibility costs are expensed as incurred. As a result of adopting this policy, on January 1, 1999, the Americas wrote off approximately \$10,000 of start up costs (net of tax) that had been capitalized on its balance sheet. This was treated as an extraordinary item in 1999.

After January 1, 1999, project costs were only capitalized once certain criteria were fulfilled including securing the power purchase contract, land rights and permits.

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**Historically projects were sold for a combination of cash and notes receivable which has revenue recognition implications**

**Revenue Recognition**

The table to the right is a summary of all the revenue relating to projects, recognized in the period under review.

When a project is sold, the Americas records the sales proceeds to the extent it is funded. The Americas primarily has three types of project sale transactions:

- *A lump sum cash payment:* All revenues and costs capitalized on the balance sheet relating to the project are recognized through the income statement. This revenue is classified as project sales revenue. The Americas also records certain project reserves at the time of sale and includes it as part of cost of sales for the project.
  - *A combination of cash and long term promissory notes, where the promissory notes form a significant portion of the consideration:* These types of sales were made prior to the period under review and are accounted for under the installment method where the appropriate portion of revenue and costs relating to the project are recognized when installment payments for the notes are received.
  - *A combination of cash and long term promissory notes, where the promissory notes form an insignificant portion of the consideration:* A proportion of revenue and all of the costs are recognized at the time of sale. The remaining revenue is treated as deferred revenue, reversed into income when the notes receivable is paid.
- A discussion of the individual projects included in the table to the right follows.

**Project Revenues**

(\$ in thousands) (except ASP)	Turbine # units	Year Ended December 31,	
		1999 Sales	2000 ASP
<b>Project sales</b>			
Storm Lake I	150	\$ 165,000	\$ 1,070
Storm Lake II	107	106,000	1,034
Lake Benton II	138	-	127,300
942			
<b>Other revenue from project sales</b>			
Lake Benton I - reserve reversal	-	-	2,900
Lake Benton I - deferred revenue	-	-	6,900
Storm Lake II - refund	-	-	161
<b>195</b>	<b>795</b>	<b>\$ 271,000</b>	<b>\$ 2,104</b>
			<b>\$ 137,261</b>
			<b>\$ 942</b>

Source: Project analysis provided by Tony Schiava

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**The net profit margin on sale of Storm Lake I was 28% compared to 16% and 13% on sale of Storm Lake II and Lake Benton II**

The table to the right illustrates the three project sales in the period under review and includes the components of each gain calculation:

**Storm Lake I**

*Project sale revenue* - The revenue for Storm Lake I in 1999 represents the total proceeds from the sales of this project net of some closing reserves.

*Revenue reserve* - The reserve against revenue comprises of a reserves for legal fees and commissions.

*Gain calculations* - The sale of Storm Lake achieved the highest profit margin (28%) for project sales in the period under review. According to Mr. Miller, the Americas was able to secure a higher price on this project sale primarily due its unique financing structure. Storm Lake I was the only project sale in the period under review that was financed with a combination of Senior and Junior debt. The deal included a special clause to require the buyer, Edison, to make annual cash contributions to the project equal to the PTCs derived. The junior debt was secured on this extra cash flow. The extra financing enabled Edison to inject less equity and hence have a lower, required rate of return. As a result, the Americas was able to secure a higher price for the deal.

The cost of sales included in the gain calculation represents the assets and liabilities on the Storm Lake I project company's balance sheet. Management indicated the net assets of the project company were allocated arbitrarily to the towers, turbines and construction categories of cost of sales. In addition, some of the closing reserves typically established on the sale of projects (such as reserves for legal fees and commissions), were in the case of Storm Lake I, netted against revenue, as discussed above.

Project Gain Calculation

(\$ in Thousands)	Storm Lake I	Storm Lake II	Lake Benton II
Gross sales revenue	\$ 169,745	\$ 111,532	\$ 138,000
Reserves	(2,136)	(4,544)	(2,700)
Net sales revenue	167,609	106,988	127,300
% sold	99%	99%	100%
Revenue recognized	165,834	105,918	127,300
Cost of sales:			
Towers	13,986	10,611	-
Development	-	-	1,557
Turbines	65,138	47,791	86,142
Construction	34,476	29,255	20,236
Interest Land & Other costs	-	-	15,495
Bridge Loan repayments	-	-	(3,854)
Cash distribution	-	-	(3,175)
Deferred profits	-	-	(15,697)
Cash balances	-	-	(415)
Cash receivable	-	-	(1,053)
Payable conversion to debt	-	-	6,026
Legal reserve	-	-	1,100
Commissions	-	-	600
Lightening protection	-	-	1,700
Teaching Reserve (GarboVAAR)	-	-	1,650
Warrranty Reserve	2,660	367	345
Misc Inventory Issues	14	348	-
Shipping	1,298	749	-
SCADA	73	150	-
Misc	56	17	-
Blades	-	-	-
Tooling	1,941	-	-
Subtotal Costs	119,641	89,289	110,657
% sold	99%	99%	100%
Costs recognized	118,445	88,396	110,657
Gain margin	28%	18%	13%
Gain	\$ 47,868	\$ 17,700	\$ 16,643

Source: Project analysis provided by Tony Schoen

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### The net profit margin on sale of Storm Lake I was 28% compared to 16% and 13% on sale of projects Storm Lake II and Lake Benton II

#### Storm Lake II

**Revenue reserve** - The reserve against sales is made up of reserves for future capital contributions, commissions, buyer due diligence expenses, legal reserve and land costs owed.

**Gain calculations** - Storm Lake II was sold to GE Capital in 1999 at a net profit margin of 16%. According to Mr. Schoen, the sale price for this project was reduced in order to secure the project sale in the first quarter.

The cost of sales included in the gain calculation represents the assets and liabilities on the Storm Lake II project company's balance sheet. Management indicated the net assets of the project company were allocated arbitrarily to the towers, turbines and construction categories of cost of sales. In addition, some of the closing reserves typically established on the sale of projects (such as reserves for legal fees and commissions), were in the case of Storm Lake II, netted against revenue, as discussed above.

#### Lake Benton II

**Project sale revenue** - During the sale of Lake Benton II, the buyer requested there be a holdback for potential state reassessment of property taxes amounting to \$2,700.

According to Mr. Schoen, this project was sold to ESI as part of the settlement for the ongoing dispute with ESI. As a part of this settlement, it was agreed Lake Benton II would be sold to ESI at a lower price and profit margin. The dispute with ESI dated from 1998 and related to a cooperation agreement between ESI and the Americas to develop wind power projects worldwide.

#### Project Gains Calculation

(\$ in thousands)	Storm Lake I	Storm Lake II	Lake Benton II
<b>Project sales</b>			
Gross sales revenue	\$ 169,645	\$ 111,532	\$ 130,000
Reserves	(2,136)	(4,544)	(2,700)
Net sales revenue	167,509	106,988	127,300
% sold	99%	99%	100%
<b>Revenue recognized</b>	<b>165,934</b>	<b>105,918</b>	<b>127,300</b>
<b>Cost of sales:</b>			
Towers	13,986	10,611	-
Development	-	-	1,557
Turbines	65,138	47,791	86,142
Construction	34,476	29,255	20,236
Interest Land & Other costs	-	-	15,495
Bridge loan repayments	-	-	(3,854)
Cash distribution	-	-	(3,175)
Deferred profits	-	-	(15,697)
Cash balances	-	-	(415)
Cash receivable	-	-	(1,053)
Payable conversion to debt	-	-	6,026
Legal reserve	-	-	1,100
Commissions	-	-	600
Lightening protection	-	-	1,700
Testing Reserve (Genbow/VAR)	-	-	1,659
Warranty Reserve	2,660	367	345
Misc inventory issues	14	348	-
Shipping	1,296	749	-
SCADA	73	150	-
Blade	56	17	-
Blade	-	-	-
Tooling	1,841	-	-
Subsiding Costs	119,641	89,269	110,657
% sold	99%	99%	100%
Costs recognized	118,445	88,766	110,657
<b>Gain margin</b>	<b>\$ 47,489</b>	<b>\$ 17,700</b>	<b>\$ 16,643</b>
	28%	16%	13%

Source: Project analysis provided by Tony Schoen

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**The net profit margin on sale of Storm Lake I was 28% compared to 16% and 13% on sale of projects Storm Lake II and Lake Benton II**

Lake Benton II, continued

*Cost of Sales* - The cost of sales for Lake Benton II reflects the assets and liabilities on the balance sheet of the project company set up for Lake Benton II. Following is a discussion on some of the items in cost of sales:

*Bridge loan repayments* - loan repayment made to Enton prior to the sale of the project

*Cash distribution* - cash proceeds from the electricity sales that were capitalized (see electricity sales section of this report)

*Deferred profits* - the intercompany profit capitalized on the balance sheet of the project company.

*Cash balances* - cash left over in the project company at time of sale; this is a negative number as this was not included in the sale.

*Cash receivable* - relates to receivables from electricity sales made by Lake Benton II, prior to sale.

*Payables converted to debt* - amounts owed by project company to the Americas Legal, commissions, lightning protection, teething and warranty reserves are set up to cover for potential future costs and are discussed in the project reserves section of this report.

Project Gains Calculation

	Storm Lake I	Storm Lake II	Lake Benton II
Project sales	\$ 169,655	\$ 111,532	\$ 130,036
Gross sales revenue	(2,136)	(4,544)	(3,700)
Net sales revenue	167,509	106,988	127,300
% sold	99%	99%	100%
<b>Revenue recognized</b>	<b>165,374</b>	<b>105,978</b>	<b>127,300</b>
<b>Cost of sales:</b>			
Towers	13,986	10,611	-
Development	-	-	1,557
Turbines	65,138	47,791	86,142
Construction	34,476	29,255	20,236
Interest Land & Other costs	-	-	15,495
Bridge Loan repayments	-	-	(3,854)
Cash distribution	-	-	(3,175)
Deferred profits	-	-	(15,697)
Cash balances	-	-	(415)
Cash receivable	-	-	(1,053)
Payable conversion to debt	-	-	6,028
Legal reserve	-	-	1,100
Commissions	-	-	600
Lightening protection	-	-	1,700
Teething Reserve (Garbo/VAR)	-	-	1,650
Warranty Reserve	2,660	367	345
Misc Inventory Issues	14	348	-
Shipping	1,298	749	-
SCADA	73	150	-
Misc	56	17	-
Blades	-	-	-
Tooling	1,941	-	-
Subtotal Costs	119,641	89,289	110,657
% sold	99%	99%	100%
Costs recognized	118,445	88,296	110,657
<b>Gain</b>	<b>\$ 47,868</b>	<b>\$ 17,700</b>	<b>\$ 16,643</b>
Gain margin	28%	16%	13%

Source: Project analysis provided by Tony Schorn

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**2000 includes \$10,000 of non recurring project related revenues**

**Lake Benton I**

*Reserve reversal* - When Lake Benton I was sold in 1998, \$2,900 of the sales proceeds was to be retained until certain project engineering checks had been completed. As this portion of the sales proceeds was funded, the Americas included this amount in the revenue recognized in 1998.

However, when the restricted cash still had not been released in 1999, the Americas recorded a reserve against this amount. In December 2000, the engineering checks were completed and the restricted cash was released resulting in the Americas reversing the reserve recorded in 1999 to 2000 revenue. An adjustment to EBITDA has been proposed to reclass the impact of this reserve reversal from 2000 to 1999.

*Deferred revenue* - Lake Benton I was sold in 1998. When the deal closed, the financing banks required the Americas to reserve \$6,900 of the purchase price to cover operational problems. The Americas recorded the \$6,900 as deferred income and recorded a corresponding note receivable due from Enron. In 2000, the Americas negotiated with the sponsoring banks to recover the remaining \$6,900 on the basis the project was operating without any problems. The Lake Benton I revenue in 2000 represents the \$6,900 being reversed into income. All the costs of the project had been recognized at the time of sale in 1998; therefore, all of the \$6,900 represents gross profits. If the Americas had used the installment method to recognize revenue from the sale of this project, the amount of revenue that should have been recognized in 2000 would have been only the project gross margin. Assuming a gross margin of 12%, the amount the Americas should have recognized in 2000 EBITDA is \$800. An adjustment to reduce 2000 EBITDA by \$6,100 has been proposed in the quality of earnings analysis.

**Storm Lake II**

*Refund* - This amount represents a refund of \$161 relating to miscellaneous escrow fees. An adjustment has been included in the quality of earnings analysis to eliminate the expense and revenue related to this amount.

**Project Revenues**

(\$ in thousands) (except ASP)	Turbine # units	Year Ended December 31,		2000	
		1999	ASP	Sales	ASP
<b>Project sales</b>					
Storm Lake I	2-750	150	\$ 165,000	\$ 1,070	\$ -
Storm Lake II	2-750	107	106,000	1,034	-
Lake Benton II	2-750	138	-	-	127,300
<b>Other revenue from project sales</b>					
Lake Benton I - reserve reversal	-	-	-	-	2,900
Lake Benton I - deferred revenue	-	-	-	-	6,900
Storm Lake II - refund	-	-	-	-	161
		<b>395</b>	<b>\$ 271,000</b>	<b>\$ 2,104</b>	<b>\$ 177,261</b>

Source: Project analysis provided by Tony Schoen

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### Maintenance revenue increased due to project sales in period under review

The table to the right illustrates the projects from which the Americas derives its maintenance revenues.

**Maintenance fees**

At April 30, 2001, the Americas has maintenance contracts with fourteen projects. The majority of maintenance contracts are cost plus 15% to 20%. The maintenance contracts with Lake Benton II and Storm Lake I are fixed price for five years beginning 2000 and twenty years beginning 1999, respectively.

Maintenance revenue increased by 36% (on amounts management could explain) between 1999 and 2000 whereas it declined by 28% for the comparative four months ended April 2000 and April 2001. The increase between 1999 and 2000, is primarily the result of projects sold in the period under review. Both Storm Lake I and Storm Lake II were sold in mid 1999, whereas Lake Benton II was sold in mid 2000. Management is unable to explain why maintenance revenue declined for the comparative four months to April 2000 and 2001.

While no quality of earnings adjustment has been proposed for the unreconciled difference, the amounts should be reconciled prior to the closing of the proposed transaction.

**Maintenance Revenues**

Project \$5 A, B, C	Year Ended December 31,		Four Months Ended April 30,			
	1999	2000	2000	2001		
ZP1	1,038	1,112	7%	416	558	-16%
Lake Benton I	535	595	11%	237	344	-17%
Lake Benton II	1,316	1,378	5%	477	69	-59%
Storm Lake I	576	1,178	103%	406	476	0%
Storm Lake II	475	983	107%	276	382	36%
Sky River	856	921	8%	357	390	41%
Victory Garden IV	252	323	28%	119	193	-46%
Delaware Mountain	223	442	98%	221	74	-37%
Painted Hills	630	903	43%	286	229	-20%
Others	535	731	37%	274	214	-22%
Unreconciled difference	1,761	1,030	-42%	1,598	261	-84%
	\$ 7,028	\$ 12,817	22%	\$ 3,527	\$ 3,841	-84%

Source: Analysis provided by Mr. Schorn

## Management and easement fees have reduced in the period under review

The table to the right illustrates the projects from which the Americas derives its management and easement revenues.

### Management fees

The Americas has management agreements with all projects sold except for three projects: Lake Benton II, Sky River and VG IV. Management fees include services for accounting, tax preparation and the preparation of management reports. According to Mr Schoen, these services are primarily performed by the Americas' accounting department at relatively little cost. The cost of providing these services is included in G&A expenses for the Americas, and not separately identified.

Management fees for five of these projects ranges from 2% to 3% of gross cash receipts of the project while the management fee for Painted Hills is 20% of net operating proceeds. The management fee for Lake Benton I, Storm Lake I and Storm Lake II ranges from \$100 to \$250 adjusted annually for CPI.

Management fees increased by 23% between 1999 and 2000, and by 11% for the comparative four months ended April 2000 and 2001.

Management was unable to explain the increase in management fees in the period under review.

### Easement fees

Easement fees are paid to land owners on which the projects are located and expensed through easement, cost of sales. The Americas subsequently recharges the respective project company (no mark up charged), which represents the easement fee revenue. Therefore, the easement fee revenue disclosed in the financial statements is only what relates to projects not controlled by the Americas. Easement fees declined by 13% between 1999 and 2000, and declined by 15% between the comparative four months ended April 2000 and 2001. Management is unable to identify why easement fees have reduced in the period.

Management and Easement Revenues

(\$ in thousands)	Year Ended December 31,		Four Months Ended April 30,			
	1999	2000	2000	2001		
<b>Management:</b>						
Project R A, B, C	\$ 122	\$ 135	11%	\$ 21	\$ 55	162%
ZP I	100	92	-8%	23	16	-30%
Lake Benton I	56	51	-9%	13	10	-23%
Storm Lake I	180	107	-41%	38	34	-11%
Storm Lake II	113	154	36%	43	86	45%
						16%
						11%
<b>Easement:</b>						
Project R A, B, C	404	432	7%	21	14	-33%
ZP I	250	229	-8%			
Sky River	141	128	-9%			
Victory Garden IV	608	575	-5%	156	117	-28%
						-3%
						-17%
						-17%
						-8%
						-35%
<b>Unconsolidated Difference</b>	478	(131)	-131%	289	32	-89%
<b>Total mgmt &amp; easements</b>	<b>\$ 2,992</b>	<b>\$ 2,323</b>	<b>-22%</b>	<b>\$ 802</b>	<b>\$ 531</b>	<b>-35%</b>

Source: Analysis provided by Mr. Schoen

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**\$1,800 of 2000 other revenue includes interest on notes receivable**

Interest income (included in other income in the table to the right)

**Storm Lake I**

*Interest on notes receivable* - In addition to the note receivable, there was a funded hold back relating to the disposal of Storm Lake I in 1999. Interest relating to this hold back (of about \$230) has been included in in revenue as part of the \$1,813 of interest on notes receivable.

**Storm Lake II**

*Interest on notes receivable* - The Americas received \$368 of interest income in 2000, that related to the interest on the note receivable of \$1,750, that was received as part of the sales proceeds for Storm Lake II. See notes receivables section of the balances sheet, for further analysis of this notes receivable.

**Lake Benton I**

*Interest on Notes receivable* - The Americas received \$1,200 of interest income relating to this "hold back" for Lake Benton I, which has been included in other revenue in 2000 (part of \$1,813 of interest income on table on right). This has been deducted from 2000 EBITDA as it represents non operational income.

As all the above represent non operational income, an adjustment has been proposed to deduct this amount from 2000 revenue.

Revenue by Type

(\$ in thousands)	Year Ended			Four Mos. Ended April 30,
	1999	2000	2001	
Tubus sales	\$ 31,590	\$ -	\$ 3,061	\$ 27.7
Wild project sales:				
Storm Lake I	151,000	10.1	-	-
Storm Lake II	106,000	22.2	161	0.1
Lake Benton I	-	9,800	5.6	-
Lake Benton II	-	127,300	72.9	-
Subtotal	277,000	139,281	84.5	3.81
Management services	2,007	2,177	2,007	46.3
Marketing services	2,899	2,333	1,803	41.1
Electricity sales	10,305	3.1	16,566	12.6
Installation sales	2,464	0.7	2,840	11
Other	35	0.0	3,610	4.0
Total Revenues	\$ 336,628	100% \$ 174,637	100% \$ 11,024	100% \$ 49,270

Source: General Ledger and information provided by Mr. Don Schuen

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**Installment sales revenue primarily relates to Project 85 A, B & C**

**Project 85 A, B & C**

The Americas recognizes revenue on installment payments Project 85 A, B & C (which were sold in 1985) using the installment method. Since the installment payments are only made in May, June, November and December, there is no installment revenue relating to these notes, recorded in the four months ended April 2000 or 2001.

According to Mr. Schoen, installment sales revenue from Project 85 A, B & C increased between 1999 and 2000 for two reasons:

- electricity prices were higher in 2000 compared to 1999 and therefore these projects were able to pay more of the installment payments owed to the Americas; and
- the principal payments increase towards the end of the payment schedule for these notes receivables resulting in more revenue being recognized.

**Other**

This relates to repayments of notes receivables issued by three employees of the Americas, Mr. Westfield, Mr. Orban and Mr. Mullinex, relating to sale of the Painted Hills Partnership (see JV income section for more details).

Installment Sales Revenue & Cost of Sales	
(\$ in thousands)	
Installment sales	Year Ended
	December 31,
	1999
	2000
Projects 85 A, B & C	\$ 2,433
Other	\$ 31
Per GL	\$ 2,463
	\$ 2,807
	\$ 33
	\$ 2,839

**Historically, project costs have represented the most significant component of cost of sales**

General - As shown in the table to the right, the Americas classifies its cost of sales based on the type of sale the costs relate to (i.e., turbine, construction, customer service, warranty, etc.). As explained in more detail below, there is little consistency between years in the classification of costs incurred. Additionally, management was unable to provide cost of sales by component (i.e., direct material, labor, overhead), as these costs are tracked by cost center rather than individual component. As a result, interpreting or calculating gross margins based on the classification of expenses presented may lead to inaccurate conclusions. The following provides a brief overview of the individual captions, more detailed breakdowns of these accounts follow the overview.

**Turbine and Construction Sales Costs** - These two accounts comprise the majority of the Americas' cost of sales balance as they include costs incurred to build turbines for both projects as well as third party sales. Mr. Schoen indicated in 1999 costs were properly broken out between turbine and construction costs; however, in 2000, the Americas lumped nearly all costs (whether related to turbines or their construction) into construction sale costs. In 2001, all costs are being lumped into turbine sale costs.

**Construction Overhead** - This account captures the administrative overhead included in the entities (owned by the Americas) that construct the projects that is not included in the engineering charge (included in construction sales costs and then eliminated through consolidation) typically included on all projects.

**Wind Turbine Manufacturing** - According to Mr. Schoen, this account represents overhead costs in excess of amounts that are absorbed by turbines through standards.

**Customer Service** - According to Mr. Schoen, these costs relate to repairs and maintenance performed by the Americas field representatives when the turbine is not under warranty. Customer service was combined with maintenance in 2000.

**Cost of Sales Components**

(\$ in thousands)	Year Ended		Four Quarters Ended	
	1999	2000	2000	April 30, 2001
Turbine sale costs	\$ 169,056	\$ 3,715	\$ (696)	\$ 32,589
Construction sale costs	74,659	111,332	12	5
Construction overhead	497	555	171	245
Wind turbine manufacturing	1,284	1,483	954	(110)
Customer service	2,399	195	1,425	(1)
Teething and warranty	17,559	7,983	1,204	1,636
Less: warranty income	(1,049)	(4,862)	(465)	(435)
Total wind turbine	264,485	120,451	2,765	33,929
Maintenance & infrastructure	11,579	14,989	3,972	4,418
Management & sublease	1,468	2,864	486	1,066
Property taxes	221	1,190	291	462
Electricity sale costs	2,511	722	217	128
Other	78	(218)	16	160
Total mgmt, maint and elec	13,857	19,547	4,982	6,234
Installation sales costs	1,320	1,588	6	-
<b>Total cost of sales</b>	<b>\$ 281,582</b>	<b>\$ 141,586</b>	<b>\$ 7,693</b>	<b>\$ 40,163</b>
Revenues	\$ 29,424	\$ 174,647	\$ 11,034	\$ 9,470
Gross Margin %	14.3%	18.9%	30.3%	18.8%

Source: General ledger

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**Warranty expenses may be understated for 1999 and 2000**

**Teething & Warranty / Warranty Income** - Mr. Schoen indicated the net warranty expense included in cost of sales represents the costs incurred in excess of the warranty reserve. Warranty reserve releases are included in warranty income. See a detailed discussion of warranty expenses and reserves in the balance sheet analysis section of this report.

**Maintenance & Infrastructure** - These costs represent maintenance costs incurred by the field service employees not covered by warranty including labor, supplies and inventory (primarily replacement parts).

**Management & Sublease** - The Americas subleases most of the land it uses from various parties. This account is comprised primarily of the subleasing costs for that land.

**Property Taxes** - This relates to property taxes paid on the assessed value of the turbines installed on projects owned by the company (typically around 1.2% of assessed value). The increase in this expense in 2000 and the four months ended April 2001 is due to many owned projects (such as Cabazon, Green Power and Lake Benon, ID) becoming operational in June 1999, resulting in 2000 being the first full year of assessment for these projects.

**Electricity Sale Costs** - When wind levels are not sufficient to properly power the turbines, the turbines must be energized through electricity the Americas must purchase. Additional costs relate to inter-connect maintenance fees charged by the utilities.

**Installation Sale Costs** - This account relates to installment payments on notes receivables for Projects 85 A, B & C. The Americas recognizes revenue and costs for these payments using the "installment method". When installments are received, the installment is recognized as revenue and the applicable portion of costs are also recognized.

**Cost of Sales Components**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	2000	April 30,
				2001
Turbine sale costs	\$ 169,036	\$ 3,745	\$ -	\$ 32,589
Construction sale costs	74,659	111,352	(690)	\$ -
Construction overhead	497	555	171	245
Wind turbine manufacturing	1,284	1,483	954	(110)
Customer service	2,399	195	1,425	(1)
Teething and warranty	17,559	7,983	1,304	1,636
Less: warranty income	(1,049)	(4,862)	(465)	(435)
Total wind turbine	264,405	120,451	2,705	33,929
Maintenance & infrastructure	11,579	14,989	3,972	4,418
Management & sublease	1,468	2,864	486	1,066
Property taxes	221	1,190	291	462
Electricity sale costs	2,511	722	217	128
Other	78	(218)	16	160
Total mgnt, mnt and elec	15,857	19,527	4,982	6,234
Installation sales costs	1,320	1,588	6	-
<b>Total cost of sales</b>	<b>\$ 281,582</b>	<b>\$ 141,586</b>	<b>\$ 7,693</b>	<b>\$ 40,163</b>
Revenues	\$329,424	\$174,647	\$11,034	\$9,470
Gross Margin %	14.5%	18.9%	30.3%	18.8%

Source: General Ledger

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**Project cost of sales consists of the net book value of the capitalized assets as well as certain reserve amounts**

**Project Cost of Sales**

The cost of project sales represents the net assets that had been capitalized on the America's balance sheet relating to the projects sold as well as costs incurred in establishing specific reserves for the project. An analysis of project costs is presented in the project gain calculation analysis earlier in this report.

**Third Party cost of Sales**

There were no third party sales in 2000. Therefore the \$3,745 does not represent third party cost of sales, rather the amount relates to teaching and property tax reserves being established.

An analysis of third party cost of sales for 2001 is presented in the 3rd party revenue section earlier in this report. Management was unable to provide a similar analysis for 1999.

The credit amount in the four months to April 30, 2000 relates to a \$250 inventory adjustment and a \$650 adjustment relating to a reversal of tooling amortization. The Americas amortizes tooling through cost of sales. All tooling relating to the Z750 had been amortized by 1999. In 2000, molds were sent to Spain which was manufacturing some Z750 turbines. The Americas credited the income statement in 2000 to reverse the amortization expensed in 1999 that related to the molds now being used by Spain.

**Third Party & Project Cost of Sales**

(\$ in thousands)	Year Ended		Four Months Ended	
	1999	2000	December 31, 2000	April 30, 2001
<b>Project Sales</b>				
StormLake I	\$ 118,445	\$ -	\$ -	\$ -
StormLake II	88,396	-	-	-
Lake Benton II	-	110,657	-	-
Total Projects	206,841	110,657	-	-
<b>Third Party Sales</b>				
Total	36,874	3,745	(696)	32,594
	<u>\$ 243,715</u>	<u>\$ 114,402</u>	<u>\$ (696)</u>	<u>\$ 32,594</u>

Source: Project Analysis provided by Mr. Schoen

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**Direct materials account for approximately 95% of total turbine costs**

**General**

Although the Americas does not categorize its manufacturing expenses by type in the general ledger, following presents information we obtained during the course of our review related to

- materials;
- labor; and
- overhead

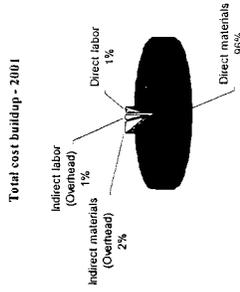
**Materials**

According to the cost build-ups for a Z750 in 1999 and EW 1.5 MW in 2001 provided by management and shown in the graph to the right, 95% of the cost to build a turbine is materials cost. The most expensive and key turbine component parts include the blades, gear box, hub and tower. As described more fully in the manufacturing operational review section of the report, these components are sourced primarily from Germany (except for blades which are manufactured for the Americas in Brazil).

**Labor**

The manufacture of wind turbines is not a labor-intensive process as the most components are sub-assemblies that are assembled in the Tehachapi facility. The table to lower right details "cost of sales" headcount as at the dates presented. Given production was ceased between July 1999 and October 2000, it is unclear what 73 factory employees at December 31, 1999 were doing.

As production of the EW 1.5 MW ramps up, the Americas is adding additional factory employees as well as field operators. As described more fully in the manufacturing operational review section of this report, the additional production demand and factory employees has decreased the efficiency of the plant.



Source: Management provided cost information

(Actual numbers)	Production Headcount		
	December 31, 1999	2000	April 30, 2001
Field Operations/Service	196	231	196
Manufacturing	67	90	59
Quality Management	4	13	4
Blade Center	2	3	2
	<u>269</u>	<u>337</u>	<u>261</u>
			<u>438</u>

Source: Headcount information provided by Mr. Orlan

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## As production increases, the risk of the over-application of overhead to inventory will rise

### Overhead

The Americas has two different types of manufacturing overhead that are applied to turbines produced:

- Direct material overhead - The rate used to calculate this overhead in 1999 was 2.98% and is 2.51% in 2001; this percentage is applied to the total value of materials received.
- Direct labor overhead - The rate used to calculate this overhead in 1999 was 177% and is 79.8% in 2001; this percentage is applied to labor costs incurred.

All of these amounts (direct materials and labor overheads calculated) are capitalized into an overhead cost pool. This pool is meant to cover all costs associated with the running of the manufacturing facility including purchasing, quality control, logistics, factory management, etc. This overhead is applied to inventory based on the percentage of the overhead pool to total production costs during the period. It is unclear why the Americas would use a formula based on costs to determine the allocation of overhead. Typically, overhead is allocated to inventory based on units in ending inventory versus units produced. Further work regarding the Americas overhead allocation methods would need to be performed to assess the appropriateness of the allocation of overhead in light of the Americas increased production.

The information to the right presents an estimate of the overhead applied for the four months ended April 30, 2001.

Management indicated the estimated amounts in the overhead pool for 2001 are as follows:

Labor	\$ 3,400
Allocations	1,000
Depreciation	900
Rent, office & other	900
Maintenance	600
	<u>\$ 6,800</u>

The following is an estimate of overhead costs through April 30, 2001 based on production information:

Average total turbine cost for 1 EW 1.5 MW	\$ 675
No. of turbine produced through 4/30	123
Estimated cost pool	<u>\$ 84,275</u>
Direct material O/H (2.51% on 96% of total cost)	<u>\$ 2,033</u>
Direct labor O/H (79.8% on 1% of total cost)	<u>673</u>
	<u>\$ 2,706</u>

The actual overhead amounts of approximately \$2,600 charged during the four months ended April 30, 2001 (see next page) are consistent with the estimation presented above.

However, due to the lack of information provided by management regarding the allocation of overhead to inventory, it is unclear if inappropriate amounts of overhead have been allocated to inventory which could result in overstated earnings. Due to the low levels of production during 2000, the impact may be immaterial, however as production increases during 2001, the risk of a material overstatement increases. Further work would be required in this area.

**Due to significant production and raw material purchases, the Americas over applied overhead costs for the YTD April 2001 period**

**Wind Turbine Manufacturing**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	2000	2001
Salaries and benefits	N/A	\$ 1,740	N/A	\$ 1,277
Employee benefits	N/A	662	N/A	483
Legal expenses	N/A	73	N/A	14
Professional services	N/A	79	N/A	31
Outside services	N/A	30	N/A	46
Office expenses	N/A	134	N/A	117
Occupancy	N/A	34	N/A	40
Utilities	N/A	68	N/A	61
Maintenance and repairs	N/A	336	N/A	237
Meals and entertainment	N/A	19	N/A	9
Business travel	N/A	308	N/A	155
Asset expenses	N/A	3	N/A	3
Capitalization contract	N/A	(306)	N/A	-
Allocated overhead	N/A	(1,955)	N/A	(2,632)
Insurance expenses	N/A	164	N/A	49
<b>General ledger balance</b>	<b>\$ 1,284</b>	<b>\$ 1,483</b>	<b>\$ 954</b>	<b>\$ (110)</b>

**Standard Cost Variances**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	2000	2001
Purchase price variance	\$ (49)	\$ (19)	N/A	\$ -
Materials cost variance	26	(193)	N/A	(241)
Labor efficiency variance	279	216	N/A	47
Labor overhead variance	29	18	N/A	-
<b>Net variance</b>	<b>\$ (51)</b>	<b>\$ 160</b>	<b>\$ -</b>	<b>\$ (193)</b>

As previously discussed, wind turbine manufacturing represents overhead costs in excess of amounts absorbed (applied as overhead) by turbine production through the standards that are established. The table to the upper right details the components of wind turbine manufacturing. Management was unable to provide a breakout of wind turbine manufacturing expenses in a consistent format for 1999 and the four months ended April 30, 2000. Further, it is unclear how the overhead amounts are recorded into the individual categories presented in the table to the upper right.

Despite the fact the Americas had minimal production in 2000, manufacturing costs remained relatively consistent between 1999 and 2000. The consistency of the costs relates to the fact these overhead expenses are generally fixed in nature. Additionally, the Americas did increase raw material inventory at the end of 2000 in preparation for the production of the 1.5 MW turbine in the US.

Due to the significant amount of production and material purchases in the first four months of 2001, actual overhead costs were less than amounts applied for this period.

Management indicated the Americas is in the process of finalizing an update to the standard costs for the EW 1.5 MW turbine. The new standard cost for the EW 1.5 MW will approximate \$815. The standard cost includes lower costs, material, labor, freight, overhead and tooling amortization.

As discussed in the inventory section of this report, the Americas has capitalized all purchase price variances on goods purchased from Germany through April 30, 2001 (approximately a \$3,300 credit balance). See further discussion of the accounting for variances in the balance sheet analysis section of this report.

Management did not provide any information related to the other variance accounts presented in the table to the lower right.

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**Average maintenance costs per turbine were consistent in 1999 and 2000, but decreased during the YTD April 2001 period due to reclassifications**

The table to the right details the components of customer service and maintenance/infrastructure costs. Included in customer service and maintenance costs are maintenance costs not covered by warranty. As previously discussed, the customer service and maintenance cost categories were combined during 2000.

The increase in customer service and maintenance costs from 1999 to 2000 was primarily driven by an increase in the number of units in the field. In July 1999, 138 units related to the Lake Benton II were placed in service.

The breakout for the four months ended April 30, 2001 includes only maintenance and infrastructure costs as management was unable to provide a breakout of customer service expenses. If a breakout of customer service was available, the unreconciled difference between the detailed breakout and the general ledger would be similar to the other periods presented in the table.

The average cost per turbine for customer service and maintenance was \$20 during 1999 and 2000. The average number of turbines in the field takes into account that Lake Benton II was placed into service midway through 1999. Average maintenance costs per turbine decreased to \$17 for the annualized April 2001 period. Management attributes the decrease to higher allocated expenses (which reduces overall expenses) in the April 2001 period and the cyclical nature of maintenance activity. Maintenance expenses are impacted by the repair schedule as well as wind speed. However, due to the overhead allocation methodology as well as warranty allocation, conclusions could not be made on the direction of maintenance costs on a per turbine basis.

Allocated expenses represent amounts reclassified to warranty expense for certain support personnel. These amounts represent reclassifications and do not impact earnings.

**Customer Service & Maintenance / Infrastructure**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
Salaries and wages	\$ 6,382	\$ 7,305	\$ 1,916	\$ 2,252
Employee benefits	1,496	1,883	519	836
Legal services	-	3	-	-
Other professional services	12	37	17	-
Outside services	2,054	1,276	300	287
Office expenses	403	364	107	105
Occupancy	117	139	41	95
Utilities	154	230	69	88
Maintenance and repairs	2,747	3,364	670	730
Meals and entertainment	41	49	8	27
Business travel	466	244	85	120
Asset expenses	267	421	145	169
Allocated expenses	-	(636)	-	(457)
Insurance expenses	20	205	32	76
Sub-total from breakout	\$ 14,059	\$ 14,887	\$ 3,927	\$ 4,328
General Ledger:				
Customer service	2,399	195	1,425	(1)
Maintenance & infrastr.	11,579	14,989	3,972	4,418
Sub-total from GL	\$ 13,978	\$ 15,184	\$ 5,397	\$ 4,417
Unreconciled difference	\$ 81	\$ (300)	\$ (1,488)	\$ (89)
Avg. # of turbines in field	694	763	625	763
Avg. cost per turbine (annualized)	\$ 20	\$ 20	\$ 26	\$ 17

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**Management indicated management and sublease costs relate to land lease costs for projects, however a breakout of the account was not provided**

Management and sublease costs relate to lease costs for wind projects for which the Americas provides management services. The lease costs are generally a percentage of the electricity generated from the project (normally 3%-6%). The Americas pays the land costs directly and then charges the amounts to the individual projects as a component of the management fee.

Management was unable to provide a breakout of the components of the account. Further, management was unable to explain the significant increases during 2000 and the four months ended April 2001.

Management and Sublease Costs

(\$ in thousands)	Year Ended	Four Mos. Ended	
	December 31,	December 31,	April 30,
	1999	2000	2001
General ledger balance	\$ 1,368	\$ 2,364	\$ 486
			\$ 1,066

**Electricity costs relate to the projects owned by the Americas and represent energy costs and maintenance fees**

The table to the right details the components of electricity costs by individual project.

Electricity costs relate to energy costs incurred by the projects and inter-connect maintenance fees charged by the utility. When the wind turbines are generating electricity, a portion of the electricity is utilized by the turbine to run the various electrical components of the turbine. When the turbine is not generating electricity (i.e., the wind is not blowing), the turbine is forced to utilize electricity from the grid. The Americas is charged on average \$0.12 per kWh for electricity received from the grid. Management indicated the inter-connect maintenance fees range from \$1-\$8 per month depending on the size of the project. The consolidation entries relate to amounts eliminated for intercompany activity for the projects owned by the Americas.

The electricity costs decrease of 71% was primarily driven by the following two reasons:

- Failing to eliminate the inter-company activity related to Cabazon (\$900). There would be no impact of earnings, as maintenance revenue would be overstated by the same amount.
- During 1999, the Americas failed to segregate electricity costs, property taxes and management and sublease costs for the Cabazon project. Rather, these amounts were all recorded as electricity costs. During 2000, the Americas began to properly segregate the costs which resulted in an overall decrease to electricity costs.

**Electricity Costs**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
Cabazon	2,183	1,078	-	255
VG Repower	-	163	-	44
ZWHC	647	913	290	243
Lake Benton II	-	143	-	-
Green Power	89	332	121	111
ZSI	245	391	96	128
	3,164	3,020	307	781
Consolidation entries	(653)	(2,298)	(290)	(653)
General ledger balance	\$ 2,511	\$ 722	\$ 217	\$ 128

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## Salaries and wages represent the most significant component of research and development costs

### Historical Costs

The table to the right is a summary of the components of research and development costs divided by operating and project cost center. Management was unable to provide product cost center information for the interim periods presented. Further, management was unable to explain the unreconciled difference between the cost center breakout and the general ledger for 2000.

As illustrated in the table, salaries and wages and other employee costs (benefits) represent the most significant component of net research and development costs, accounting for 86%, 59%, 98% and 83% respectively for the periods presented.

Management indicated there were approximately 38 individuals employed by the research and development department at the end of 1999 and 2000. There has been some recent turnover in the department due to the Euron annual performance assessment. The 2001 budget provides for hiring an additional 10 employees. Mr. Christenson indicated historically the Americas has been a desirable place for engineers to work. The ability to retain and attract new research employees will be critical to the continued development of new and enhanced product offerings post transaction.

Management indicated the research and development department for EWC was combined during 2000 with the department headquartered in Germany, but US employees remained based in California. As a result of the consolidation, the Americas has incurred significant increases in business travel for US based personnel traveling to Germany.

Management indicated the increase in professional services during 2000 and the April 2001 period related to sub-contractor costs for the development of the power system for the EW 1.5 MW turbine.

Included in the NREL grants for 2000 were approximately \$1,300 of reimbursements from EWC-Spain related to co-development efforts for the TZ 900 turbine.

### Turbine Development Costs

Operating Cost Center	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
Salaries and wages	\$ 2,707	\$ 2,704	\$ 620	\$ 881
Employee benefits	507	655	182	230
Business travel	137	562	64	175
Outside services	127	164	31	103
Office expenses	111	135	27	48
Maintenance and repairs	67	179	21	23
Utilities	99	125	25	56
Occupancy	25	22	7	5
Asset expenses	9	10	4	2
Meals and entertainment	8	35	3	13
Legal services	4	30	-	14
Professional services	2	553	26	191
Insurance	1	7	1	2
Capitalization contract	-	(94)	-	-
Sub-total	3,764	5,089	1,011	1,743
<b>Project Cost Center</b>				
1.5 MW	3,116	1,247	NA	NA
TZ 900	2,055	1,434	NA	NA
Other	-	670	NA	NA
Sub-total	5,229	3,986	NA	NA
Total	9,003	9,075	NA	NA
Difference	(1)	222	(1,057)	(205)
	9,004	8,853	2,068	1,948
NREL Grants	(5,263)	(3,942)	(1,250)	(615)
General Ledger	\$ 3,741	\$ 3,716	\$ 818	\$ 1,333

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## The majority of research and development expenses relate to NREL grant programs

The table to the right is a summary of major research and development programs undertaken by the Americas during the periods under review. The following presents an overview of research and development expenses obtained through discussions with Craig Christenson, Vice-President, Engineering.

### NREL Grant Programs

The majority of research and development expenses relate to cost share programs with NREL, a governmental agency associated with the US Department of Energy. The cost share programs require the Americas to respond to requests for proposals related to specific grant programs available. Mr. Christenson indicated normally two to three developers are selected for inclusion in a specific program. The grant programs operate on a 70%-30% cost share arrangement, with the NREL paying for 70% of the stated budget. The Americas submits monthly invoices to the NREL detailing expenses and requests for reimbursement. NREL grants are recorded as a direct reduction to research and development expenses. During the periods under review, the Americas had two major NREL programs in process. The two programs were the Near Term Research and Testing program, ("NTRT"), and the Next Generation Turbine project, ("NGT"). The following is a summary of the two programs.

The NTRT program began in 1997 and was substantially complete by the end of 2000. The program's goal was to improve the cost effectiveness of the 750 kW turbines. The Americas has been able to reduce the cost of this turbine by 20% as a result of these research and development efforts. Although the 750 kW turbine is not currently in production in the US, the benefits of this research are being utilized in the production of the 750 kW turbine in Spain. Additionally, some benefit from this research is being utilized in the development of the 900 kW unit and the production of the EW 1.5 MW unit in the US.

### Significant Research and Development Programs

(\$ in thousands)

Program	Begh. Date	End Date	Total Amount	NREL Grant
NTRT	1997	2000	\$ 8,000	\$ 5,600
NGT	2000	2002	\$ 20,000	\$ 15,000
900kW	2000	2001	\$ 2,300	\$ -

Source- Management provided information

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### A proposal for the next NREL grant program will be submitted in late 2001

#### NREL Grant Programs, continued

The NCT program commenced in 1999 and has approximately two years remaining. The initial goal of the program was to reduce the cost of energy to \$0.25 per kWh. At the beginning of the program, the 750 kW turbine was generating energy at between \$0.40 and \$0.45 per kWh. The EW 1.5 MW turbine is currently generating electricity at \$0.26 per kWh. As the program has developed, it was determined the initial goal of \$0.25 per kWh was too aggressive and the plan has been revised with the NREL's consent to \$0.30 per kWh. The Americas plans to introduce a prototype EW 1.5 MW turbine late in 2001 that meets this criteria and have it in production by late 2002.

#### Future NREL Programs

During the third quarter of 2001, the Americas anticipates submitting a proposal for a NREL program for the Low Wind Speed Turbine project. The Americas anticipates the program budget will be approximately \$20,000 per manufacturer, with two to three manufacturers selected for participation in the program. Management believes the Americas will be successful in winning funds for this project, as the NREL has been pleased with the Americas past performance with programs. Additional competition may exist for these funds as Vestas and NEG Micon, foreign based manufacturers, may bid for these funds as they are in the process of establishing US manufacturing facilities. It is unclear if the backing of Enron as the corporate parent has assisted the Americas in securing government funding.

#### Internal Programs

In addition to the NREL programs, the Americas conducts research projects that are financed internally. Currently, a program to develop a 900 kW turbine is underway. The 900 kW turbine is being developed to compete with other manufacturers in the world that offer machines in excess of 750 kW for areas that can not support MW machines (areas such as Central and Latin America). The program started in 2000 and a prototype was introduced in Spain in January 2001, with hopes of having a prototype in the US by the end of 2002.

#### Significant Research and Development Programs

(\$ in thousands)

Program	Begin. Date	End Date	Total Amount	NREL Grant
NTRT	1997	2000	\$ 8,000	\$ 5,600
NGT	2000	2002	\$ 20,000	\$ 15,000
900kW	2000	2001	\$ 2,300	\$ -

Source: Management provided information

### Business development costs are expensed as incurred during the start-up phase of projects

The table to the right is a summary breakout of business development costs for the periods presented. Business development expenses relate to start-up costs for potential business opportunities. In accordance with the accounting provision Statement of Position 98-5, Reporting on Start-Up Activities, these costs are expensed as incurred until certain criteria for capitalizing costs have been achieved.

Management indicated the difference between the sub-total and general ledger related to internal costs capitalized for projects which meet the criteria for capitalization.

Business development expenses as a percentage of revenue have fluctuated significantly during the periods under review. Business development expenses were 1.7%, 4.2%, 18.3% and 6.9%, respectively for the periods presented. The fluctuations are the result of the significant swings in revenue (discussed earlier) and the fixed nature of a majority of the business development costs.

As illustrated in the table, salaries and wages and other employee costs represent the most significant component of business development costs, accounting for 39%, 44%, 45% and 44% respectively for the periods presented. Mr. Miller indicated the business development department has expanded as the strategic decision to focus on development activities has resulted in additional headcount. Currently, the business development group maintains approximately 41 employees as compared with 19 and 40 as of December 31, 1999 and 2000, respectively. Mr. Miller indicated the plan is to expand the business development group to 50 employees by the end of 2001.

The Americas does not currently offer any sales incentive or commission plans for development employees. Rather, employees are compensated with a base salary and participate in the Americas performance bonus plan.

#### Business Development Expenses

(\$ in thousands)	Year Ended		Four Mos. Ended	
	December 31, 1999	2000	April 30, 2000	2001
Salaries and wages	\$ 2,168	\$ 2,995	\$ 910	\$ 1,223
Land lease expenses	1,377	1,511	605	472
Outside services	1,255	1,170	288	219
Legal services	429	475	8	82
Employee benefits	418	442	135	299
Business travel	343	404	99	271
Other professional services	213	188	79	165
Office expenses	170	178	55	94
Utilities	128	174	62	82
Occupancy	41	24	10	17
Meals and entertainment	31	41	9	29
Asset expenses	7	8	2	3
Insurance	3	39	18	74
Maintenance and repairs	2	98	34	23
Construction costs	-	-	-	445
Sub-total	6,585	7,837	2,314	3,498
Unreconciled difference	1,145	510	298	80
General ledger	\$ 5,440	\$ 7,327	\$ 2,016	\$ 3,418

Source: General Ledger

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### The Americas has made the strategic decision to acquire desirable land rights for the future sale to project developers

Land lease expense relates to the costs to secure land option rights and the lease option costs paid to various individuals on a monthly, quarterly or yearly basis. The Americas records these costs as start-up expenses through the business development account. The increased costs during the periods under review are the result of a strategic decision to acquire more land option rights which can eventually be offered to project developers as part of a turbine sale. This plan is similar to the Montfort transaction in 2001, which included the bundling of a land sale and turbine sale.

While the strategic plan is to transition away from ownership in project development efforts, the Americas will continue to perform pre-development activities (including acquiring land rights) in an effort to increase third party sales.

Legal services, other professional services and outside services relate to third party costs associated with development activities. These costs include securing land rights, consulting studies, engineering costs and other start-up related costs. These costs have remained relatively consistent during the periods under review.

Management indicated the construction costs recorded in the April 2001 period do not relate to true construction costs. Rather the amounts were labeled as construction costs because they were not originally included in the business development forecast for 2001. The majority of the costs relate to the buy-out of Windtricity, a former partner in selected pre-development activity.

#### Business Development Expenses

(\$ in thousands)	Year Ended		Four Mos. Ended	
	December 31,	2000	2000	April 30,
	1999			2001
Salaries and wages	\$ 2,168	\$ 2,995	\$ 910	\$ 1,223
Land lease expenses	1,377	1,511	605	472
Outside services	1,255	1,170	288	219
Legal services	429	475	8	82
Employee benefits	418	442	135	299
Business travel	343	404	99	271
Other professional services	213	188	79	165
Office expenses	170	178	55	94
Utilities	128	174	62	82
Occupancy	41	24	10	17
Meals and entertainment	31	41	9	29
Asset expenses	7	8	2	3
Insurance	3	39	18	74
Maintenance and repairs	2	98	34	23
Construction costs	-	-	-	415
Sub-total	6,585	7,837	2,314	3,498
Unreconciled difference	1,145	510	298	80
General ledger	\$ 3,400	\$ 7,327	\$ 2,012	\$ 3,418

Source: General Ledger

### Unrecorded land acreage represents options to build projects on land owned by third parties

Management indicated unrecorded land acreage represents land options rights obtained by the Americas to develop wind turbine projects. These payments are expensed as business development costs as they relate to predevelopment activities.

The total expense, which is recorded in business development, related to the unrecorded land acreage was \$1,500 and \$500 for the year ended December 31, 2000 and the four months ended April 30, 2001, respectively.

Management provided limited information related to these land rights. Should this transaction proceed an assessment of the future economic benefit of these land options would be required.

#### Unrecorded Land Acreage

State	Total # of acres
California	127,705
Canada	710
Colorado	3,354
Hawaii	40
Iowa	11,030
Minnesota	36,164
Montana	38,473
New York	2,933
Oregon	6,963
South Dakota	1,353
Texas	45,583
Washington	39,358
Wyoming	11,000
<b>Totals</b>	<b>325,066</b>

Source: Supplemental information provided by Ms. Haynes

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PricewaterhouseCoopers

### G&A headcount costs have remained relatively stable except for one-time bonuses paid to the Americas' former president

The table to the right is a summary of the Americas general and administrative expenses for the periods presented. The following summarizes the salient points from the significant balances.

#### Salaries and Wages

The following table details the headcount by G&A department at the end of each period under review:

	December 31,		April 30,	
	1999	2000	2000	2001
Executive	2	2	2	2
Acctg, IT & Planning	25	20	26	23
Legal	6	6	8	6
Human Resources	15	17	14	17
Government Affairs	2	1	2	1
Transportation/Flight	5	3	5	3
Communications	3	4	4	4
<b>Total</b>	<b>58</b>	<b>53</b>	<b>61</b>	<b>56</b>
Sat. & wages (excl. Karras bonus)	\$ 4,816	\$ 4,863	\$ 1,746	\$ 1,660
Per employee	\$ 83	\$ 92	\$ 86	\$ 89

Mr. Orban indicated the overall salaries & wages decrease from 1999 to 2000 was largely due to the resignation of the Americas President (Mr. Ken Karras) in February of 2000. Otherwise, cost per employee has remained relatively steady during the period. Headcount decreased from April 2000 to the end of 2000 due to the overall decrease in business; Mr. Orban noted headcount is increasing in 2001 due to the ramp up in production and sales.

The table to the lower right details salaries and bonuses for the Americas' presidents during the period under review. As is shown, a quality of earnings adjustment is proposed for the difference between the amounts paid to former presidents during the periods under review versus the agreed upon salary and bonus for Mr. Unanoff.

#### General & Administrative Expenses

(\$ in thousands)	Year Ended		Four Mos. Ended	
	December 31,	2000	2000	April 30,
1999	2000	2000	2001	
\$ 6,105	\$ 4,863	\$ 1,746	\$ 1,660	
Salaries & wages	1,434	1,180	-	-
Bad debt	1,333	1,153	472	536
Employee benefits	1,403	1,041	365	342
Other professional svcs.	1,219	811	278	105
Legal services	1,271	727	159	190
Outside services	885	695	308	139
Allocated overhead	401	508	152	116
Business travel	605	376	113	138
Asset expenses	418	375	243	138
Office expenses	344	354	121	133
Utilities	232	434	85	188
Insurance	186	176	69	71
Occupancy	50	59	43	48
Other				
	\$ 15,926	\$ 12,742	\$ 4,154	\$ 3,804
% of revenue	4.8%	7.3%	37.6%	7.7%

Source: General ledger

Source: General ledger

	Year Ended	
	December 31,	2001 (F)
1999	2000	
\$ 1,666	\$ 541	\$ -
Ken Karras	134	249
Dave Ramm	1,800	790
Sub-total	500	500
Adam Unanoff	\$ (1,300)	\$ (290)
EBITDA Adjustment		n/a

Source: Schedule provided by Mr. Schoen

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**\$780 of bonuses over reserved in 1999 were reversed in 2000**

**Salaries and Wages (continued)**

Salaries and wages also includes bonus expense for administrative personnel. According to Mr. Schoen, beginning in 2000, all the Americas G&A employees were included in the bonus plan. Bonuses are based on a predetermined personal target, an Americas target and an Etron target and all three targets must be met in order to qualify for the bonus. Prior to 2000, bonuses were only available to management and were discretionary.

Mr. Schoen indicated bonus expense is accrued based on the prior year's bonuses paid amount. This methodology does not take business or personnel growth into consideration and could lead to large expenses charged in the fourth quarter.

Total bonus expense recorded during 2000 was approximately \$2,100. Management indicated total projected bonus expense for 2001 is approximately \$2,200. 2000 and 2001 bonus expense by department is as follows:

Category	2000	2001 (F)
G&A	\$ 1,289	\$ 1,036
R&D	357	504
Cost of sales	251	488
Business development	240	210
<b>Total</b>	<b>\$ 2,137</b>	<b>\$ 2,238</b>

Mr. Schoen indicated during 2000, \$780 of bonuses accrued during 1999 were reversed and helped to offset 2000 bonus expenses. A quality of earnings adjustment has been proposed to eliminate the impact of this reserve.

**Bad Debts Expense**

Refer to the accounts receivable section of this report for a detailed discussion on bad debts expense, including timing of when expenses are recorded, and the adequacy of related reserve.

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**General & Administrative Expenses**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	2000	April 30, 2001
Salaries & wages	\$ 6,105	\$ 4,863	\$ 1,746	\$ 1,660
Bad debt	1,434	1,180	472	536
Employee benefits	1,333	1,153	365	342
Other professional svcs.	1,403	1,041	278	105
Legal services	1,219	811	159	190
Outside services	1,271	727	308	139
Allocated overhead	885	695	508	116
Business travel	401	508	376	113
Asset expenses	605	376	113	138
Office expenses	418	375	243	138
Utilities	344	354	121	133
Insurance	232	424	85	188
Occupancy	186	176	69	71
Other	90	59	43	48
<b>Total</b>	<b>\$ 15,926</b>	<b>\$ 12,742</b>	<b>\$ 4,154</b>	<b>\$ 3,804</b>
% of revenue	4.8%	7.3%	37.6%	7.7%

Source: General ledger

**The majority of legal expenses in 2000 relate to the PanAero litigation**

**Employee Benefits**

According to Mr. Schoen, these expenses include medical and dental insurance, 401(k) match and education. Refer to the human resources section of this report for further detail on programs available to employees.

**Other Professional Services**

Mr. Schoen indicated this account includes audit, consulting and lobbying costs. A breakout of this account was requested, however, management did not provide this information.

**Legal Services**

Legal service costs include outside legal costs related to the review of customer and vendor contracts, human resource issues, tax appeals and litigation. Mr. Schoen indicated the reduction in overall legal costs relates to the conclusion of the PanAero settlement and the ESI litigation. Mr. Schoen stated during 1999, the Americas won the PanAero settlement and was awarded \$2,900 (PanAero appealed). At the time the settlement was awarded, the Americas recorded a receivable and reduced legal expenses by \$1,700, the amount management estimated would eventually be collected.

During 1999 and 2000, the Americas recorded approximately \$460 in each period related to the PanAero litigation.

During 2000, the Americas received a \$2,900 payment from PanAero to settle the suit. Upon receipt of the cash, the Americas recorded the receipt of cash, the collection of the receivable and recorded \$1,200 as income into other revenues. A quality of earnings adjustment has been proposed to eliminate this income as it is considered non-recurring. The adjustment takes into account the expenses recorded in 1999 and 2000.

**General & Administrative Expenses**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	December 31,	April 30,
Salaries & wages	\$ 6,105	\$ 4,863	2000	2001
Bad debt	1,434	1,180	\$ 1,746	\$ 1,660
Employee benefits	1,333	1,153	472	536
Other professional sves.	1,403	1,041	365	342
Legal services	1,219	811	278	105
Outside services	1,271	727	159	190
Allocated overhead	885	695	308	139
Business travel	401	508	152	116
Asset expenses	605	376	113	138
Office expenses	418	375	243	138
Utilities	344	354	121	133
Insurance	232	424	85	188
Occupancy	186	176	69	71
Other	90	59	43	48
	<b>\$ 15,926</b>	<b>\$ 12,742</b>	<b>\$ 4,154</b>	<b>\$ 3,804</b>
% of revenue	4.8%	7.3%	37.6%	7.7%

Source: General ledger

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**Insurance expenses are also allocated from Enron**

**Outside Services**

Outside services consist of temporary labor and promotion/publicity expenses. A breakout of this account was requested, however as of the date of this report, management did not provide this information.

**Allocated Overhead**

See following slides for detailed discussion on amounts allocated to the Americas by Enron.

**Asset Expense**

This account consists of maintenance expense for the corporate aircraft. The decrease between periods presented is the result of the disposition of one of the two corporate aircraft in February 2000. The quality of earnings analysis was not adjusted for these costs presuming the use of the corporate aircraft would continue.

**Insurance Expense**

This account represents the direct expenses for business insurance. As discussed on the following pages, the Americas is allocated an insurance charge from Enron. Insurance costs are discussed in the risk management section of this report.

**Other**

This account includes maintenance and repairs and meal and entertainment expense.

**General & Administrative Expenses**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	2000	December 31,	April 30,
	\$ 6,105	\$ 4,863	2000	2001
			\$ 1,746	\$ 1,660
Salaries & wages	1,434	1,180	472	536
Bad debt	1,333	1,153	365	342
Employee benefits	1,403	1,041	278	105
Other professional svcs.	1,219	811	159	190
Legal services	1,271	727	308	139
Outside services	885	695	152	116
Allocated overhead	401	508	113	138
Business travel	605	376	243	138
Asset expenses	418	375	121	133
Office expenses	344	354	85	188
Utilities	232	424	69	71
Insurance	186	176	43	48
Occupancy	90	59		
Other				
	\$ 15,926	\$ 12,712	\$ 4,154	\$ 3,804
% of revenue	4.8%	7.3%	37.6%	7.7%

Source: General ledger

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**The Americas are allocated costs on an annual basis from Enron**

The table to the right presents a summary of Enron costs allocated to the Americas for the periods under review.

**Background**

Enron provides certain tax, legal, human resource, finance and risk management functions to the Americas. At the end of the year, Enron calculates the amount it will charge the Americas during the coming year. Mr. Schoen indicated the Americas believes most of the charges are arbitrarily determined and few actual services are provided relative to the amounts charged.

The Americas records 1/12th of this amount on a straight-line basis to expense each month during the year. Any other costs incurred by Enron on behalf of the Americas is charged directly to the Americas. Mr. Dave Andrews, allocations manager, indicated no formal services agreement exists between the Americas and Enron.

Management indicated all of the Enron allocated costs are charged to the Americas (i.e. no costs are allocated to Europe).

**Group Overhead Costs**

In 1999, the Americas was included within the Enron Energy Services Group (EES) and therefore allocated some of the costs of that group. During 2000, the Americas was transferred to Enron Global for 11 months and then to the Transportation group. The Americas was not charged allocations from these groups except for EES tax preparation during the transition. Mr. Andrews indicated neither the EES Group, Enron Global nor the Transportation Group provided any services to the Americas.

**Allocated Costs**

(\$ in thousands)	Allocation Method	Year Ended December 31,	
		1999	2001 Est.
HR - Ray Bennett	EES Group	\$ 21	\$ -
President - Tom White	EES Group	57	-
Finance & Accounting	EES Group	25	-
O/H - Tom White	EES Group	70	-
EES Tax	Ant. resources	36	90
Group O/H costs	Ant. resources	209	90
State tax group	Ant. resources	24	26
Corporate tax	Ant. resources	32	32
Ad Valorem Tax	Properties, tax & MMF	33	50
Tax preparation costs	Properties, tax & MMF	89	108
Insurance Premiums	Ant. resources	961	789
Corporate Finance	Ant. resources	193	307
Associate program	Direct usage	-	258
Employee Comm.	% of total employees	11	125
ECM Risk Activities	Ant. resources	87	11
Risk M. - Houston	Ant. resources	33	38
Corporate Legal	Usage	31	92
Corporate Secretary	Ant. resources	38	25
Other	Ant. resources	34	30
Other allocated costs	Various	1,408	8
<b>Total</b>		<b>1,706</b>	<b>1,360</b>
Less insurance premiums		(821)	(765)
<b>Net Allocations</b>		<b>\$ 885</b>	<b>\$ 595</b>

Source: Information provided by Mr. Dave Andrews

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**Allocated costs from Enron approximated \$700 during 2000**

**Tax Preparation Costs**

The Americas is charged for the preparation of state, local and corporate tax returns by Enron. According to Mr. Andrews, the costs charged are based on management's estimate of anticipated resources required to complete the returns.

**Other Allocated Costs**

Insurance premiums represent costs associated with insuring the Americas and Europe. No further detail was provided by Mr. Andrews. Refer to the risk management section of this report for further detail on the programs in place.

Corporate finance costs relate to the Enron finance group that provides assistance in financing/borrowing, investment and cash management.

Associate program costs relate to a project finance analyst temporarily provided by Enron. The Americas anticipates hiring this analyst directly in 2001.

Employee communications costs relate to printings and mailing of the Americas information and newsletters to employees.

ECM risk activities costs relate to the Enron department that tracks intercompany balances and monitors risk management activities.

Risk management Houston costs relate to a department set up to analyze the risk management function and advise local risk management when issues arise.

**Reduction of Insurance Premiums**

This amount relates to insurance premiums directly attributable to wind projects. These costs are reversed out of the overhead allocation and into the project's SG&A expenses which are included in the Americas' results through consolidation.

**Allocated Costs**

(\$ in thousands)	Cost Type	Allocation Method	Year Ended December 31,	
			2000	2001 Est.
	HR - Ray Bennett	EES Group	\$ 21	\$ -
	President - Tom White	EES Group	57	-
	Finance & Accounting	EES Group	25	-
	O/H - Tom White	EES Group	70	-
	EES Tax	Ant. resources	36	90
	Group O/H costs		209	-
	State tax group	Ant. resources	24	26
	Corporate tax	Ant. resources	32	32
	Ad Valorem Tax	Properties, tax & MNF	33	19
	Tax preparation costs		89	50
	Insurance Premiums	Ant. resources	961	789
	Corporate Finance	Ant. resources	193	307
	Associate program	Direct usage	-	125
	Employee Comm.	% of total employees	11	11
	ECM Risk Activities	Ant. resources	87	92
	Risk M. - Houston	Ant. resources	33	25
	Corporate Legal	Usage	51	-
	Corporate Secretary	Ant. resources	38	30
	Other	Various	34	8
	Other allocated costs		1,408	1,262
	<b>Total</b>		<b>1,706</b>	<b>1,460</b>
	Less insurance premiums		(821)	(765)
	<b>Net Allocations</b>		<b>\$ 885</b>	<b>\$ 695</b>

Source: Information provided by Mr. Dave Andrews

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**Stand-alone costs would need to be factored into the 2001 forecast**

The table to the right is an analysis of the potential stand-alone costs that would be incurred by the Americas post-acquisition. The stand-alone costs are presented in a range, as the amounts represent estimates. The table also includes an estimate of the quality of earnings adjustment related to stand-alone costs.

**Insurance**

The amount shown as the actual expenses for 2000 represents the insurance costs allocated to the Americas from Enron and the insurance costs recorded as a component of general and administrative expenses.

It is estimated there would be significant increases to the Americas stand-alone insurance costs. An analysis of estimated costs is presented in the risk management section of this report.

**Tax Preparation**

This amount represents the expenses charged to the Americas for the preparation of state, corporate, local and ad valorem taxes.

**Accounting**

Currently, nine employees (primarily located in Houston and working in the accounting and finance area) have been seconded to the Americas by Enron. The cost of these employees is currently included in C&A expenses under salaries and wages. Management noted it is unlikely these employees will continue with the Americas post-transaction and would need to be replaced with new employees in California.

Management declined to provide the costs associated with the annual audit. It is our understanding the audit of the Americas was conducted using a materiality threshold of \$1,600 for all adjustments. In the future, as a stand-alone company, that level of materiality would not necessarily be appropriate and more detail testing may be required. As a result, it is presumed that audit costs would increase.

**Stand-Alone Cost Analysis**

(\$ in thousands)	Estimated Actual 2000	PwC's Stand-Alone Estimate (Yearly)
Insurance	\$ 1,500	\$2,500-\$3,600
Tax preparation	142	150-250
Accounting	1,225	1,400-1,750
Treasury	307	300-500
Employee benefits	6,000	8,000-10,000
Legal	811	800-1,000
Inform. Technology	1,400	3,500-4,600
<b>Total</b>	<b>\$ 11,385</b>	<b>\$16,650-\$21,100</b>
Mid-point of 2000 estimate		18,875
Estimated actual 2000 expenses		(11,385)
EREC allocation		(3,610)
Enron allocation		(695)
2000 stand-alone adjustment		\$ 3,185

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**2000 EBITDA should be reduced related to stand-alone costs**

**Treasury**

Treasury costs represent those costs allocated to the Americas from the Etron finance group that provides assistance in financing/borrowing, investment and cash management. While Mr. Schoen does not believe the Americas receives services for these costs and therefore has not included these costs in management's go-forward estimates, the Americas will require some sort of treasury function as international/cross-border activity is projected to increase.

**Employee Benefits**

Based on information provided by management and analysis, the stand-alone employee benefit costs are estimated at \$9,000 for 2001. See further discussion in the human resources section of this report.

**Legal**

Based on discussions with management, 2000 legal expenses appeared to represent a recurring level of expenses. Accordingly, the stand-alone cost estimate approximates 2000 levels.

**Information Technology**

Information technology costs relate to salaries and related benefits and other related technology spending. The stand-alone costs are based on the industry benchmark for a manufacturer of 1% of revenue. See discussion of information technology costs in the information technology section of this report.

**One-Time Expenses**

The Americas would incur certain one-time expenses related to the transition to a stand-alone entity such as re-branding costs and public debt and financing costs. The amounts of these types of expenses would need to be estimated and included in the 2001 cash flow forecast (no estimate was made in this analysis).

**Stand-Alone Cost Analysis**

(\$ in thousands)	Estimated Actual 2000	PwC's Stand-Alone Estimate (Yearly)
Insurance	\$ 1,500	\$2,500-\$3,600
Tax preparation	142	150-250
Accounting	1,225	1,400-1,750
Treasury	307	300-500
Employee benefits	6,000	8,000-10,000
Legal	811	800-1,000
Inform. Technology	1,400	3,500-4,000
<b>Total</b>	<b>\$ 11,385</b>	<b>\$16,650-\$21,100</b>
Mid-point of 2000 estimate		18,875
Estimated actual 2000 expenses		(11,385)
EREC allocation		(3,610)
Etron allocation		(695)
2000 stand-alone adjustment		\$ 3,185

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### Joint venture income is predominantly from the Sky River and Victory Gardens JV Partnerships

A summary of all joint venture agreements as well as a description of the ownership structure for the significant joint ventures is included in Appendix 6 and 7, respectively. The table on the right presents the components of income from joint ventures. The key joint venture entities are discussed below:

**Mesa entities**

The Mesa entities' only source of income is note repayments related to the sale of two projects in 1983: Zond PanAero I and Zond Pan Aero II ("ZP I" and "ZP II"). Both ZP I and ZP II are in arrears to the Mesa entities for the note repayments. Management's estimates of future cash flows from ZP I and ZP II indicate there is no requirement for an impairment reserve at the Mesa entity level and therefore, the ZP I and ZP II partnerships have a fixed price contract with SCE to sell electricity at \$0.102 per kWh until the end of the partnerships in 2004/2005. Difficulties with receiving payment from SCE were described earlier in this report.

**Victory Gardens and Sky River**

These two joint ventures represent the Americas' most profitable JV partnerships. The JV income from these projects has remained stable between 1999 and 2000. However, there is a significant reduction in JV income between the first four months of 2000 and 2001. According to management, due to SCE delaying its payments in 2001 (see next page for details), management conservatively accrued for sales to SCE at \$0.07 per kWh, although the Sky River partnership has a fixed price contract (at \$0.11 per kWh) with SCE until 2001.

In May 1997, the Americas sold its interest in Sky River and Victory Garden IV and retained an option to buy back the shares. This option was exercised in June 2000. As the Americas essentially retained all the risks and rewards associated with the projects, and retained an option to repurchase the shares, the Americas continued to account for income from these two partnerships as income from joint ventures. See Joint Venture investment section of report for further analysis of this issue.

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
<b>Mesa entities</b>				
MCC	\$ 1,261	\$ 1,242	\$ 182	\$ 117
MCCII	691	670	71	20
MWD	(2)	(14)	(55)	(18)
	<u>1,950</u>	<u>1,898</u>	<u>198</u>	<u>119</u>
<b>Victory Gardens IV &amp; Sky River</b>				
VGIV	23	23	8	8
SR	53	51	18	18
QF Assets	10,625	-	2,327	-
Sky River	-	9,232	-	(238)
VGIV	-	1,155	-	181
Annot of SR/VGIV	(625)	(625)	(417)	(208)
	<u>10,076</u>	<u>8,838</u>	<u>1,936</u>	<u>(239)</u>
<b>Management company</b>				
PHWD	(12)	66	3	4
<b>Other JVs</b>				
Lake Benton I	(26)	(89)	1	(23)
Storm Lake II	(8)	(59)	(12)	(12)
Storm Lake I	(28)	(51)	(11)	(16)
	<u>(62)</u>	<u>(199)</u>	<u>(22)</u>	<u>(51)</u>
<b>Other projects</b>				
Cabazon	(107)	-	(933)	-
VGRepower	126	-	14	-
	19	-	(919)	-
<b>Total</b>	<b>\$ 11,971</b>	<b>\$ 11,003</b>	<b>\$ 1,196</b>	<b>\$ (167)</b>

Source: General ledger

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### Joint venture income is predominantly from the Sky River and Victory Gardens IV JV Partnerships

**Management company**

This is a 50% joint venture with Energy Unlimited to manage a wind project in Pain Springs.

**Other JVs**

Although these JVs create losses, they are offset to some extent by PTCs generated by these operations. See tax section of this report.

**Other projects**

Both Cabazon and VG Repower, which became operational in June 1999, were initially treated by the Americas as equity investments since management was of the view these projects were being held for sale and therefore the Americas only exercised temporary control. Since December 2000, the Americas has begun consolidating the results of Cabazon and VG Repower as these projects have not been sold.

Although the combined results of these projects should have been consolidated in 1999, no quality of earnings adjustment is proposed on the basis of materiality.

(\$ in thousands)	Year Ended		Four Mos. Ended	
	December 31,	2000	2000	April 30,
	1999			2001
<b>Mesa entities</b>				
MCC	\$ 1,261	\$ 1,242	\$ 182	\$ 117
MCC-II	691	670	71	20
MWD	(2)	(14)	(55)	(18)
	<u>1,950</u>	<u>1,898</u>	<u>198</u>	<u>119</u>
<b>Victory Gardens IV &amp; Sky River</b>				
VGIV	23	23	8	8
SR	53	53	18	18
QF Assets	10,623	-	2,327	-
Sky River	-	9,232	-	(238)
VGIV	-	1,155	-	181
Amount of SR/VGIV	(625)	(625)	(417)	(208)
	<u>10,076</u>	<u>9,838</u>	<u>1,966</u>	<u>(239)</u>
<b>Management company</b>				
PHWD	(12)	66	3	4
<b>Other JVs</b>				
Lake Benton I	(26)	(89)	1	(23)
Storm Lake II	(8)	(59)	(12)	(12)
Storm Lake I	(28)	(51)	(11)	(16)
	<u>(62)</u>	<u>(199)</u>	<u>(22)</u>	<u>(51)</u>
<b>Other projects</b>				
Cabazon	(107)	-	(933)	-
VG Repower	126	-	14	-
	<u>19</u>	<u>-</u>	<u>(919)</u>	<u>-</u>
<b>Total</b>	<b>\$ 11,971</b>	<b>\$ 11,603</b>	<b>\$ 1,196</b>	<b>\$ (167)</b>

Source: General Ledger

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**Cash distributions increased by 216% between 1999 and 2000**

**Cash Distribution**

The table on the right provides a summary of cash distributions by joint venture.

**Mesa entities**

As a result of the PanAero legal dispute, the Americas (being the general partner of this joint venture) held back part of the cash distributions in 1999. In 2000, with the settlement of this dispute, cash distributions held back in 1999, were paid out as part of the 2000 distribution.

According to the JV agreement, the Americas shares 50% of the cash distributions of the Mesa entities. Cash distributions are received four times a year in May, June, November and August. The cash distribution for May 2001 has not yet been received, as payments for electricity sales have not been received from SCE. According to management, the settlement with SCE has been signed for all joint ventures except the Mesa joint venture as agreement has not been reached with PanAero regarding the suitability of the agreement.

**Victory Garden IV and Sky River**

Cash distributions from Victory Garden IV are received twice a year in June and December. Cash distributions from Sky River are also received twice a year in July and January. There have been no cash distributions from either of these partnerships in 2001, due to the payment delays from SCE. Management is not able to explain why distributions increased in 2000.

**PHWD**

Management was unable to explain why cash distributions from PHWD increased in 2000.

**Distributions from Investments**

(\$ in thousands)	December 31,		April 30,	
	1999	2000	2000	2001
MWD	\$ 155	\$ 156	\$ -	-
MCC	731	2,477	-	-
MCC II	295	1,592	-	-
	1,181	4,225	-	-
Sky River	-	3,149	-	-
VGIV	-	825	-	-
QF Assets	1,164	331	-	-
	1,164	4,305	-	-
PHWD	57	621	-	108
StormLake II	-	11	-	-
StormLake II	-	22	-	-
	-	33	-	-
<b>Total distributions</b>	<b>\$ 2,402</b>	<b>\$ 9,184</b>	<b>\$ 108</b>	<b>108</b>

Source: Supplementary information provided by management

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**Reported EBITDA has been reduced for equity income net of cash distributions**

**Quality of Earnings adjustment**

Management includes equity and joint venture income as a component of EBITDA due to the Americas' history as a project developer. As the strategic business focus is to transition away from start-to-finish project development and ownership in developed projects, equity income, net of cash distributions, has been excluded in the calculation of adjusted EBITDA.

The amortization relates to the write down of the step up that was carried out in 1997 relating to the Sky River and Victory Garden, IV projects. See Investment section on the balance sheet for further details.

**Proposed Quality of Earnings Adjustment**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
JV/Equity Income	\$ 11,971	\$ 11,603	\$ 1,196	\$ (167)
JV Distributions	(2,402)	(9,184)	-	108
Add back amortization	(625)	(625)	(417)	(208)
	<b>\$ 8,944</b>	<b>\$ 1,794</b>	<b>\$ 779</b>	<b>\$ (267)</b>

Source: General Ledger

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**Other income and expense items appear to represent recurring activity and are included in EBITDA**

The table to the right is a summary of other income and expense for the periods presented. Management includes other income and expense in the calculation of EBITDA, as these amounts appear to represent recurring business expenses, they have been included in EBITDA. In the future, the Americas should consider reclassifying these expenses in general and administrative costs.

Management was unable to provide a breakout of the "other" amounts included in other income and expense.

**Other Income and Expense**

(\$ in thousands)	Year Ended		Four Mos. Ended	
	1999	December 31, 2000	2000	April 30, 2001
Gain on sale of assets	\$ 42	\$ 31	\$ 26	\$ 1
Rest. charges	(17)	(14)	(2)	(20)
Political charges	(115)	(101)	(3)	(9)
Other	(381)	(161)	(55)	(23)
Total (expense)	\$ (469)	\$ (245)	\$ (34)	\$ (51)

Source: General Ledger

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### Americas summary balance sheets

For a discussion of the individual account balances not presented below, please see individual analysis in the slides to follow.  
**Intercompany receivables** - This amount comprises amount due from Europe and eliminates in consolidation.  
**Deferred taxes** - Refer to the tax section of this report for discussion concerning tax matters.  
**Intercompany payables** - This amount includes balances due to Europe and eliminates as part of consolidation.

**Notes payable - Enron** - The amount due Enron at December 31, 1999, 2000 and April 30, 2001 is comprised of the following:

(\$ in thousands)	12/31/99	12/31/00	04/30/01
Enron for Tacke	\$ 1,877	\$ -	\$ -
Enron Promissory	6,480	-	-
Enron Revolver	13,626	55,483	127,706
EREC	1,711	(1,025)	(4,056)
Enron 455M Bridge	174,789	59,385	60,423
	<b>\$ 198,483</b>	<b>\$ 113,843</b>	<b>\$ 184,093</b>

It is our understanding all amounts due to Enron will be transferred into equity prior to the consummation of the proposed transaction. We had not performed testing on these balances, however, the large decrease in 2000 is the result of the sale of the Lake Benton II project in June 2000.

**Shareholders' Equity** - The amount is comprised of common stock, contributed capital, cumulative translation adjustment, retained earnings and current year income or loss. Excluding a \$40 reconciling adjustment, shareholder's equity rolls properly from December 31, 2000 to April 30, 2001.

	12/31/99	12/31/00	4/30/01
<b>Assets</b>			
Cash	\$ 2,076	\$ 5,793	\$ 7,515
Restricted cash	2,619	2,769	2,849
Trade accounts receivable, net	13,712	8,052	18,397
Receivables from related parties	15,319	4,891	5,942
Intercompany receivables	31,807	40,670	37,229
Notes receivable - current	1,339	1,333	1,333
Inventories	21,244	56,480	101,178
Prepaid expenses	1,697	3,177	4,645
Current deferred taxes	1,623	1,623	1,623
Total current assets	<b>91,626</b>	<b>124,988</b>	<b>181,111</b>
Notes receivable	10,944	9,304	9,297
Property, plant and equipment, net	209,746	102,069	107,866
Land - wind resource acreage	9,521	9,469	9,469
Equity investments	46,393	57,263	57,161
Goodwill	78,531	75,613	74,640
Other deferred assets	6,754	5,202	5,372
Total Assets	<b>\$ 453,525</b>	<b>\$ 384,148</b>	<b>\$ 444,916</b>
<b>Liabilities</b>			
LT debt - current portion	\$ 1,928	\$ 2,445	\$ 3,067
Accounts payable	7,070	7,247	10,719
Intercompany payables	321	-	-
Accrued liabilities	32,689	46,539	37,914
Income taxes payable	-	-	-
Total current liabilities	<b>42,008</b>	<b>56,231</b>	<b>51,700</b>
Long term debt	30,026	27,583	25,924
Notes payable - Enron	198,403	113,843	184,093
Other deferred liabilities	8,321	5,902	5,925
Deferred income taxes	9,191	(3,067)	(2,982)
Total Liabilities	<b>287,949</b>	<b>204,462</b>	<b>264,660</b>
<b>Shareholders' Equity</b>			
Total Shareholders Equity	165,576	183,686	180,256
Total Liabilities & Equity	<b>\$ 453,525</b>	<b>\$ 384,148</b>	<b>\$ 444,916</b>

Source: General Ledger

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**The Americas has two loans outstanding which require a debt service reserve to be held as restricted cash**

**Cash**

The Americas has 34 (actual) cash accounts: one for each of the 30 operating companies, two restricted accounts, one general and one payroll account.

Mr. Schoen was unable to provide an explanation for the increases in the cash balances but believed the increases were primarily attributable to timing. Management indicated any excess cash is used to pay down the Americas' working capital line with Enron. Mr. Schoen was unable to indicate how much cash was considered "excess" that could be used to prepay debt. In addition, he was not able to provide any details regarding cash management program for the Americas. The working capital line has a fixed interest rate of 6.5%.

There are six individuals with the authorization to sign checks: Msrs. Umanoff, Miller, Gates, Orban, Biernat and Westfeld.

**Restricted cash**

There are two loans outstanding with a debt covenant provision requiring a debt service reserve equal to 105% of the next loan payment be held as restricted cash. These loans are with Fortis Bank for Cabazon and Trust Company West for ZMY (a holding company for the Americas formed in 1995 for financing purposes).

For the ZMY loan, drawings can be made out of the restricted cash account for general use on the day after a note payment has been made if the next note payment is less than the prior one. Payment is required to be made in July and January of each year. Refer to the third party debt slide for details of the underlying loans.

Restricted cash also includes electricity sale deposits. Management indicated electricity sales proceeds which are due to minority investors are held as restricted cash at Sunwa Bank prior to being paid.

	Total Cash		
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Cash	\$ 2,076	\$ 5,793	\$ 7,515
Restricted cash	2,619	2,769	2,849
<b>Total cash</b>	<b>\$ 4,695</b>	<b>\$ 8,562</b>	<b>\$ 10,364</b>

Source: General ledger

	Restricted Cash		
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Cabazon	\$ 1,397	\$ 1,796	\$ 1,796
ZMY	1,196	947	965
Electricity holdback	26	26	88
<b>Restricted cash</b>	<b>\$ 2,619</b>	<b>\$ 2,769</b>	<b>\$ 2,849</b>

Source: General ledger

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**The increase in accounts receivable at April 30, 2001 from December 31, 2000 is primarily attributable to Montfort and Trent Mesa sales**

**General Overview**

The table to the upper right details the components of accounts receivable for the periods presented, while to the lower right is an accounts receivable aging at December 31, 2000 and April 30, 2001. Management was unable to provide an accounts receivable aging at December 31, 1999. Management indicated the Americas records an allowance for doubtful accounts based on the specific identification method and amounts presented here are net of those reserves.

The Americas classifies accounts receivable between related party receivables and third party receivables. At December 31, 2000 and April 30, 2001, related party receivables were primarily comprised of management, maintenance and easement fees due from joint ventures and limited partnerships not owned by the Americas. In addition to management, maintenance and easement fees, the December 31, 1999 balance includes receivables related to holdbacks associated with the sale of Lake Benton I and Storm Lake I and II. It is unclear as to why these receivables have been classified by management as related party receivables.

Third party receivables are primarily comprised of amounts related to electricity and turbine sales to third parties. The increase in third party accounts receivable at April 30, 2001 is primarily attributable to SCE not paying for the electricity sold to them in the period from November 2000 through March 2001 (approximately \$7,000) and the sale of nearly 26 EW 1.5 MW turbines to Montfort and Trent Mesa (approximately \$41,000 of revenue, of which approximately \$12,000 remained in accounts receivable as of April 30, 2001). The increase in days sales outstanding at December 31, 2000 and April 30, 2001 compared to December 31, 1999 is attributable to higher revenue in 1999 as compared to 2000 as the Americas had two project sales in 1999 versus one in 2000. Days sales outstanding has remained relatively consistent at April 30, 2001 compared to December 31, 2000.

According to management, the difference between the aging and the general ledger balances is attributable to an adjustment in the general ledger to record actual maintenance receivables as compared to the estimated receivable included in the aging schedule. No further detail was provided.

**Accounts Receivable**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Related party receivables	\$ 15,319	\$ 4,891	\$ 5,942
Third party receivables	13,712	8,052	18,597
<b>Total Receivables, net</b>	<b>\$ 29,031</b>	<b>\$ 12,943</b>	<b>\$ 24,539</b>
Bad debt expense	\$ 1,434	\$ 1,180	\$ -
Revenues	\$ 329,424	\$ 174,647	\$ 49,470
Days sales outstanding	31.4	43.9	46.0

**Accounts Receivable Aging**

(\$ in thousands)	12/31/2000	4/30/2001
Current	\$ 6,444	\$ 14,566
30 Days	1,086	(53)
60 Days	186	2,118
+90 Days	5,953	8,634
Amount per G/L	13,669	25,265
Maintenance receivable	12,943	24,539
True up	\$ 726	\$ 726

Source: Supplemental information provided by management

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**The Americas had \$1,963 in management fee receivables at December 31, 2000 attributable to insurance claims for lightning strikes at the Lake Benton I and Storm Lake II project sites**

As shown in the table to the right, the outstanding receivables from related parties has fluctuated during the periods under review. Each of the significant components is described below.

**Management**

Management receivables represent management, maintenance and easement fees paid to the Americas for managing wind projects. At December 31, 1999, 2000 and April 30, 2001, the number of projects on which the Americas earned such fees were as follows:

	12/31/1999	12/31/2000	4/30/01
Maintenance	14	15	14
Management	12	12	12
Easement	8	9	6

The increase in related party management fee receivables at December 31, 2000 as compared to December 31, 1999 is primarily attributable to insurance receivables of \$1,179 and \$784 for lightning damage at Lake Benton I and Storm Lake II, respectively. The Americas received payment on the Lake Benton I insurance claim in March 2001.

The increase in management receivables at April 30, 2001 compared to December 31, 2000 is primarily attributable to an increase in receivables due from projects that sell electricity to SCE. The amount receivable from these four projects was \$314 and \$1,511 at December 31, 2000 and April 30, 2001, respectively.

**Accounts Receivable - Related Party**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Management	\$ 3,356	\$ 5,363	\$ 5,639
Employee Advances	339	77	604
Sky River	221	344	203
VGIV	115	143	137
Turbine Sales	11,342	18	18
Reserve	(54)	(1,054)	(659)
<b>Related party receivables</b>	<b>\$ 15,319</b>	<b>\$ 9,801</b>	<b>\$ 5,982</b>

Source: General Ledger

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**The Americas recorded a reserve of \$1,000 in 2000 related to 1998 maintenance receivables from the Lake Benton I project**

**Employee Advances**

Employee receivables represent travel advances paid to employees. Management stated employee advances are netted against expense reimbursements. The small balance at December 31, 2000 is attributable to minimal construction and installation work being performed at the end of the year. Management indicated the increase at April 30, 2001 is attributable to work currently being performed on the Montfort and Trent Mesa projects. Management was unable to provide a summary of this account balance at December 31, 1999, 2000 and April 30, 2001 as the Americas only maintain the current balance.

**Turbine Sales**

Management indicated the receivable at December 31, 1999 relates to holdbacks associated with the sales of the Lake Benton I and Storm Lake I and II projects. We verified collection of these amounts.

**Reserve**

The Americas increased the related party reserve by \$1,000 in 2000 as a result of unpaid maintenance due from the Lake Benton I project since 1998. Lake Benton I was sold to GE Capital in December 1998; prior to the sale, the Americas was owed maintenance of \$771. It is unclear why this amount was not taken into consideration during the sale process; however, subsequent to the sale, the Americas attempted to collect this amount from GE Capital but they refused to pay, rendering the collection doubtful.

During 2001, the Americas wrote off \$394 in receivables which reduced the reserve to \$659.

**Accounts Receivable - Related Party**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Management	\$ 3,356	\$ 5,363	\$ 5,639
Employee Advances	339	77	604
Sty River	221	344	203
XGIV	115	143	137
Turbine Sales	11,342	18	18
Reserve	(54)	(1,054)	(659)
<b>Related party receivables</b>	<b>\$ 15,319</b>	<b>\$ 4,891</b>	<b>\$ 5,942</b>

Source: General Ledger

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**The amount receivable from China has been fully reserved**

**Turbine and Construction**

The chart to the bottom right provides a breakout of turbine, construction and other receivables.

**Turbine sales**

Montfort and Trent Mesa amounts are receivables generated through third party turbine sales through April 2001. Amounts owed by Delaware Mountain (\$1,552 for turbines and \$53.6 of the construction total) were created in 1999. Management is currently negotiating a potential settlement with Delaware Mountain for a total of \$1,700. Amounts due from China relate to the sale of turbines in 1998 for which China has made no payments. See the allowance for doubtful accounts page for a discussion of reserves established for these items.

**Third Party Reserve**

The reserve at December 31, 1999, 2000 and April 30, 2001 is primarily attributable to the \$1,432 reserved for amounts due from China.

**Accounts Receivable - Third Party**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Turbine and construction	\$ 10,441	\$ 7,663	\$ 16,842
Electricity	1,411	1,661	3,300
Interest receivable	24	22	22
BRPU	3,300	-	-
Devo	138	138	(7)
Receivables - reserve	(1,602)	(1,432)	(1,560)
<b>Third party receivables</b>	<b>\$ 13,712</b>	<b>\$ 8,052</b>	<b>\$ 18,597</b>

Source: General ledger

**Turbine and Construction Receivable**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Turbine sales:			
Montfort	\$ -	\$ -	\$ 8,312
Trent Mesa	-	-	3,575
Delaware Mountain	1,552	1,552	1,552
China	1,432	1,432	1,432
Nebraska	379	230	230
Bell Niye Receivable	350	-	-
Other	977	256	244
Sales	4,690	3,470	15,345
Construction	667	578	536
NRGL	2,852	2,805	414
BRPU	-	275	-
Pan Airo	1,700	-	-
Other	532	535	547
<b>Total Receivable</b>	<b>\$ 10,441</b>	<b>\$ 7,663</b>	<b>\$ 16,842</b>

Source: General ledger

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**The Americas has gross receivables outstanding from SCE of \$7,386; to date, only \$4,086 has been reserved despite SCE's precarious financial position**

**Electricity**

Management indicated the increase in electricity receivables at April 30, 2001 is attributable to SCE's inability to pay energy suppliers from November 2000 through March 2001 as a result of the California energy crisis. At April 30, 2001, the Americas had a gross receivable due from SCE of approximately \$7,386 which has been offset by a debit recorded directly to sales of \$4,086. \$3,060 of the gross accounts receivable are in excess of 60 days past due at April 30, 2001.

In May 2001, the Americas filed suit against SCE for breach of contract. In June 2001, a settlement agreement between SCE and the electricity suppliers (including the Americas) provided for the repayment of outstanding amounts, new pricing for the next five years and the dismissal of any outstanding legal disputes. The significant terms of the agreement are as follows:

A payment of 10% of the outstanding balance would be paid upon the execution of the agreement. Further, an additional 10% payment would be received when SCE is restored to creditworthiness. The electricity suppliers will receive 7% annual interest on the remaining outstanding principle. The payment of the remaining 80% outstanding would occur five days after SCE receives financing that arises from the Memorandum of Understanding ("MOU") with the California Department of Water Resources. The MOU provides for the State of California to purchase transmission facilities from SCE.

According to management, the major risk surrounding the settlement is the California legislature will not approve the agreement or the agreement will provide the necessary relief to SCE, which may cause SCE to declare bankruptcy. Assuming the first two payments are received on the gross outstanding balance, a net asset adjustment of \$1,700 has been proposed to account for the remaining outstanding receivables that have not been written-off. See the table to the bottom right for a calculation of this net asset adjustment. As a result of the non-recurring nature of SCE's failure, no adjustment to quality of earnings has been proposed.

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Turbine and consumption	\$ 10,441	\$ 7,663	\$ 16,842
Electricity	1,411	1,661	3,300
Interest receivable	24	22	22
BRPU	3,300	-	-
Devo	138	138	(7)
Receivables - reserve	(1,602)	(1,432)	(1,560)
<b>Third party receivables</b>	<b>\$ 13,712</b>	<b>\$ 8,052</b>	<b>\$ 18,597</b>

Source: General Ledger

**Net Asset Adjustment**

Gross receivable	4/30/2001
	\$ 7,129
Less: amount written-off	
At risk amount	4,069
	3,060
Initial 10% payment	713
Second 10% payment	642
Rounding	5
<b>Net asset adjustment</b>	<b>\$ 1,700</b>

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### A significant portion of the amounts greater than 90 days past due relate to pre 1999 activity

The schedule to the right presents the accounts receivable in excess of 90 days past due at April 30, 2001. Following is a brief discussion of the balances greater than \$250.

**Related Party**

Deferred 1998 maintenance - LB I

As previously discussed, this receivable is from GE Capital. Management indicated collection of this amount is doubtful.

Storm Lake II Lightning Insurance Claim

Management indicated this amount represents the remaining receivable from insurance carriers attributable to a lightning strike on the Storm Lake II property in 1999. Management stated the remaining payment has yet to be made as a result of the two insurance companies determining who actually owes the Americas the money. As this amount relates to 1999, collection appears to be in question.

2000 Lightning Insurance Claim

Management indicated the amount represents estimated insurance refund attributable to lightning strikes that occurred in 2000.

**Third Party**

Electricity (EES, CAB, VGRPR, ZWHC)

The total of these past due accounts (\$2,295) represents amounts due from SCE related to electricity sales. As previously discussed, SCE did not pay for electricity from November 2000 through March 2001 which caused the projects not to be able to pay the Americas for services provided.

Accounts receivable > 90 days

Related Party	4/30/01
Deferred 1998 maintenance-LB I	\$ 771
799 Lightning insurance claim-SL II	685
2000 Lightning insurance claim	400
Management fees-SL I	233
Essement-LB I	225
Interest accrual-SL II	210
Retention-SL II	188
Retention-SL I	169
Management fees-SL II	154
Maintenance-KSC	126
Maintenance-BSB	110
Other	331
<b>Third Party</b>	
Delaware Mountain retention	1,552
China turbine sales	1,432
CAB - electricity	1,033
ZWHC - electricity	861
Delaware Mountain retention	542
VGRPR - electricity	268
NPPD turbine sales	230
GMP turbine sales-pre 1998	143
Enron Energy Services - electricity	133
Other	279
<b>Total &gt; 90 days</b>	<b>10,066</b>
Specific reserve - China	(1,432)
<b>Over 90 day balance - aging</b>	<b>\$ 8,634</b>

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**The China turbine sales are fully reserved for as of April 30, 2001**

**China Turbine Sales** - Receivable represents amounts due from three Chinese provinces, each of which purchased ten turbines (30 total) in 1996. Management indicated the Chinese have disputed the cause of the turbines' under performance and have refused to pay the remaining balance. As shown, the amount has been fully reserved.

**Delaware Mountain** - As previously stated, management indicated Delaware Mountain has offered \$1,700 in full settlement of the total \$2,000 receivable outstanding as of April 30, 2001. The Americas has a general project construction reserve of \$130 related to this project.

Accounts receivable > 90 days

(\$ in thousands)	4/30/01
<b>Related Party</b>	\$
Deferred 1998 maintenance-LB I	771
7999 Lightning insurance claim- SL II	685
2000 Lightning insurance claim	400
Management fees- SL I	233
Basement-LB I	225
Interest accrual- SL II	210
Retention- SL II	188
Retention- SL I	169
Management fees- SL II	154
Maintenance- SSC	126
Maintenance- 83B	110
Other	331
<b>Third Party</b>	
Delaware Mountain retention	1,532
China turbine sales	1,432
CAB- electricity	1,033
ZWHC- electricity	861
Delaware Mountain retention	542
VGBPR- electricity	268
NPPD turbine sales	230
GMP turbine sales-pre 1998	143
Enron Energy Services - electricity	133
Other	270
<b>Total &gt; 90 days</b>	<b>10,066</b>
Specific reserve - China	(1,432)
<b>Over-90 day balance - aging</b>	<b>\$ 8,634</b>

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**A quality earnings adjustment of \$350 should be recorded for the year ended December 31, 2000 attributable to insurance claim receivable**

As part of the closing of the transaction, indemnification concerning the collectibility of accounts receivable should be considered.

A quality of earnings adjustment has been proposed to reduce earnings by \$350 for the year ended December 31, 2000 attributable to the lightning insurance claim receivable. The Americas recorded a receivable of \$3,300 in 2000 related to lightning insurance settlement. As previously stated, the Americas has yet to receive \$685. The adjustment assumes the Americas will only receive 50% of the amount outstanding.

Through our discussions with management, the collectibility of certain receivables was determined to be questionable. Although management believes the reserve to be adequate, past failure to collect long outstanding amounts as well as prudence would indicate an increase in reserves to be necessary. The table to the bottom right details the accounts considered to be uncollectible as well as the proposed increase to the reserves.

Of the proposed net asset adjustment, we have included \$350 in the quality of earnings analysis for 2000 as the receivable was recorded in 2000. All other questionable receivables were created before 1999 and therefore did not impact the analysis.

**Allowance for Doubtful Accounts**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Related parties	\$ 54	\$ 1,054	\$ 659
Third party reserve	1,602	1,432	1,560
Accounts receivable reserve	1,656	2,486	2,219
	1999	2000	4M 2001
Bad debt expense	\$ 1,434	\$ 1,180	\$ -

Source: General Ledger

**Proposed Net Asset Adjustment**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
China	\$ 1,432	\$ 1,432	\$ 1,432
Deferred maintenance - LBI	771	771	771
Lightning insurance claim	-	392	343
Delaware Mountain	264	264	264
Other	281	281	143
Proposed reserve	2,748	3,140	2,953
Actual reserve	1,656	2,486	2,219
Decrease in net assets	\$ 1,092	\$ 654	\$ 734

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**\$7,600 of the net investment in notes receivables at April 30, 2001 relates to Projects 85 A, B & C**

**General**

As described in the income statement section of this report, the Americas sold wind projects in the past for a combination of cash and notes receivable. The Americas has applied the installment method to recognize revenues and costs related to these notes receivable. Cash collections of the Americas allocates to principal result in recognition of income until such time that the deferred income has been fully recognized.

For valuation purposes, the Americas follows Financial Accounting Standard No. 114, *Accounting by Creditors for Impairment of a Loan* ("FAS 114"), which requires impaired loans be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, at the loans' observable market price or at the fair value of the collateral if the loan is collateral dependent.

The Americas tests the value of its notes by comparing the net value of notes receivable with the net present value of estimated future cash flows from the underlying project. The following describes the short and long term notes receivable balances at the Americas at December 31, 1999, 2000 and April 30, 2001.

**Project 85 A, B & C**

In 1985, the Americas sold three wind systems to three California limited partnerships (the "Partnerships") for a total of \$99,200, comprising \$49,100 in cash and \$50,100 in the form of sixteen-year notes receivable (the "Purchase Notes") which are non recourse to the limited partners. The Purchase Notes are being repaid from the sale of electricity generated by the Partnerships and are secured by the assets of the wind power projects. The power generated by the wind system is sold to SCE.

Since the early 1990's, the Partnerships have not made their full scheduled payments under the Purchase Notes and Agreements and management expects the Partnerships will continue to be unable to meet their full obligations.

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**Purchase Notes Receivables**

	12/31/1999	12/31/2000	04/30/2001
(\$ in thousands)			
<b>Projects 85 A,B &amp; C</b>			
ST notes receivable	\$ 1,374	\$ 1,403	\$ 1,403
85 A,B & C	165	130	130
ZSI officers and investors	\$ 1,539	\$ 1,533	\$ 1,533
<b>LT notes receivable</b>			
85 A,B & C	\$ 18,600	\$ 15,764	\$ 15,764
Interest receivable on 85 A,B & C notes	3,406	3,406	3,406
Reserve for 85 A,B & C	(2,793)	(2,793)	(2,793)
Lake Benton I	1,500	1,500	1,500
Storm Lake II	1,750	1,750	1,750
Other notes receivables	89	89	81
Deferred income - 85 A,B & C	(8,399)	(7,161)	(7,161)
Lake Benton I	(1,300)	(1,500)	(1,500)
Storm Lake II	(1,750)	(1,750)	(1,750)
Other deferred income (note 1)	(15)	-	-
Unreconciled difference	57	-	-
<b>Total</b>	<b>\$ 10,944</b>	<b>\$ 9,304</b>	<b>\$ 9,297</b>

Source: Tony Schoen

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**\$7,600 of the net investment in notes receivables at April 30, 2001 relates to Projects 85 A, B & C**

**Project 85 A, B & C, continued**

At December 31, 1995, since the net investment in the Purchase Notes receivable was greater than the net present value of estimated future cash flows, the Americas recorded a valuation allowance with a corresponding charge to bad debt expense of approximately \$5,000. The Americas also stopped accruing interest on the Purchase Notes beginning January 1, 1995.

According to Mr. Schoen, once the Americas stopped accruing for interest on the Purchase Notes, the value of the investment decreased relative to the present value of future cash flows and therefore, \$2,200 of the original reserve was released to income in 1998.

The cash flow projection used for the FAS 114 calculation in 2001 included a residual value of \$7,500 for the wind systems. This residual value was calculated, according to Mr. Schoen, using the present value of the cash flows for the project after the Partnerships terminate in 2005, up to the end of the underlying power purchase agreement in 2015. The present value of the future cash flows up to 2005 (including the residual value of the wind systems) exceeded the net value of the notes, (including the note interest receivable of \$3,406) net of the reserve of \$2,800.

At the end of the Partnerships, the assets of the Partnerships will be sold to the highest bidder. The Americas' notes are secured by the assets of the Partnerships. Therefore, management believes at the end of the Partnerships, the Americas will either buy out the wind farms for the amount owed to them (and run the farm for the remaining life of the power purchase agreement (15 years) or the higher bidder will pay the Americas for the amount owed and take over the assets of the Partnerships.

Based on the information provided by management, no additional reserve for the notes would be required as of April 30, 2001.

**Purchase Notes Receivables**

	12/31/1999	12/31/2000	04/30/2001
(\$ in thousands)			
Projects 85 A, B & C	\$ 1,374	\$ 1,403	\$ 1,403
ST notes receivable	165	130	130
85 A, B & C	\$ 1,539	\$ 1,533	\$ 1,533
ZSI officers and investors			
LT notes receivable			
85 A, B & C	\$ 18,660	\$ 15,764	\$ 15,764
Interest receivable on 85 A, B & C notes	3,406	3,406	3,406
Reserve for 85 A, B & C	(2,793)	(2,793)	(2,793)
Lake Benton I	1,500	1,500	1,500
Storm Lake II	1,750	1,750	1,750
Other notes receivables	89	89	81
Deferred income - 85 A, B & C	(8,399)	(7,161)	(7,161)
Lake Benton I	(1,500)	(1,500)	(1,500)
Storm Lake II	(1,750)	(1,750)	(1,750)
Other deferred income (note 1)	(15)	-	-
Unreconciled difference	57	-	-
<b>Total</b>	<b>\$ 10,944</b>	<b>\$ 9,304</b>	<b>\$ 9,297</b>

Source: Tony Schoen

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**Sale proceeds for Lake Benton I and Storm Lake II included notes receivables that do not have a pre determined payment schedule**

**Lake Benton I & Storm Lake II**

There have been no payments of principal relating to these notes, in the period under review. According to Mr. Schoen, there is no payment schedule for these notes. However, the Americas has received a payment for interest relating to these notes, which has been recorded as revenue in 2000. The carrying value of these notes is offset by the deferred revenue liability recognized.

	12/31/1999	12/31/2000	04/30/2001
<b>Purchase Notes Receivables</b>			
(\$ in thousands)			
Projects 85 A, B & C	\$ 1,374	\$ 1,403	\$ 1,403
ST notes receivable	165	130	130
85 A, B & C	\$ 1,539	\$ 1,533	\$ 1,533
ZSI officers and investors			
<b>LT notes receivable</b>			
85 A, B & C	\$ 18,600	\$ 15,764	\$ 15,764
Interest receivable on 85 A, B & C notes	3,406	3,406	3,406
Reserve for 85 A, B & C	(2,793)	(2,793)	(2,793)
Lake Benton I	1,500	1,500	1,500
Storm Lake II	1,750	1,750	1,750
Other notes receivables	89	89	81
Deferred income - 85 A, B & C	(8,399)	(7,161)	(7,161)
Lake Benton I	(1,500)	(1,500)	(1,500)
Storm Lake II	(1,750)	(1,750)	(1,750)
Other deferred income (note 1)	(15)	-	-
Unreconciled difference	57	-	-
<b>Total</b>	<b>\$ 10,944</b>	<b>\$ 9,304</b>	<b>\$ 9,297</b>

Source: Tony Schoen

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### The significant increase in inventory at April 30, 2001 is primarily attributable to hub-sourcing problems

The table to the right details the components of inventory for the periods presented. The following presents an overview of the various components based on the information made available to us. Management was unable to provide sub-ledgers or other documentation for these balances. For a company of this size and balances of this magnitude, this lack of support is considered highly unusual. Accordingly, we were unable to perform many standard diligence procedures on these balances.

#### Raw Materials, Work in Progress ("WIP") and Finished Goods

According to management, raw materials inventory is valued at standard purchase price while WIP and finished goods inventory includes material, labor and overhead costs at standard. (As discussed in more detail below, the reserve account is also used to account for purchase price variances.) Classifications between raw materials, WIP and finished goods in the production facility are made by Mr. Rugh, inventory manager, based on the stage of production at the balance sheet date. According to management, inventory is maintained on a first-in, first-out basis. Full physical inventories are taken in November of each year, with quarterly cycle counts performed. Both Mr. Schoep and Mr. Rugh indicated there have not been any significant inventory adjustments as a result of these counts.

According to management, the significant increase in the value of inventory from December 31, 1999 to December 31, 2000 was related to the PTC which expired in June 1999. Management noted the Americas made a sales push through June 1999 to clear out most of the Americas' inventory. Production did not resume until October 2000, after both the PTC was reinstated and the manufacturing facility was retooled for production of the new EW 1.5 MW turbine. (Although there was no production at the end of 1999, there was \$2,275 of inventory in WIP. According to management, this inventory consisted primarily of nine Z \$50 models at the Tehachapi location, which were being reworked; no supporting detail was provided for this amount.)

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#### Inventory Summary

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Raw materials	\$ 16,609	\$ 24,161	\$ 29,049
WIP	796	3,114	(8)
Finished goods	2,275	14,601	13,071
In transit	-	-	16,956
Service	-	101	30,360
Spare parts	1,764	15,300	15,533
Less: reserve	(200)	(797)	(3,899)
<b>Total inventories</b>	<b>\$ 21,244</b>	<b>\$ 56,480</b>	<b>\$ 101,178</b>

#### Inventory Turnover

(\$ in thousands)	1999	2000	4Q2001
Cost of sales	\$ 281,582	\$ 141,024	\$ 28,658
Average total inventory	24,233	38,862	78,829
<b>Inventory turns</b>	<b>11.6</b>	<b>3.6</b>	<b>1.1</b>

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**A significant portion of the materials required for the EW 1.5 MW turbine are sourced from Germany.**

**Raw Materials, WIP and Finished Goods, continued**

From December 31, 2000 through April 30, 2001, inventory also increased significantly. Management represented this increase was the result of increased production of the EW 1.5 MW as well as sub-sourcing problems. At April 30, 2001, as a result of not receiving hubs, completed turbines are being held in finished goods inventory unavailable for installation.

**Construction in Progress ("CIP")**

According to management, CIP inventory represents construction site inventory items related to turbine installations, which have not been invoiced to the customer. Management indicated there was no amount in CIP at April 30, 2001 as all on-site inventory was invoiced to customers.

**In Transit**

A significant portion of critical components for turbine manufacture are sourced by the central procurement department in Germany. All such goods are first shipped to the German facility (and invoiced to them); once they are received in Germany, they are shipped to the Americas. In transit items are those en route from the German facility; the value is stated at standard. Historically the Americas only recorded inventory receipts (by debiting inventory and crediting intercompany payables when goods were received). Management indicated a monthly consolidation reconciliation was performed in Houston to ensure in transit shipments were recorded in Europe's inventory balance. However, beginning in 2001, a mechanism has been created which creates a report determining the amount in transit. The amount in transit was recorded on the Americas' accounts at April 30, 2001. It is unclear as to why the Americas receives inventory in this manner, rather than having the materials drop shipped to the US.

See the operational due diligence section of this report for discussion concerning the sourcing of raw materials.

**Inventory Summary**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Raw materials	\$ 16,609	\$ 24,161	\$ 29,049
CIP	796	3,114	(8)
WIP	2,275	14,601	13,071
In transit	-	-	16,956
Finished goods	-	-	30,360
Service	-	101	116
Spare parts	1,764	15,300	15,533
Less: reserve	(200)	(797)	(3,899)
<b>Total inventories</b>	<b>\$ 21,244</b>	<b>\$ 56,480</b>	<b>\$ 101,178</b>

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**Approximately \$3,000 of spare parts inventory is considered obsolete**

**Inventory Reserve Analysis**

The table to the right details the movement in the reserve for service and spare parts (excluding purchase price variances) during the periods under review.

Management stated the Americas records an estimate for inventory reserves based on historical write-offs and the specific identification of obsolete or unusable inventory. However, management was unable to produce documentation related to this identification of parts, indicating only that amounts were obtained through discussions with warehousing personnel.

Due to the production shift from the Z750 to the EW 1.5 MW, a portion of the existing Z750 spare parts inventory has been rendered obsolete. Management indicated the \$1,380 provision added in 2000 was to address this issue. However, Mr. Holt, field maintenance, indicated while all Z750 spare parts inventory is considered useable, approximately \$3,000 will likely not be used over the next 20 to 30 years (the life of the Z750).

Based on these estimates, an adjustment to increase the spare parts reserve by \$3,000 at April 30, 2001 has been proposed. Because most of this inventory was acquired prior to 1999 (verbal representation of Mr. Rugh and Mr. Holt), a quality of earnings adjustment related to this issue has not been proposed. Should LJM proceed with this transaction, we recommend a complete physical inventory and net realizable value analysis be performed.

**Inventory Reserve Roll-Forward**

(\$ in thousands)	1999	2000	2001
Beginning reserve balance	\$ 640	\$ 200	\$ 797
Provisions	-	1,380	-
Decreases	(440)	(783)	-
Ending reserve balance	\$ 200	\$ 797	\$ 797
Total gross inventory	\$ 21,444	\$ 57,277	\$ 101,975
Reserve / total inventory	0.9%	1.4%	0.8%

Source: General Ledger and Schedule provided by Mr. Schoen

**Beginning in July 2001, the Americas will record a monthly estimate in order to bring the inventory reserve to 3% of the gross inventory balance**

**Inventory Reserve Analysis, continued**

Additionally, management estimates the Americas will be unable to utilize approximately 60% of the \$800 lattice steel currently in raw materials inventory. To date, none of this amount has been reserved. A net asset adjustment of \$300 (\$860\*60%) has been proposed. Again, due to management's representation that this steel was purchased prior to 1999, a quality of earnings adjustment was not proposed.

Management indicated beginning in July 2001, the Americas will record a monthly estimate in order to bring the inventory reserve to 3% of the gross inventory balance. If this methodology had been in place during the year ended December 31, 1999, 2000 and the four months ended April 30, 2001, the following adjustments would be required:

(\$ in thousands)	12/31/1999	12/31/2000	04/30/2001
Average gross inventory	\$ 26,464	\$ 39,361	\$ 79,626
Less: gross value of Z 750 spare parts and steel separately reserved	16,160	16,160	16,393
	10,304	23,201	63,233
Reserve %	3%	3%	3%
Calculated reserve	309	696	1,897
Current reserve	(200)	(797)	(797)
Adjustment proposed	\$ 109	\$ (101)	\$ (1,100)
Adjustment rounded	\$ 110	\$ (100)	\$ (1,100)

A quality of earnings adjustment for the amounts above has been proposed. The related net asset adjustments are shown in the table to the right.

**Proposed Net Asset Adjustment**

(\$ in thousands)	12/31/1999	12/31/2000	04/30/2001
3% reserve	\$ 309	\$ 696	\$ 1,897
Z 750 spare parts	3,000	3,000	3,000
Steel	516	516	516
Proposed reserve balance	3,825	4,212	5,413
Actual reserve recorded	(200)	(797)	(797)
Net asset adjustment	\$ 3,625	\$ 3,415	\$ 4,616

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**The increase in other deposits is attributable to additional deposits with two turbine blade manufacturers**

**Property taxes**

Personal property taxes due to the county for wind turbines are paid once a year in August for the full year from July 1 to June 30 for all projects owned by the Americas. These property taxes owed by the Americas decreased from \$357 at December 31, 1999 to \$77 at December 31, 2000 and \$28 at April 30, 2001. Management indicated the Americas had \$293 of prepaid taxes at December 31, 1999 related to Calhoun which accounts for the difference between periods.

The difference in the balance from December 31, 1999 to December 31, 2000 is the result of \$611 paid during 2000 on the Lake Benton 1 project. Mr. Schoen indicated when Lake Benton 1 was sold in 1998, the Americas provided GE Capital with an indemnification that property taxes would be paid by the utility purchasing the electricity from Lake Benton 1. The utility disputed they are required to pay the personal property taxes claiming the taxes should have been included in the management fee. Management indicated the Americas recorded a \$2,000 reserve in project reserve in 2000 attributable to this property tax dispute. The difference between the \$2,000 reserve and the \$611 paid during 2000 was recorded as "cushion" for potential future property taxes due on Lake Benton 1. An adjustment to increase net assets by \$1,390 to eliminate the excess reserve has been proposed.

**Prepaid Expenses**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Other deposits	\$ 1,229	\$ 1,415	\$ 2,067
Deferred insurance	111	1,074	1,939
Property taxes	357	688	639
<b>Total prepaids</b>	<b>\$ 1,697</b>	<b>\$ 3,177</b>	<b>\$ 4,645</b>

Source: General ledger

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**Management did not provide detailed information on deferred insurance**

**Other Deposits**

According to management, other deposits include amounts required by certain vendors as well as amounts related to certain projects. The chart to the bottom right provides a breakdown of these "other" amounts.

As shown, the increase in deposits at April 30, 2001 compared to December 31, 2000 is attributable to additional deposits for fiberglass which is used to make the turbine blades of both the EW 750 and the EW 1.5 MW. Since the manufacturing of turbine blades is a capital intensive process, the Americas' vendors require deposits to cover a portion of the vendors material purchase costs; these deposits are then used as credits towards payables. Management indicated the amounts deposited were based on an informal agreement with the vendors. No further detail of these deposits was available for our review.

Management indicated "other deposits" is primarily attributable to land bonds required to be deposited with the Bureau of Land Management when land is leased. No supporting documentation was provided.

**Deferred Insurance**

Deferred insurance includes amounts prepaid for property and liability insurance. Management could not explain why prepaid insurance increased so dramatically from December 31, 1999 to April 30, 2001. We requested but were not provided with a listing of deferred insurance. Should LJM proceed with the transaction, we recommend further procedures be performed on this account balance. Refer to the risk management section of this report for further discussion on insurance.

**Prepaid Expenses**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Other deposits	\$ 1,229	\$ 1,415	\$ 2,067
Deferred insurance	111	1,074	1,939
Property taxes	357	688	639
<b>Total prepaids</b>	<b>\$ 1,697</b>	<b>\$ 3,177</b>	<b>\$ 4,645</b>

Source: General ledger

**Other Deposits**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Saertex	\$ -	\$ 588	\$ 1,108
Jeffco	-	469	577
Other	307	358	382
Lake Benton I	426	-	-
Lake Benton II	496	-	-
<b>Total deposits</b>	<b>\$ 1,229</b>	<b>\$ 1,415</b>	<b>\$ 2,067</b>

Source: Schedule provided by Mr. Schoen

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**The increase in other deposits is attributable to additional deposits with two turbine blade manufacturers**

**Property taxes**

Personal property taxes due to the county for wind turbines are paid once a year in August for the full year from July 1 to June 30 for all projects owned by the Americas. These property taxes owed by the Americas decreased from \$357 at December 31, 1999 to \$77 at December 31, 2000 and \$28 at April 30, 2001. Management indicated the Americas had \$293 of prepaid taxes at December 31, 1999 related to Colabzon which accounts for the difference between periods.

The difference in the balance from December 31, 1999 to December 31, 2000 is the result of \$611 paid during 2000 on the Lake Benton 1 project. Mr. Schoen indicated when Lake Benton 1 was sold in 1998, the Americas provided GE Capital with an indemnification that property taxes would be paid by the utility purchasing the electricity from Lake Benton 1. The utility disputed they are required to pay the personal property taxes claiming the taxes should have been included in the management fee. Management indicated the Americas recorded a \$2,000 reserve in project reserve in 2000 attributable to this property tax dispute. The difference between the \$2,000 reserve and the \$611 paid during 2000 was recorded as "cushion" for potential future property taxes due on Lake Benton 1. An adjustment to increase net assets by \$1,390 to eliminate the excess reserve has been proposed.

**Prepaid Expenses**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Other deposits	\$ 1,229	\$ 1,415	\$ 2,067
Deferred insurance	111	1,074	1,939
Property taxes	357	688	639
<b>Total prepaids</b>	<b>\$ 1,697</b>	<b>\$ 3,177</b>	<b>\$ 4,645</b>

Source: General Ledger

**Management indicated the Americas' information system does not maintain historical fixed asset information**

The table to the right details the components of fixed assets for the periods presented. The following presents a brief analysis of the amounts included based on the information made available by management.

Management indicated the Americas' information system does not maintain historical fixed asset information. Rather, fixed asset information can only be obtained as of the current date. Management provided historical fixed asset additions and deletions, which were maintained on excel spreadsheets. Management also indicated depreciation information is maintained by individual operating entities and not on an individual asset class basis.

As previously stated, management was unable to provide sub-ledgers detailing the composition of any balances shown above. For a company of this size and fixed assets of this magnitude, this lack of support is considered highly unusual. Accordingly, we were unable to perform many standard diligence procedures on these balances.

**General**

Management noted it is the Americas policy to capitalize all fixed assets with cost in excess of \$1,000 (actual) and an estimated useful life in excess of one year. Management indicated the Americas takes a half month depreciation the month an asset is placed into service. The useful lives of fixed assets are as follows:

Fixed Asset Type	Useful Life
Data processing equipment	3
Automobiles	5
Wind energy systems	5
Substation (included in other)	5
Furniture & fixtures	7
Machinery & equipment	7
Tooling	7
Aircraft	10
Buildings	15
Leasehold improvements	20

**Net Fixed Assets**

	12/31/1999	12/31/2000	4/30/2001
Cabazon	\$ -	\$ -	\$ 38,882
Wind energy systems	110,624	110,597	51,804
Tooling	13,109	17,017	18,060
Land and buildings	8,926	9,530	9,560
Automobiles & aircrafts	9,231	8,780	9,406
Data processing equipment	4,989	5,959	6,431
CIP	107,051	-	5,654
Machinery	3,661	5,122	5,257
Other	3,421	3,426	3,426
Furniture & fixtures	1,096	1,288	1,281
<b>Total PP&amp;E, gross</b>	<b>262,708</b>	<b>161,719</b>	<b>170,161</b>
<b>Accumulated Depreciation</b>			
ZSI	24,035	26,005	27,073
ZWHC	13,726	14,846	15,192
ZES	12,411	13,716	13,984
Cabazon	-	-	4,498
Other	2,191	5,143	1,548
<b>Total accumulated depreciation</b>	<b>52,363</b>	<b>59,710</b>	<b>62,295</b>
<b>Total PP&amp;E, net</b>	<b>\$ 209,745</b>	<b>\$ 102,009</b>	<b>\$ 107,866</b>

Source: General ledger

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**A detailed listing of the fixed assets included in the individual wind energy system projects was not provided**

Cabazon and Wind Energy System

The Cabazon and wind energy system balances are comprised of the following:

	12/31/1999	12/31/00	4/30/01
Cabazon	\$ 18,526	\$ -	\$ 38,882
Green power	8,976	10,176	22,837
ZWHC	9,826	9,826	9,826
Energy transfer system	72,896	90,595	8,965
Other wind energy system	110,624	110,597	110,686

Management indicated the fluctuation in the individual captions above is attributable to changes in classification in the general ledger during the periods presented. We were not provided with a detailed listing of the fixed assets included in the individual accounts. The potential exists there are items capitalized that should have been expensed.

**Net Fixed Assets**

	12/31/1999	12/31/2000	4/30/2001
Cabazon	\$ 110,624	\$ 110,597	\$ 58,882
Wind energy systems	13,009	17,017	51,804
Tooling	8,926	9,530	18,060
Land and buildings	9,231	8,780	9,960
Automobiles & aircrafts	4,989	5,959	9,406
Data processing equipment	107,051	-	6,431
CLP	3,661	5,122	5,654
Machinery	3,421	3,426	5,257
Other	1,096	1,288	3,426
Furniture & fixtures	262,108	161,719	1,281
Total PP&E, gross			170,161
Accumulated Depreciation			
ZSI	24,035	26,005	27,073
ZWHC	13,726	14,846	15,192
ZES	12,411	13,716	13,984
Cabazon	-	-	4,498
Other	2,191	5,143	1,548
Total accumulated depreciation	52,363	59,710	62,295
Total PP&E, net	\$ 209,745	\$ 102,009	\$ 107,866

Source: General Ledger

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**Management was unable to provide the net book value of the tooling assets for the Z550 and Z750 turbines**

Tooling

Tooling includes molds and other specific tool and equipment required for the production of turbines and blades. The increase in tooling since 1999 is the result of the new equipment required for the EW 1.5 MW.

Management was unable to provide the depreciated value of tooling associated with the Z550 and Z750. Accordingly, a net asset adjustment to write-off the tooling assets has not been proposed. In the future, the Americas should consider using a shorter useful life for model-specific tooling.

Should LJM progress with this transaction, the net book value of the Z550 and Z750 tooling assets should be estimated and excluded from the net assets of the Americas.

**Net Fixed Assets**

	12/31/1999	12/31/2000	4/30/2001
(\$ in thousands)			
Cabazon	\$ -	\$ -	\$ 58,882
Wind energy systems	110,624	110,597	51,804
Tooling	13,109	17,017	18,060
Land and buildings	8,926	9,530	9,960
Automobiles & aircrafts	9,231	8,780	9,406
Data processing equipment	4,989	5,959	6,431
CIP	107,051	-	5,654
Machinery	3,661	5,122	5,257
Other	3,421	3,426	3,426
Furniture & fixtures	1,096	1,288	1,281
Total PP&E, gross	262,108	161,719	170,161
Accumulated Depreciation			
ZSI	24,035	26,005	27,073
ZWHC	13,726	14,846	15,192
ZES	12,411	13,716	13,984
Cabazon	-	-	4,498
Other	2,191	5,143	1,548
Total accumulated depreciation	52,363	59,710	62,295
Total PP&E, net	\$ 209,745	\$ 102,009	\$ 107,866

Source: General ledger

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**The decrease in net fixed assets at December 31, 2000 is attributable to the sale of Lake Benton II**

Automobiles and aircraft

This account includes all automobiles and trucks utilized by the Americas as well as aircraft. One of the two aircraft owned by the Americas was sold at cost (\$998) to its former president during 2000.

Construction in process

The Americas had \$107,051 in fixed assets capitalized at December 31, 1999 attributable to Lake Benton II which was sold for a gain of \$16,643 in 2000. We were not provided with a detailed listing of the fixed assets included in Lake Benton II. The potential exists there were items capitalized in fixed assets which should have been expensed.

Construction in process at April 30, 2001 represents costs in connection with the building of the India Mesa project. Management provided a summary of costs at April 30, 2001 but was unable to provide a detailed listing of the costs capitalized related to this project.

Machinery

Machinery includes all machines and equipment utilized by the Americas in its manufacturing facility and field operations. A crane was purchased during 2000 (\$1,031) accounting for the majority of the increase.

**Net Fixed Assets**

	12/31/1999	12/31/2000	4/30/2001
(\$ in thousands)			
Cabazon	\$ -	\$ -	\$ 58,882
Wind energy systems	110,624	110,597	51,804
Tooling	13,109	17,017	18,060
Land and buildings	8,926	9,530	9,960
Automobiles & aircrafts	9,231	8,780	9,406
Data processing equipment	4,989	5,959	6,431
CIP	107,051	-	5,654
Machinery	3,661	5,122	5,257
Other	3,421	3,426	3,426
Furniture & fixtures	1,096	1,288	1,281
Total PP&E, gross	262,108	161,719	170,161
<b>Accumulated Depreciation</b>			
ZSI	24,035	26,005	27,073
ZWHC	13,726	14,846	15,192
ZES	12,411	13,716	13,984
Cabazon	-	-	4,498
Other	2,191	5,143	1,548
Total accumulated depreciation	52,363	59,710	62,295
<b>Total PP&amp;E, net</b>	<b>\$ 209,745</b>	<b>\$ 102,009</b>	<b>\$ 107,866</b>

Source: General Ledger

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**Fair market value information of wind resource acreage is unknown**

Management indicated wind resource acreage represents land owned by the Americas which may or may not have projects developed on the land currently. The table to the bottom right provides a summary of wind acreage by site and whether the land contains turbines.

Management indicated the reserve was recorded as an audit adjustment in 1986 but was unsure how the reserve was determined or which land was covered by the reserve.

Should LJM progress with this transaction, additional work should be performed to assess the future economic benefit and net realizable value for the land.

Wind Resource Acreage

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Wind resource acreage Reserve	\$ 10,057 (536)	\$ 10,005 (536)	\$ 10,005 (536)
	\$ 9,521	\$ 9,469	\$ 9,469

Source: General Ledger

**Acreage Value By State**

(\$ in thousands)	Land with Turbines	Land Alone	Total Cost 4/30/01
California	\$ 5,809	\$ 4,111	\$ 9,920
Iowa	-	69	69
Oregon	-	16	16
	\$ 5,809	\$ 4,196	\$ 10,005

Source: Schedule proved by Mr. Schoen

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## The Americas exercised an option to repurchase qualified facilities in 2000

### Federal Energy Regulatory Commission

As a result of Enron's acquisition of PGC (a regulated utility), in order to comply with FERC regulations, the Americas was required to divest itself of certain equity investments in qualifying facilities - projects Sky River, Victory Gardens IV and a 50% interest in project 231. These interests were sold to RADAR for \$12,500 (\$500 in cash and a note receivable of \$12,000) in May 1997. The Americas retained a repurchase option (call option) to buy back the equity investment in the qualified assets at a predetermined declining option exercise price. The option was exercisable over the next 23 years. The option price decline each year was based on depreciation of the assets over their useful life. The pricing methods assumed the net book value of the investment equated to the fair market value. The Americas guaranteed that RADAR would receive a minimum return relating to the transaction. Note receivable payments from RADAR to the Americas would be dependent on the cash flows from the qualified assets after deducting a management fee to RADAR.

As the Americas continued to operate both Victory Gardens IV and Sky River, and since the Americas retained an option to buy back the shares sold, this transaction was not treated as a sale, according to SFAS 66.

Prior to the sale of the two projects, there was a step up in the carrying value of the investments, which was pushed through as a purchase accounting adjustment when Enron acquired the Americas. This step up is being amortized over 23 years. (the amortization is charged to the JV income account - see JV income section for adjustment to JV income quality of earnings adjustment for more details).

A note receivable for the \$12,000 and a corresponding strike price reserve for the same amount was created at the time of sale. The \$500 cash payment was offset against the notes receivable balance. The Americas continued to account for its share of the income from Victory Gardens and Sky River as Joint venture income. The management fee charged by RADAR is debited to the JV income account.

According to management, in June 2000, Enron obtained an exemption from complying with the FERC regulations, on the basis that it demonstrated "good faith" to dispose of its interest in PGC. The Americas therefore exercised its option to buy back the shares sold to RADAR, in June 2000.

When projects Cabazon, Green Power and VG Repower came into operation in June 1999, they were also sold under a similar arrangement, and bought back in December 2000.

Summary of accounting entries at:

(i) Time of sale:

Dr	Note receivable	12,500
Cr	Strike price liability	12,500

(ii) When cash is received:

Dr	Cash	500
Cr	Note receivable	500

Dr	Strike price liability	500
Cr	Investment	500

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### The majority of investments on the balance sheet relate to the Mesa, Sky River and Victory Garden IV joint ventures

#### Equity Investments

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
<b>Mesa entities</b>			
MWD	\$ 787	\$ 616	\$ 598
MCC	5,095	3,860	3,977
MCC II	3,224	2,303	2,322
	9,106	6,779	6,897
<b>Sky River &amp; Victory Gardens IV</b>			
Sky River	564	8,628	8,420
VG IV	1,156	1,941	2,132
QF Assets	20,938	19,982	19,774
	22,658	30,551	30,326
<b>Other projects</b>			
Lake Benton	(243)	(319)	(320)
Storm Lake II	252	181	170
Storm Lake	428	355	339
	437	217	189
PHWD	1,421	866	723
<b>Subsidiaries</b>			
Cabazon	(107)	-	-
Other subsidiaries	12,744	12,765	12,789
EWHC BV	-	3,211	3,211
IWECO	-	1,122	2,873
Other	134	153	153
	12,771	17,251	19,026
<b>Total</b>	<b>\$ 46,393</b>	<b>\$ 55,664</b>	<b>\$ 57,161</b>

Source: General Ledger

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The table on the right is a break out of the investments on the Americas balance sheet. The investments have been grouped by projects they relate to, following discussions with Management.

#### Mesa entities

As described in the Joint Venture income section of the report, the Mesa entities' only source of income is note repayments related to the sale of two projects in 1985: Zond PanAero I and Zond Pan Aero II (ZP I and ZP II). Both ZP I and ZP II are in arrears with regards to the note repayments. Management's estimates of future cashflows indicate there is no requirement for an impairment reserve.

#### Sky River & Victory Gardens IV

Management was unable to separate out the investment in Sky River from the investment in Victory Gardens IV, which are both included in the QF assets investment.

As described on the previous page, the Americas repurchased its investment in both Sky River and Victory Gardens I, in 2000. The cost of buying back the shares and the related transaction fees (\$2,300) has been capitalized within the carrying value of the investment in Sky River and Victory Gardens IV.

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**The majority of investments on the balance sheet relate to the Mesa, Sky River and Victory Garden IV joint ventures**

Equity Investments

	12/31/1999	12/31/2000	4/30/2001
(\$ in thousands)			
<b>Mesa entities</b>			
MWD	\$ 787	\$ 616	\$ 598
MCC	5,095	3,860	3,977
MCC II	3,224	2,303	2,322
	9,106	6,779	6,897
<b>Sky River &amp; Victory Gardens IV</b>			
Sky River	564	8,628	8,420
VG IV	1,156	1,941	2,132
OF Assets	20,938	19,982	19,774
	22,658	30,551	30,326
<b>Other projects</b>			
Lake Benton	(243)	(319)	(320)
Storm Lake II	252	181	170
Storm Lake	428	355	319
	437	217	189
PHWD	1,421	866	723
<b>Subsidiaries</b>			
Cabazon	(107)	-	-
Other subsidiaries	12,744	12,765	12,789
EW/HC BV	-	3,211	3,211
IWECO	-	1,122	2,873
Other	134	153	153
	12,771	17,251	19,026
<b>Total</b>	<b>\$ 46,393</b>	<b>\$ 55,664</b>	<b>\$ 57,161</b>

Source : General Ledger

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**Goodwill relates to EREC's acquisition of Zond in January 1997**

The goodwill balance relates to EREC's acquisition of the outstanding common stock, preferred stock, warrants and common stock options of Zond on January 3, 1997 for approximately \$124,500. The fair market value of the assets acquired was approximately \$34,500. Goodwill is amortized on a straight-line basis over 30 years. The original amount of goodwill generated from the purchase was approximately \$87,000. Annual amortization expense related to goodwill is approximately \$3,000.

	Goodwill		
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Goodwill, net	\$ 78,531	\$ 75,613	\$ 74,640
Amortization expense	1999	2000	4N12001
	\$ 2,835	\$ 2,918	\$ 973

Source: General ledger

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**The large decrease in debt issuance costs at December 31, 2000 is attributable to the sale of Lake Benton II in June 2000**

**Patents**

Management indicated the amount capitalized relative to patents includes costs to acquire the patents and any legal costs to defend them. The primary patent the Americas holds is for the Variable Speed Constant Frequency (VCSF) technology. This technology allows the turbines to output a constant frequency even when the turbines are accelerating and decelerating due to changes in wind speed. The VCSF patent is amortized over the life of the patent which is 17 years and has 14 years remaining. Management was unable to provide a listing of patents and the related costs capitalized. Further work would need to be performed to assess the capitalized and carrying value of the patents.

**Debt issue costs**

Management indicated the debt issuance costs are for Cabazon and ZMY related to notes issued by Fortis Bank and Trust Company West, respectively. Management indicated the significant decrease in debt issuance costs from December 31, 1999 to December 31, 2000 was primarily the result of the sale of Lake Benton II and the related write-off of the debt issuance costs. We requested but were not provided a listing of debt issuance costs.

**Leaseholds**

The amount classified as leaseholds relates to a up front payment of \$1,500 paid to Mr. John Rudnick for a 30 year lease of his land, Rudnick Ranch, which is undeveloped land. This up front payment made in 1993 is being amortized into expense over the lease term. In addition, Mr. Rudnick is being paid a \$15 quarterly amount for the use of the Rudnick Ranch.

**Other Deferred Assets**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Patents, net	\$ 2,075	\$ 2,601	\$ 2,538
Debt issue costs, net	3,027	1,391	1,358
Leaseholds, net	1,016	965	951
Goodwill on IWECO purchase	481	453	444
Organization costs, net	155	92	81
<b>Total other deferred assets</b>	<b>\$ 6,754</b>	<b>\$ 5,502</b>	<b>\$ 5,372</b>

**Goodwill on IWECO purchase**

The Americas purchased the Greek Development Co. in 1995, the purchase resulted in goodwill of \$840 which is being amortized 30 years. IWECO represents two wind farms in Greece. Management indicated all the Americas acquisitions are amortized over their estimated useful lives, which the Americas believes is 30 years. Management was unable to explain why this amount is included in other deferred assets instead of goodwill.

**Organization costs**

Organization costs relate to costs incurred in the formation of the Americas' subsidiaries. The organization costs are being amortized over a 5 year period. The amounts should have been expensed when incurred. Due to the insignificant nature of the account balance we have not proposed an adjustment to net assets or quality of earnings.

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**Supporting documentation for the Americas' trade accounts payable balances were unavailable**

According to Mr. Schoen, the Americas does not maintain a sub-ledger for accounts payable. Instead, the balance represents the aggregation of accounts payable from the Americas' various operating companies. Mr. Schoen indicated each of the operating companies with accounts payable balances had roughly 50 vendors; however, he represented no sub-ledgers are maintained for their balances. Mr. Schoen did provide a schedule that indicated who the Americas' top vendors were and how much was outstanding to those vendors at December 31, 2000 and April 30, 2001. As no sub-ledgers are maintained, it is unclear what the source was for these vendor balances; therefore, the amounts should be considered directional only. These balances are discussed on the following page.

Mr. Schoen indicated the operating companies each had accounts payable of a different nature:

- Systems Inc. primarily includes general and administrative items such as payroll, legal and professional services.
- Systems Corp. is the manufacturing arm of the Americas and its accounts payable is largely for inventory.
- Constructors Corp. is the construction division of the Americas whose vendors are principally subcontractors. The balance at April 30, 2001 is primarily comprised of \$2,448 payable to Patrick & Henderson for the Trent Mesa, Montfort and Indian Mesa I projects.

**Accounts Payable**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Systems Inc.	\$ 1,028	\$ 1,232	\$ 912
Systems Corp.	2,302	5,775	3,473
Constructors Corp.	3,540	216	2,572
<b>Total trade A/P</b>	<b>7,070</b>	<b>7,243</b>	<b>6,957</b>
Overdraft	-	4	3,762
<b>Total accounts payable</b>	<b>\$ 7,070</b>	<b>\$ 7,247</b>	<b>\$ 10,719</b>

	1999	2000	4M 2001
Cost of goods sold	\$ 281,387	\$ 141,386	\$ 40,163
Days payable outstanding	9.2	18.7	32.0

Source: General ledger

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**Supporting documentation for the Americas' trade accounts payable balances were unavailable**

While the total accounts payable balance remained stable between December 31, 1999 and December 31, 2000, the component composition changed significantly. Accounts payable for construction decreased due to production (and therefore residual installation and construction) being halted from July 1999 through October 2000. On the other hand, inventory purchase payables which were low at December 31, 1999 due to the production halt increased at December 31, 2000 as production ramped up again. The corresponding increase in constructors payable is evident at April 30, 2001.

As shown, total accounts payable increased from December 31, 2000 to April 30, 2001 as a result of an overdraft. Management indicated the overdraft balance is due to timing and represents negative cash related to invoices paid April 30, 2001.

The increase in days payable outstanding (DPO) from 19 days at December 31, 2000 to 32 days at April 30, 2001 is largely due to the overdraft. When only taking trade accounts payable into consideration, DPO increases from 19 days to 21 days over the same period.

As previously stated, management was unable to provide sub-ledgers detailing the composition of any balances shown above. For a company of this size and payables of this magnitude, this lack of support is considered highly unusual. Accordingly, we were unable to perform many standard diligence procedures on these balances.

Accounts Payable

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Systems Inc.	\$ 1,028	\$ 1,252	\$ 912
Systems Corp.	2,502	5,775	3,473
Constructors Corp.	3,540	216	2,572
Total trade A/P	7,070	7,243	6,957
Overdraft	-	-	3,762
<b>Total accounts payable</b>	<b>\$ 7,070</b>	<b>\$ 7,247</b>	<b>\$ 10,719</b>

1999	2000	4M 2001
\$ 281,382	\$ 141,386	\$ 40,163
Cost of goods sold		
Days payable outstanding	9.2	18.7
		32.0

Source: General Ledger

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### The Americas' top vendors have shifted from professional service providers to manufacturing suppliers

The total to the right details the amounts owed to the Americas' top 10 vendors at December 31, 2000 and April 30, 2001. As noted previously, it is unclear how these balances were obtained and the "top 10" determined as the Americas does not maintain accounts payable sub-ledgers. Therefore, we can make no statements regarding their accuracy or completeness.

As shown, from December 31, 2000 to April 30, 2001, the composition of the top ten has shifted towards manufacturing vendors as opposed to general and administrative service providers. According to Mr. Schoen this is due to an increase in turbine production and a ramping up of inventory over the period. Vendor terms are generally net 30 days, although some vendors do provide 2%/10/net 20 terms. Mr. Schoen stated it is the Americas' policy to take advantage of these discounts when possible.

According to information provided by management, supplier lead times vary by type of items purchased and by vendor location:

- Gearbox approximately 31 weeks, which includes 5 weeks of ocean shipment and customs clearing;
- Converters and generators are approximately 21 weeks;
- Towers 16 weeks; and
- Blade approximate 13-15 weeks.

Management indicated the long lead times are primarily attributable to utilizing international vendors from Germany and Brazil. The Americas is currently assessing verifying several domestic vendors. Refer to the operational due diligence section of this report for further discussion of supplier relationships.

#### Amounts Owed to Top Vendors

(\$ in thousands)	12/31/00	4/30/01	Description
Patrick & Henderson	333	\$ 2,438	Turbine installation subcontract
Sanwa Bank	-	-	Payroll taxes
Rock, Inc.	-	253	Turbine parts (bearings)
MSE Power Systems	186	-	Engineering services
Milbank, Tweed	151	-	Legal services
Cincinnati Bear	-	144	Gearbox manufacturer (750)
B&B Surplus	-	139	Manufacturing hardware
Arnold & Porter	-	131	Legal services
ABB Control	231	81	Turbine parts (main panel)
Noah Lampert	-	80	Blade manufacturer
Staples	-	71	Office supplies
ABS Manufacturing	60	65	Frame manufacturer (1.5)
Linklaters	63	-	Legal services
Bagloff and co.	-	56	Building construction
EDD	54	-	Payroll taxes
Bossard, Intl	47	-	Manufacturing hardware
Analog Devices	40	-	Manufacturing parts supplier
Arthur Andersen	40	-	Accounting services
<b>Total</b>	<b>\$ 1,205</b>	<b>\$ 3,468</b>	

Source: Supplemental information provided by Mr. Schoen

Total AP 7,247 10,719  
 % Coverage 16.6% 32.4%

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**There were no advance payments at December 31, 1999 due to production being shut down from July 1999 to October 2000**

The table to the right details the components of accrued liabilities as of the dates presented. Below is a discussion of the significant balances.

**Advanced Payments**

The advanced payment accrual represents customer deposits on wind turbine sales. Management indicated customers are required to deposit 20% at the signing of the contract. As manufacturing was shut down from July 1999 until October 2000, the Americas did not have any deposits on hand at December 31, 1999. Management provided a schedule of advanced payments at December 31, 2000 and April 30, 2001, respectively. The December 31, 2000 balance represents a \$20,445 deposit from Trent Mesa while the April 30, 2001 balance is comprised of a \$15,530 deposit from Trent Mesa, a \$1,140 deposit from Montfort and a \$2,400 deposit from Mill Run.

**Project Completion Reserves**

See Project Analysis for a discussion concerning project completion reserves.

**Professional Fees**

The table to the bottom right provides a summary of accrued professional fees. Management indicated accrued professional fees is not a proper account heading as the account balance is primarily comprised of miscellaneous accruals (including legal and accounting fee accruals).

IWECO represents the purchase of a 10% interest in IWECO from Mr. Dimitri Alexopoulos for \$1,750 (\$500 cash and the remainder an outstanding payable) during 2001 (78% previously owned by Americas). The operating results for IWECO are consolidated as part of Europe. IWECO holds two wind farms in Greece. Management indicated Mr. Alexopoulos helped develop these projects and received a 10% interest as a result of the development.

**Accrued Liabilities**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Advanced payments	\$ 6	\$ 20,445	\$ 19,070
Project completion	18,979	13,629	10,093
Professional fees	6,333	5,906	3,515
Vacation	1,443	1,613	1,718
Warranty (short term)	794	1,347	1,347
Interest	918	468	847
Bonuses	3,727	2,645	750
Royalties	256	273	391
DWR	171	171	171
Payroll	6	-	12
Commissions	-	-	-
<b>Total accrued liabilities</b>	<b>\$ 32,689</b>	<b>\$ 46,509</b>	<b>\$ 37,914</b>

Source: General Ledger

**Accrued Professional Fees**

(\$ in thousands)	12/31/99	12/31/00	4/30/01
IWECO settlement	\$ -	\$ -	\$ 1,250
General reserve	1,179	1,077	1,077
Cabazon accrued royalties	-	585	555
Accrued machinery	1,031	2,094	-
Lake Benton 1	1,686	-	-
Other	2,437	2,150	1,883
<b>Accrued professional</b>	<b>\$ 6,333</b>	<b>\$ 5,906</b>	<b>\$ 4,765</b>

**Accrued professional fees includes numerous items unrelated to professional expenses**

**Professional Fees, continued**

Management indicated the Americas maintains a general reserve "cushion" established for any potential unrecorded liabilities. We have proposed an adjustment to increase net assets by \$1,080 to eliminate this general reserve for unrecorded liabilities.

Cabazon accrued royalties represent royalty payments to Cabazon Power, Inc. ("CPI") for approximately 15% of Cabazon's electricity sales. Cabazon was established as a joint venture between the Americas and CPI in 1999, but in 2000, the Americas purchased CPI's interest in the joint venture in return for this future royalty payment. Management indicated the accrued balance is attributable to the Americas not paying CPI as a result of not receiving payment from SCE for electricity sales from November 2000 to March 2001.

Management indicated accrued machinery represents fixed assets received by the Americas for which invoices were not received by the end of the year. The adjustment to record such amounts is only performed at the end of the year. The increase at December 31, 2000 is attributable to an expansion project performed at the Tachahapi facility attributable to the gearing up for the EW 1.5 MW production.

Other is comprised of several miscellaneous accruals related to such items as property taxes, insurance, audit fees and consulting fees.

**Accrued Liabilities**

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Advanced payments	\$ 6	\$ 20,445	\$ 19,070
Project completion	18,979	13,629	10,093
Professional fees	6,333	5,906	3,515
Vacation	1,443	1,613	1,718
Warranty (short term)	794	1,347	1,347
Interest	918	468	847
Bonuses	3,727	2,645	750
Royalties	236	273	391
DWR	171	171	171
Payroll	6	12	12
Commissions	76	-	-
<b>Total accrued liabilities</b>	<b>\$ 32,689</b>	<b>\$ 46,509</b>	<b>\$ 37,914</b>

Source: General ledger

**Accrued Professional Fees**

(\$ in thousands)	12/31/99	12/31/00	4/30/01
IWECO settlement	\$ -	\$ -	\$ 1,250
General reserve	1,179	1,077	1,077
Cabazon accrued royalties	-	585	555
Accrued machinery	1,031	2,094	-
Lake Benton 1	1,686	-	-
Other	2,437	2,150	1,883
<b>Accrued professional</b>	<b>\$ 6,333</b>	<b>\$ 5,906</b>	<b>\$ 4,765</b>

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**The Americas recorded an adjustment to reduce accrued bonus by \$780 at December 31, 2000 related to pre 2000 activity**

**Accrued Vacation**

Vacation earned is a vested benefit provided to employees and at termination, employees are paid their accrued vacation balance. Management indicated there is no maximum to the number of days an employee can carryover. No further information was provided.

**Accrued Warranty**

See additional analysis for a discussion concerning warranty accruals.

**Accrued Interest**

Accrued interest relates only to third party debt, according to management, the fluctuation in the accrued interest account is solely attributable to timing of debt payments.

**Bonuses**

Management indicated the Americas changed its bonus policy beginning in 2000 when bonuses became available to all employees based on the following:

- Eirron corporate performance goals,
- EWC performance goals and
- Individual employee performance goals.

Prior to 2000, only management employees were paid a discretionary bonus. Management indicated all bonuses are paid in January.

Accrued Liabilities			
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Advanced payments	\$ 6	\$ 20,445	\$ 19,070
Project completion	18,979	13,629	10,093
Professional fees	6,333	5,906	3,515
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Interest	918	468	847
Bonuses	3,727	2,645	750
Royalties	236	273	391
DWR	171	171	171
Payroll	6	12	12
Commissions	76	-	-
<b>Total accrued liabilities</b>	<b>\$ 32,689</b>	<b>\$ 46,509</b>	<b>\$ 37,914</b>

Source: General Ledger

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**Accrued bonuses as of April 30, 2001 represent approximately 1/3rd of the forecast 2001 bonus expense**

**Bonuses, continued**

Accrued bonuses decreased by \$1,082 at December 31, 2000 compared to December 31, 1999. Management indicated the decrease is primarily attributable to the former president's accrued bonus of \$1,289 at December 31, 1999 as well as the reversal of \$780 related to unused 1999 accruals. These amounts were offset by increased bonuses payable related to the change in bonus program. The former president was paid his accrued bonus in February 2000. The reversal was recorded as a reduction to general and administrative expenses. To eliminate the impact of this reversal, we have included a reduction to EBITDA for the year ended December 31, 2000 and an addback to EBITDA for the year ended December 31, 1999 for \$780.

The decrease in accrued bonus of \$1,895 at April 30, 2001 as compared to December 31, 2000 is attributable to the payment of the December 31, 2000 accrued bonus in January 2001 offset by the amount accrued for 2001. The amount accrued at April 30, 2000 is approximately 1/3rd of the budgeted 2001 bonus expense of \$2,239.

	Accrued Liabilities			
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001	
Advanced payments	\$ 6	\$ 20,445	\$	19,070
Project completion	18,979	13,629		10,093
Professional fees	6,333	5,906		3,515
Vacation	1,443	1,613		1,718
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Bonuses	3,727	2,645		750
Royalties	236	273		391
DWR	171	171		171
Payroll	6	12		12
Commissions	76	-		-
<b>Total accrued liabilities</b>	<b>\$ 32,689</b>	<b>\$ 46,509</b>		<b>\$ 37,914</b>

Source: General Ledger

**Royalties are paid to nine land owners for the right to build wind projects on their land**

**Royalties**

Accrued royalties represent the amount due to landowners who have given the Americas the right to build wind projects on their land. As part of allowing the Americas to use their land, the owners receive royalty fees. At December 31, 1999, 2000 and April 30, 2001, the Americas was paying royalties to nine land owners.

**Accrued DWR**

Management indicated the accrual represents amounts owed to Dean Witter Reynolds, the placement agent, related to fees attributable to notes receivable on Project 85 A, B, C. The Americas is paying DWR \$171 annually from 1996 to 2006. The amount accrued represents the current portion. The long term portion of this account was \$607, \$514 and \$537 at December 31, 1999, 2000 and April 30, 2001, respectively.

**Accrued Payroll**

Salaried employees are paid on the 15th and the last day of the month while hourly employees are paid bi-weekly. Management was unsure whether bi-weekly employees are paid in arrears but noted the bi-weekly hourly payroll is approximately \$600. Should LJM proceed with the transaction we recommend further procedures be performed on this account balance. Due to this timing, it appears additional reserves could have been required at the dates presented but no further information was provided by management that would enable us to calculate a reserve.

	Accrued Liabilities		
(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
Advanced payments	\$ 6	\$ 20,445	\$ 19,070
Project completion	18,979	13,629	10,093
Professional fees	6,333	5,906	3,315
Vacation	1,443	1,612	1,718
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Interest	918	468	847
Bonuses	3,727	2,645	750
Royalties	236	273	391
DWR	171	171	171
Payroll	6	12	12
Commissions	76	-	-
<b>Total accrued liabilities</b>	<b>\$ 32,689</b>	<b>\$ 46,509</b>	<b>\$ 37,914</b>

Source: General Ledger

### Three different types of warranties are offered by the Americas

#### Types of Warranties Offered

- Currently, the Americas offers three different types of warranties:
- Parts: provides for the replacement of defective parts within the warranty period;
  - Availability: provides for payments for lost electricity sales due to turbine malfunctions; and
  - Power curve: provides for payments if the turbine does not generate electricity at stated levels under stated conditions.

Parts warranties generally cover the first two years of operation with options to purchase additional years for a negotiated price. There are typically no additional extensions/price considerations made for availability and power curve beyond the first two years.

#### Current Warranty Reserve Balances

##### Reserves in the Americas' Balance Sheet

Currently the Americas maintains several types of warranty reserves as indicated in the table to the top right. Separate short and long term warranty accounts are maintained within accrued liabilities and other long term liabilities, respectively. In addition, reserves for warranties are also included within the project reserve accounts. Management also indicated the classification between short and long term reserves is rather arbitrary; one-fifth is allocated to short term and the rest to long term. When evaluating warranty exposure and reserve coverage, though, management views all of these reserves on a combined basis.

#### Reserves by Product Type

As presented in the lower right table, management also monitors the amount of reserves maintained by product type. However, Mr. Schoen indicated the Americas does not necessarily utilize and/or monitor this breakdown carefully and it should be considered directional in nature only.

#### Summary of Reserves for Warranties

(\$ in thousands)	12/31/1998	12/31/1999	12/31/2000	04/30/2001
Warranty Reserve				
Short term	\$ 515	\$ 794	\$ 1,347	\$ 1,347
Long term	4,633	7,147	5,389	5,389
	\$ 5,148	\$ 7,941	\$ 6,736	\$ 6,736
Warranty Amts. incl. in Project Reserves		3,744	8,373	5,575
	\$ 5,148	\$ 11,685	\$ 15,109	\$ 12,311

Source: General Ledger and Project Reserve Analysis provided by Mr. Schoen

#### Warranty Reserve by Turbine Type

(\$ in thousands)	12/31/1998	12/31/1999	12/31/2000	04/30/2001
Z550	\$ 785	\$ 785	\$ 1,235	\$ 1,235
Z750	4,363	10,900	13,874	11,076
	\$ 5,148	\$ 11,685	\$ 15,109	\$ 12,311

Source: Warranty analysis provided by Mr. Schoen and Mr. Ben Hoya

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## The Americas' accounting for "pay-as-you-go" warranties is not in accordance with US GAAP

### Accounting for Product Warranties

According to Mr. Westfeld, the accounting for warranty expense and reserves depends on the time the warranty is purchased.

- Warranties purchased at time of turbine sale ("at sale") - At the time of sale, the warranty reserve is established by debiting cost of sales and crediting the reserve for the assumed warranty cost for two years. As warranty costs are incurred, they are expensed; however, on a monthly basis, the costs are reversed by utilizing the reserves for the total warranty expense incurred (presuming the reserve was adequate to cover the costs).

In establishing reserves, the Americas utilized an expected cost of \$1,350 (actual dollars) per turbine per year for the Z550 and \$3,500 (actual dollars) per turbine per year for the Z750. Management indicated an estimated cost of \$15 per turbine per year will be utilized for the new EW 1.5 MW turbines.

Based on our review, the accounting treatment described above is consistent with US GAAP.

- Warranties paid on a month-by-month basis ("pay-as-you-go" or "PAYG"). According to Mr. Westfeld, certain customers in the US prefer to pay for warranties monthly versus having to pay the cost at the time the turbines are purchased. In these situations, there is no reserve recorded at the time of sale. Rather, as payments are received from the customers, cash is debited and the reserve credited. As warranty costs are incurred, they are expensed; however, on a quarterly basis, the costs are reversed by utilizing the reserves for the total warranty expense incurred.

The accounting treatment employed by the Americas for these PAYG warranties described above is not in accordance with US GAAP.

According to FASB Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* ("TB90-1"), revenue from separately priced extended warranty and product maintenance contracts should be deferred and recognized into income on a straight-line basis over the contract period. In addition, costs of services performed under the contract should be expensed as incurred. This guidance is applicable to all warranty agreements not included in original sales and is effective for all agreements put in place subsequent to December 15, 1990.

By not recognizing deferred revenue, establishing reserves as payments are received and not expensing costs as incurred, the Americas is not following US GAAP. See following slides for discussion on impact of rectifying this application.

### Serial Defects Discovered in the Z750

During 1999, the Americas determined there were serial defects in the Z750 and the amounts reserved would be inadequate. Information provided by the field operations department indicated the issues appeared driven by gearbox and converter issues (design, specification and application errors including both contact patterns and input loads outside of design specifications). At this point, management "established" additional warranty reserves, designated as "leeching" reserves, by not releasing accruals that were no longer needed and recording additional expenses. However, these amounts were arbitrary and not based on a formula.

US GAAP states when a liability is probable and reasonably estimable, an accrual should be established. Even under PAYG contracts, a loss should be recognized for costs expected in excess of the deferred revenue amounts and a reserve established for any additional estimated costs at the time the costs are reasonable estimable.

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**Costs incurred by field operations do not mirror warranty expense**

**Warranty Reserve Rollforward and Income Statement Impact**

The tables to the right detail the warranty reserve rollforward provided by management as well as the net profit and loss impact of warranty expenses and income from the general ledger for the periods under review.

As previously noted, the Americas (properly) recorded a reserve at the time of sale for "sale customers" and (improperly) increased warranty reserves as fees were collected from "PA YG customers". In addition, the Americas (improperly) increased the reserve during 2000 when it established a receivable from insurance related to a lightning strike that occurred in 1999. Finally, other reserves were "added" by not releasing other accruals that were no longer needed and expensing additional amounts. The utilization of reserves, according to management, followed warranty costs incurred by field operations. However, as shown in the table to the bottom right, costs incurred by field operations do not mirror warranty expenses for any of the periods under review.

In the future, not only should the Americas correctly apply US GAAP, warranty accruals should be established based on statistical studies of past service histories to determine future failure rates.

See following slide for the calculation of the impact applying US GAAP to the Americas accounting for warranties would have on the periods under review.

**Field Operations - Correction of Warranty Issues**

Field operations has a comprehensive corrective action process to address current warranty issues and track progress and effectiveness of corrective measures.

	1998	1999	2000	4M2001
Beginning balance (\$ in thousands)	\$ 583	\$ 5,148	\$ 11,685	\$ 15,109
Fees collected: at sale	740	4,979	435	-
Fees collected: PA YG	-	1,049	1,544	435
Insurance recoveries	-	-	3,318	-
Reserves added	3,825	1,558	9,340	-
Reserves utilized	-	(1,049)	(11,213)	(3,233)
Ending balance	\$ 5,148	\$ 11,685	\$ 13,109	\$ 12,311

Source: Warranty analysis provided by Mr. Scheen and Mr. Ron Floyd

	1998	1999	2000	4M2001
Expense (\$ in thousands)	\$ 2,954	\$ 17,559	\$ 7,983	\$ 1,636
Income	\$ 2,355	\$ (1,049)	\$ (4,862)	\$ (435)
	\$ 2,355	\$ (6,510)	\$ 3,121	\$ 1,201

Source: General Ledger

	1998	1999	2000	4M2001
not available (\$ in thousands)	\$ 3,733	\$ 1,170	\$ 208	\$ 208
available	\$ 12,082	\$ 11,999	\$ 4,222	\$ 4,222
	\$ 15,815	\$ 13,169	\$ 4,430	\$ 4,430

Source: Warranty expense analysis provided by Mr. Biernat and Mr. Jerry Holt

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**Significant EBITDA adjustments are required related to warranty coverage**

Assessing Impact of Applying US GAAP to Warranty Accounting  
 In order to assess the impact of applying US GAAP to the Americas warranty accounting, we performed the following:

- Obtained a listing from management detailing all warranties outstanding (by site) including turbine type, number of turbines, warranty type, warranty start date, warranty period and warranty fee (for PAYG customers) - See Appendix 8 for this listing;
- Assumed the warranty cost per 2750 turbine was \$18 for a three year period once serial defects were identified (these amounts were obtained from field operations);
- Obtained schedule of actual warranty costs incurred by type of turbine and site for 1999, 2000 and the four months of 2001 from field operations; and
- Calculated warranty expense and income as well as warranty reserve and deferred revenue for each of the warranties outstanding during the periods under review.

The table to the top right details the estimated net warranty expense for the periods under review as well as the resultant additional expense/income amounts. We have included these estimates in the quality of earnings analysis.

The table to the bottom right details the estimated warranty reserve required at the end of each period as well as the resultant increase/decrease in net assets. We have included these estimates in our net assets analysis.

**Reserves for the EW 1.5 MW Turbine**

To date, no reserves have been established by the Americas related to the EW 1.5 MW turbines sold. We have not included any reserves in our analysis as all warranties related to EW 1.5 MW turbines have been established under PAYG contracts.

**Estimated Net Warranty Expense**

	1999	2000	4M 2001
Net warranty expense in CL	\$ 16,510	\$ 3,121	\$ 1,201
Warranty expense in COS	-	1,750	-
Expense sub-total	16,510	4,871	1,201
Calculated net warranty expense	34,444	9,853	443
	(17,934)	(4,982)	758
Rounding	34	32	(58)
Resultant additional (expense) / income	\$ (17,900)	\$ (4,950)	\$ 700

**Estimated Warranty Reserve Required**

	12/31/1998	12/31/1999	12/31/2000	04/30/2001
Warranty reserves in CL	\$ 5,148	\$ 11,685	\$ 15,109	\$ 12,311
Estimated reserve required	458	22,687	20,328	16,730
	4,690	(11,002)	(5,219)	(4,419)
Rounding	10	2	19	19
Resultant increase / (decrease) in net assets	\$ 4,700	\$ (11,000)	\$ (5,200)	\$ (4,400)

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**Project reserves are created at the completion of construction for various project contingencies**

**General**

According to management, the Americas historically established project reserves for various contingencies relative to projects it was working on. Certain reserves were established as projects were built while others were established at time of sale:

**During Construction**

According to Ms. Labee, project accountant, construction reserves are typically established towards the end of the construction of a project, in order to help estimate the total cost of a project. They include estimates for the cost of erection of towers, power curve testing, engineering subcontractors and any other work that needs to be performed to complete the project.

**Time of Sale**

Completion costs reserves - These include costs incurred at the time of sale, such as commissions to business development personnel and attorneys fees.

Closing costs reserves - Completion costs include an estimate of the cost of work to be contractually performed to complete the wind system.

Teaching and warranty reserves - These are reserves to cover the cost of the replacement of any of the parts for the Z750 turbines. In addition, any of the unutilized portions of the completion and closing reserves, are 'swept' into teaching reserves. Refer to separate section on warranty and teaching reserves prior to this project reserve analysis.

Projects	Project Reserves			Excess Reserve
	12/31/1999	12/31/2000	04/30/2001	
Citazon	\$ 489	\$ 60	\$ 53	\$ 43
Green Power I	964	567	566	366
Delaware Mountain	830	756	130	100
Lake Benton I	6,461	3,523	2,286	-
Lake Benton II	858	4,384	234	234
Storm Lake I	3,286	1,532	203	203
Storm Lake II	3,882	2,195	1,013	263
YG Repower	208	160	-	-
YG Power Partners	-	-	160	160
Teaching & warranty reserves	-	450	5,375	-
Unreconciled difference	-	-	(127)	-
<b>Subtotal</b>	<b>\$ 18,979</b>	<b>\$ 13,629</b>	<b>\$ 10,093</b>	<b>\$ 1,609</b>

Source: Project reserve analysis provided by Mr. Schoen

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Project Reserves Contingencies

**The accruals for Cabazon, Green Power I and Delaware Mountain are not required as of April 30, 2001**

The table on the right illustrates the major components of the reserves established for each project. Management was unable to provide a breakdown of teething reserves by project as of April 30, 2001; therefore the amount has been included as one lump sum as of that date. See section covering warranty reserves for additional analysis.

**Cabazon, Green Power I & Delaware Mountain**

According to management, there is no further construction work required for any of these projects. Therefore, the Americas is over reserved by \$749 as at April 30, 2001. Management also confirmed the reduction in the reserve for these three projects between 1999 and April 2001 reflects construction expenses charged to the reserve with none of the reserves being released to the income statement.

**Lake Benton I**

In total, reserves of Lake Benton I decreased significantly from 1999 to 2000 and again from 2000 to April 30, 2001. The majority of this decrease relates to the clearing of various items from closing the sale as well as the use of warranty and teething reserves.

**Liquidated damages** - According to Mr. Schoen, this reserve was established in order to make a payment to the funding banks for delays in the construction of the project. However, it was later decided to make this payment using the warranty reserves.

**Legal reserve** - This reserve is to cover for legal fees incurred on the sale of the project.

**Project Reserves**

Projects	(\$ in thousands)		Excess Reserve
	12/31/1999	12/31/2000 04/30/2001	
<b>Cabazon</b>			
Construction reserves	\$ 489	\$ 60	\$ 53
Green Power I			
Construction reserves	964	567	566
<b>Delaware Mountain</b>			
Construction reserve	830	756	130
<b>Lake Benton I</b>			
Construction reserve	88	-	-
Teething reserve	1,101	1,233	??
Warranty reserves	1,588	(299)	(299)
Liquidated damages	1,439	-	-
Legal reserve	178	-	-
Future capital contributions	500	500	500
Reserve for funded hold back	1,367	-	-
Escrow reserve	200	89	85
Reserve for property taxes	2,000	2,000	-
	<b>6,463</b>	<b>3,523</b>	<b>2,286</b>
<b>Lake Benton II</b>			
Construction reserve	726	226	190
TIC contingency reserve	132	-	-
Teething reserve	-	3,711	??
Commissions	-	306	(94)
Legal reserve	-	63	60
Lightening protection	-	79	78
<b>Subtotal</b>	<b>\$ 858</b>	<b>\$ 4,384</b>	<b>\$ 234</b>
	<b>\$ 9,602</b>	<b>\$ 9,291</b>	<b>\$ 3,269</b>

Source: Project reserve analysis provided by Mr. Schoen

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**The Lake Benton I property tax reserve is over-reserved by \$1,390 as of April 30, 2001**

**Project Reserves**

Projects	12/31/1999	12/31/2000	04/30/2001	Excess Reserve
Calazon	\$ 489	\$ 60	\$ 53	\$ 53
Construction reserves	964	567	566	566
Green Power I	830	756	130	130
Construction reserves	88	-	-	-
Delaware Mountain	1,101	1,233	??	??
Construction reserve	1,388	(299)	-	(299)
Lake Benton I	1,439	-	-	-
Teething reserve	178	-	-	-
Waranty reserves	500	500	500	500
Liquidated damages	1,367	-	-	-
Legal reserve	200	89	85	85
Future capital contributions	2,000	2,000	2,000	2,000
Reserve for funded hold back	6,461	5,823	2,286	2,286
Reserve for property taxes	726	226	190	190
Subtotal	132	-	-	-
Lake Benton II	-	3,711	??	??
Construction reserve	-	306	(94)	(94)
TIC contingency reserve	-	63	60	60
Teething reserve	-	79	78	78
Commissions	858	4,384	234	234
Legal reserve	9,602	9,191	3,269	983
Lightening protection				
Subtotal				

Source: Project reserve analysis provided by Mr. Schoen

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**Lake Benton I, continued**  
**Future capital contributions** - Future capital contributions represent a funding mechanism to pay the junior debt which was a part of this transaction. The banks required the Americas pay a portion of the cash receipts from the project's operation, that represented the amount of PTCs being generated. The Americas negotiated a maximum limit on future funding obligations and set up a reserve for the maximum future liability as part of the project reserves.

**Easement reserve** - This reserve relates to easement fees the Americas pays to farmers for the right to use the land on which this project is located. The Americas recharges the respective project companies for the easement fee. However, fees owed to the Americas on the project company's balance sheet are subordinated, and the auditors for the Americas required a reserve to be established on Americas' balance sheet.

**Reserve for property taxes** - As described in the prepaids section of this report, the Americas established this reserve to cover a \$600 property tax payment it made on behalf of Lake Benton I which appeared uncollectible. A net asset adjustment to reduce the reserve by \$1,390 has been included in our analysis.

**Lake Benton II**  
**Construction reserve** - The reserves for Lake Benton II in total increased dramatically in 2000 as a result of the teething reserves recorded for the project. The balance decreased to April 30, 2001 primarily because teething reserves were not allowed to individual projects. All other balances, as described below, are considered unnecessary. No further construction work is planned for this project; therefore, the construction reserve of \$190 at April 30, 2001 is not required.

**The majority of the reserves related to Lake Benton II have either been utilized or reversed as of April 30, 2001**

**Lake Benton II**

**TIC Contingency reserve** - The Industrial Company ("TIC") performed all turbine and tower erection for the Midwest projects (which included Lake Benton I, Storm Lake I and Storm Lake II). In 1999, the Americas was in dispute with TIC over change orders requested by TIC and therefore recorded a reserve assuming TIC won the full amount in dispute. The settlement resulted in a pay out that was less than what was accrued. Mr. Schoen confirmed the unutilized portion of the reserve has been transferred into 'teething' reserves.

**Commissions** - This reserve represents accruals for commissions mainly relating to Mr. Gates, head of the commercial operations. The commission is calculated as a percent of the net profit on the project sale.

**Legal reserve** - This reserve relates to potential legal costs arising from the sale of the project.

**Lightning protection** - In 1999, many of the Americas' turbines in the Midwest were damaged by lightning strikes. The lightning protection reserve was established to cover the cost of installing lightning protection equipment in each of these turbines. According to Mr. Schoen, there is no further work required with respect to lightning protection, and therefore the reserve is no longer required.

**Project Reserves**

(\$ in thousands)

Projects	12/31/1999	12/31/2000	04/30/2001	Excess Reserve
<b>Calkeon</b>				
Construction reserves	\$ 489	\$ 60	\$ 53	\$ 53
Green Power I	964	567	566	566
Construction reserves	830	756	130	130
<b>Lake Benton I</b>				
Construction reserve	88	-	-	-
Teething reserve	1,101	1,233	??	-
Warranty reserves	1,588	(299)	(299)	-
Liquidated damages	1,439	-	-	-
Legal reserve	178	-	-	-
Future capital contributions	500	500	500	-
Reserve for funded float back	1,367	-	-	-
Basement reserve	200	89	85	-
Reserve for property taxes	-	2,000	2,000	-
	<b>6,461</b>	<b>3,523</b>	<b>2,286</b>	-
<b>Lake Benton II</b>				
Construction reserve	726	226	190	190
TIC contingency reserve	132	-	-	-
Teething reserve	-	3,711	??	-
Commissions	-	306	(94)	(94)
Legal reserve	-	63	60	60
Lightening protection	-	79	78	78
	<b>858</b>	<b>4,384</b>	<b>234</b>	<b>234</b>
<b>Subtotal</b>	<b>\$ 9,602</b>	<b>\$ 9,291</b>	<b>\$ 3,269</b>	<b>\$ 983</b>

Source: Project reserve analysis provided by Mr. Schoen

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**Project reserves are potentially over-reserved by approximately \$1,600 as of April 30, 2001**

**Storm Lake I**

The nature of the other reserves recorded for Storm Lake I is the same as those described for Lake Benton I. According to Ms. Lahee, the \$203 accrued for this project at April 30, 2001 is not required.

**Storm Lake II**

Other than the substitution reserve, the reserves are the same as those described above for Storm Lake I and Lake Benton I.  
**Substitution reserve** - The original cost estimated for the substitution for this project was approximately \$6,000. The substitution, which was being constructed by the utility company that was also going to buy the electricity produced by the project, cost only \$3,000. Mr. Schoen has confirmed \$2,500 of this excess reserve has been transferred to the teething reserve. The remaining \$500 is being maintained in project reserves as there is a potential the utility company may request a reduction in the electricity price charged to reflect the lower capital cost of the project.

**Excess Reserves**

As shown in the table presented opposite and the discussion throughout this analysis, the Americas is potentially over reserved by \$1,609 with respect to certain project reserves. A net asset adjustment has been proposed for this amount. According to Mr. Schoen, any excess reserves are used to cover teething and warranty costs.

Projects	Project Reserves			Excess Reserve
	12/31/1999	12/31/2000	04/30/2001	
Sub total from previous page	\$ 9,602	\$ 9,291	\$ 3,269	\$ 983
<b>Storm Lake I</b>				
Construction reserve	1,631	63	60	60
TIC contingency reserve	751	-	??	-
Teething reserve	1,101	1,290	95	95
Lightening protection	1,500	96	95	95
Legal reserve	300	83	48	48
	<b>5,286</b>	<b>1,532</b>	<b>203</b>	<b>203</b>
<b>Storm Lake II</b>				
Substitution reserve	500	500	500	-
TIC contingency reserve	538	-	-	-
Other Construction reserve	1,193	170	180	180
Teething reserves	1,101	1,189	??	-
Future capital contributions	250	250	250	-
Legal reserve	300	86	83	83
	<b>3,882</b>	<b>2,195</b>	<b>1,013</b>	<b>263</b>
<b>VG Repower</b>				
Construction reserve	208	160	-	-
VG Power Partners	-	-	160	160
Legal reserve	-	450	5,575	-
Teething & warranty reserves	-	-	(127)	-
Unreconciled difference	-	-	-	-
<b>Total Project reserves per CL</b>	<b>\$ 18,979</b>	<b>\$ 13,629</b>	<b>\$ 10,993</b>	<b>\$ 1,609</b>

Source: Project reserve analysis provided by Mr. Schoen.

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### The largest component of third party debt relates to the financing for the Cabazon project

The tables to the right details the components of third party debt held by the Americas as well as the salient terms.

**Fortis** - This loan relates to the Cabazon project. Related to this debt, the Americas is required to maintain a restricted cash debt service account (refer to the cash portion of this report for further detail). The Fortis note is secured by substantially all of the property and equipment located at the Cabazon wind project. Management indicated there are no prepayment penalties associated with the Fortis loan.

**Trust Company West** - The Americas secured a loan from Trust Company West ("TCW") through Zond Mesa-VGIV ("ZMV"), a wholly owned subsidiary. The agreement was entered into for working capital needs and the cash flows from the ZMV project are pledged against the loan. Additionally, Encon provides a guarantee for the loan. This guarantee will need to be taken into consideration if there is refinancing of this loan.

The financing agreement is secured by all of the outstanding stock of ZMV. In addition, this facility contains restrictive covenants such that distributions from ZMV's indirect interest in joint ventures must be deposited directly to a restricted collateral account included in restricted cash. Distribution may be made on the date of note payment, or to the extent the balance of the account exceeds 105% of the next payment due.

Management indicated although there is available cash on-hand in the Americas to repay the \$3,800 remaining outstanding amount on this loan, the TCW loan agreement contains a significant prepayment penalty and has resulted in the Americas not paying off the outstanding amounts, despite the high interest rate. Management did not provide any information related to the prepayment penalty.

Third Party Debt

(\$ in thousands)	12/31/1999	12/31/2000	4/30/2001
<b>Short term debt:</b>			
TCW	\$ 1,188	\$ 1,354	\$ 1,809
Fortis	608	1,077	1,258
Other	81	-	-
Leases	51	14	-
Sub-total short-term debt	1,928	2,445	3,067
<b>Long term debt:</b>			
TCW	4,495	3,141	1,988
Fortis	25,443	24,366	23,875
Other	88	76	61
Sub-total long-term debt	30,026	27,583	25,924
<b>Total third party debt</b>	<b>\$ 31,954</b>	<b>\$ 30,028</b>	<b>\$ 28,991</b>

Source: General ledger

(\$ in thousands)

Instrument	Begin. Date	Term (in years)	Principal Amount	Interest Rate	Payments Due
Fortis	12/14/1999	15	\$ 30,000	LIBOR+1.3%	Semi-annually Feb., Aug.
TCW	07/01/1995	7.5	\$ 8,430	13.25%	Semi-annually Jan., July
	07/01/1996		\$ 570		

Source: EHC financial statements/footnotes

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**Appendix 6: Project Summaries**

Company Name	Ownership	Structure	Entity	Series	Units	Due Date	Partnership
85 A, B & C	1%	Equity	Vestas	A - 160; B - 240; C - 200	-	-	12/31/2005
Project 251	100%	Consolidated	Vestas		223	-	-
ZP I & ZP II	0.50%	Equity	Vestas	ZP I - 300; ZP II - 160		ZP I - May 1985; ZP II - Dec 1984	12/31/2004
Cabazon	100%	Consolidated	Z 750 Series		53	-	-
Lake Benton I	1%	Equity	Z 750 Series		143	-	12/31/2018
Lake Benton II	0%	N/A	Z 750 Series		138	June 2000	-
Storm Lake I	1%	Equity	Z 750 Series		150	-	10/17/2002
Storm Lake II	1%	Equity	Z 750 Series		107	-	-
Green Power I	100%	Consolidated	Z 750 Series		22	-	-
Victory Garden Repower	100%	Consolidated	Z 750 Series		9	-	Perpetual
Sky River	50%	Equity	Vestas		342	-	12/31/2020
Victory Garden IV	50%	Equity	Vestas		98	-	07/01/2019
Painted Hills	50%	Equity	Vestas		231	1985	12/31/2015 (Joint Venture)

Source: Project Analysis provided by Mr. Schoen

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**Appendix 8: Warranty Summary by Project**

EWC Ownership	Turbine Type	No. of Turbines	Warranty Type	Warranty Start	Warranty Period (Years)	Warranty Fee/Turbine/Year	Total Annual Fee	Reserve Balance			
								12/31/1998	12/31/1999	12/31/2000	12/31/2001
<b>1996</b>											
CSW - FUTURE, TX	Z550	12	At Sale	Jun-96	5	n/a	n/a	79	85	87	87
Green Mountain Power, VT	Z550	11	At Sale	Jun-96	5	n/a	n/a	96	103	105	105
<b>1997</b>											
Korea	Z550	1	At Sale	Jun-97	5	n/a	n/a	8	9	9	9
Mexico	Z550	1	At Sale	Jun-97	5	n/a	n/a	9	9	10	10
<b>1998</b>											
China T, H, TH	Z550	30	At Sale	4-12/98 (A)	2	n/a	n/a	243	266	272	272
Algonia - Cedar Falls, IA	Z750	3	At Sale	Jun-98	5 (D)	n/a	n/a	38	42	44	44
NPPD, NE	Z750	2	At Sale	Jun-98	5	n/a	n/a	25	28	29	29
Lake Benton I, MN	Z750	143	PAYG	Dec-98	13	\$3	\$429	4,134	3,147	3,294	3,294
LIB Fees								(2,400)	(2,697)	(2,824)	(2,824)
<b>1999</b>											
Stem Lake II, IA	Z750	107	PAYG	Mar-99	15	3	321	-	367	367	367
Delaware Mountain, TX	Z750	40	At Sale	Jun-99	5	n/a	n/a	-	700	700	700
Green Power, CA	Z750	22	PAYG	6/04-06/06 (B)	3	5	110	-	385	385	385
Stem Lake I, IA	Z750	150	At Sale (C)	Jun-99	5	n/a	n/a	450	2,625	2,625	2,625
Victory Garden Repower, CA	Z750	9	PAYG	Jun-99	5	5	27	-	158	158	158
Waverly, IA	Z750	2	At Sale	Jun-99	5	n/a	n/a	-	35	35	35
Western Resources, KS	Z750	2	At Sale	Jun-99	5	n/a	n/a	-	14	14	14
Owneagh, N. Ireland	Z550	10	At Sale	Nov-99	2	n/a	n/a	86	93	93	93
<b>2000</b>											
Chandax, Crete	Z550	18	At Sale	11/01-11/03	3	5	50	-	135	135	135
Megall, Wisot, Crete	Z550	9	At Sale	Dec-99	5	n/a	n/a	-	57	68	68
Chabazon, CA	Z750	53	PAYG	Dec-99	10	3.65	193	660	660	695	695
Lake Benton II, MN	Z750	138	PAYG	Jun-00	5	3	414	1,720	1,720	435	435
<b>2001</b>											
Montic, W. Mass, TX	Z115	17	PAYG	Apr-01	5	16.75	285	-	-	-	-
Trick, Mass, TX	Z115	9	PAYG	Mar-01	5	30	270	-	-	-	-
<b>Total</b>		<b>780</b>						<b>\$ 5,148</b>	<b>\$ 7,947</b>	<b>\$ 6,796</b>	<b>\$ 6,796</b>
								Warranty reserve - fees to general ledger			
								- included in project reserves			
								<b>\$ 5,148</b>			
								<b>\$ 17,685</b>			
								<b>\$ 15,109</b>			
								<b>\$ 12,311</b>			

Source: Warranty summaries provided by Mr. Schoen and Mr. Ron Hoyt  
 (A) Warranty start date in diquide (B) Only comes into play if option is exercised (C) Warranty fees included as part of sale price (D) Assumed - no information available

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Committee on Governmental Affairs  
EXHIBIT #A-11

QF 87-365  
ZWHC LLC

**Vinson & Elkins**  
ATTORNEYS AT LAW

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THE WILLARD OFFICE BUILDING  
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**ORIGINAL**

Committee on Governmental Affairs  
**EXHIBIT #A-11a**

WRITER'S TELEPHONE  
(202) 639-6533

May 14, 1997

Ms. Lois D. Cashell, Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Dockets Room 1A  
Washington, D.C. 20426

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OFFICE OF THE SECRETARY  
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FEDERAL ENERGY REGULATORY COMMISSION

RE: Zond Windsystems Holding Co., Docket No. QF87-365- 003

Dear Ms. Cashell:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292, please find enclosed an original and fourteen copies of a "Request for Certification of Qualifying Facility Status for Small Power Production Facility" relating to the Zond Windsystems Holding Co. wind turbine facility. As discussed in the application, the recertification is based on changes in the ownership of Zond Windsystem Holding Co., necessitated by the changes in status that result from the proposed merger of Enron Corp., an indirect owner of the Zond Windsystems Holding Co., with Portland General Corporation, as described in the Commission's order in Enron Corp., 78 FERC ¶ 61,179 (1997).

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,



Adam Wenner

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supplemented on July 1, 1987, and August 12, 1987, the Commission granted certification as a qualifying small power production facility to the wind energy facility (the "Facility") then being developed by Zond Systems, Inc. ("Zond Systems") at a site in the Tehachapi Mountains, Kern County, California.<sup>3/</sup> As stated in the initial application, Zond Systems ultimately formed ZWHC to own the Facility. On September 8, 1992, ZWHC filed a Notice of Self-Recertification of the Facility to reflect the change in ownership, a reduction in the Facility's capacity, and the inclusion of an undivided ownership interest in privately and cooperatively owned transmission and interconnection facilities within the definition of the Facility.<sup>4/</sup> (The Initial Certification and the Notice of Self-Recertification are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, ZWHC hereby incorporates by reference the Prior Certifications with respect to its Application for Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.

**1b. Full Address of Applicant**

Zond Windsystems Holding Company  
P.O. Box 1910  
13000 Jameson Road  
Tehachapi, California 93561  
(805) 822-6835

---

<sup>3/</sup> Zond Systems, Inc., 41 FERC ¶ 62,079 (1987).

<sup>4/</sup> Docket No. QF87-365-002. ZWHC owns these facilities through its wholly owned subsidiary Sagebrush Partner Twenty Inc.

**1c. Ownership**

ZWHC is a California corporation with 100 percent of its outstanding capital stock held by Zond Systems.<sup>2/</sup> Zond Systems is a wholly owned subsidiary of Zond Corporation ("Zond"), which is a wholly owned subsidiary of Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent of the outstanding stock of EREC.<sup>3/</sup> On February 27, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation ("PGC") (the "Merger") under Section 203 of the Federal Power Act.<sup>4/</sup> PGC is the sole parent company of Portland General Electric Company, an electric utility. Following the completion of the Merger, Enron will become an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>5/</sup> As a result, Enron's interest in ZWHC will be considered ownership by an "electric utility holding company" for purposes of section 292.206.<sup>6/</sup>

<sup>2/</sup> The current ownership of ZWHC is depicted on the chart attached as Exhibit A.

<sup>3/</sup> The remaining 21.67% of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC's stock or is an "electric utility" or an "electric utility holding company." None of these individuals or entities is engaged in the generation or sale of electric power or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities; "eligible facilities" as "exempt wholesale generators" under Section 32(a) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994); or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>4/</sup> Enron Corp., 78 FERC ¶ 61,179 (1997).

<sup>5/</sup> 15 U.S.C. § 79c(a)(1) (1994).

<sup>6/</sup> 18 C.F.R. § 292.206 (1996).

In order to ensure that ZWHC will remain in compliance with section 292.206, prior to the Merger of Enron and PGC, Zond Systems will sell 50 percent of its interest in ZWHC<sup>10/</sup> to RADR ZWS, LLC ("RADR ZWS"), a Delaware limited liability company owned by a Managing Member and Regular Members.<sup>11/</sup> As a result, RADR ZWS will hold a 50 percent interest in ZWHC. The Managing Member of RADR ZWS will be RADR ZWS MM, LLC, a limited liability company owned by three individuals, and the Regular Members will be individuals. (The Managing Member, its upstream owners, and the Regular Members are referred to collectively as the "RADR ZWS Owners.") None of RADR ZWS or the RADR ZWS Owners is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA.<sup>12/</sup>

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<sup>10/</sup> Prior to the sale, ZWHC will merge with and into ZWHC LLC, a Delaware limited liability company, and ZWHC stock will be converted to "member interests" that will be owned by Zond Systems and RADR ZWS. This change in corporate form does not affect the determination of ownership of the Facility under section 292.206. ("ZWHC" will be used to refer to both Zond Windsystems Holding Company and ZWHC LLC).

<sup>11/</sup> The new ownership of ZWHC is depicted on the chart included in Exhibit A.

<sup>12/</sup> The individuals who will own RADR ZWS MM, LLC, as well as the Regular Members, may invest directly or indirectly, through investment entities that they control. If they invest through such entities, the entities will also satisfy the above-described restrictions respecting utility-related activities and ownership.

Upon the transfer of a membership interest in ZWHC to RADR ZWS, Zond Systems and RADR ZWS will each own a 50 percent member interest in ZWHC, RADR ZWS will receive 50 percent of the distributions from ZWHC. For purposes of determining the ownership of ZWHC, a limited liability company, it is appropriate to treat ZWHC as a partnership and to apply the Commission's standards, established in Ultrapower 1.<sup>127</sup> Under the ZWHC Limited Liability Company Agreement (the "LLC Agreement"), Zond Systems and RADR ZWS will each be entitled to 50 percent of ZWHC's profits, losses, tax benefits, and surplus on liquidation.

Zond Systems and RADR ZWS will each hold 50 percent of the voting interests in ZWHC. Zond Systems will be the Managing Member in ZWHC, with responsibility for day-to-day operation of the Facility.<sup>128</sup> However, a majority vote will be required for all major decisions, and neither Zond Systems nor RADR ZWS will have the authority to alter the allocation of the stream of benefits. ZWHC will not be permitted to enter into any contracts with any affiliate of either member without approval by the other member.<sup>129</sup>

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<sup>127</sup> 27 FERC ¶ 61,094 (1984).

<sup>128</sup> The LLC Agreement will also provide that Zond Systems will receive a fee of \$75,000 annually as compensation for the performance of its duties as Managing Member. These fees do not exceed the compensation that would have been paid to an unaffiliated entity, see Acme POSDEF Partners L.P., 72 FERC ¶ 62,264 at 64,830 (1995) ("Acme POSDEF"), and accordingly are not part of the "stream of benefits" from the Facility.

<sup>129</sup> Depending on the timing of the Merger, it may be necessary to implement some of the changes described herein, such as the transfer of an ownership interest and the loan, prior to the issuance of a final order in the instant proceeding.

## II. Description of ZWHC's Operations

ZWHC sells all of the output of the Facility to Southern California Edison Company ("SCE") pursuant to power purchase agreements, the last of which expires in 2017. SCE also supplies electrical service to the Facility.

Zond Systems, a wholly owned subsidiary of Zond Corporation, provides operations and maintenance service to ZWHC pursuant to a Windsystem Management Agreement ("O&M Agreement") executed on June 30, 1992. Zond Systems receives a fee based on a percentage of costs incurred for direct labor and benefits for services provided under the O&M Agreement plus reimbursement of direct and indirect costs. RADR ZWS will ratify the O&M Agreement.

Zond Systems also leases or owns the land on which the Facility is located and provides an easement to ZWHC for use of the property pursuant to two agreements executed on June 30, 1992 ("Easement Agreements"). Payments under the Easement Agreements do not exceed the market rate for such an easement. RADR ZWS will ratify the Easement Agreements.

EREC will provide a loan to RADR ZWS, the proceeds of which will be used to finance the acquisition of a 50 percent member interest in ZWHC. The interest rate will be at a market rate, and RADR ZWS will be free to seek alternative sources of financing. The loan will convey no management control or entitlement to profits or losses from the Facility to EREC.

An affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of the interest of RADR ZWS in the Zond Facilities.

RADR ZWS will grant Zond Systems an option to purchase its member interest in ZWHC. The option agreement will provide that during the term of the existing power purchase agreements,

the option may only be exercised if the exercise would not adversely affect the QF status of the Facility, unless there has been a change in law or Commission regulations, or a change to the agreements that would permit the option to be exercised without materially and adversely affecting ZWHC's rights under these power purchase agreements (the "QF Period").<sup>16/</sup> As noted above, ZWHC's existing power purchase agreements, which require the Facility to be a QF, extend through 2017. Consequently, the effect of this provision is that, absent such a change, the Facility will remain a QF through 2017. Following the Merger, if Zond Systems were to exercise the option after the expiration of the power purchase agreements, the Facility would cease to be a QF; prior to that time ZWHC will seek a Commission determination that it is an "exempt wholesale generator" under Section 32(a)(1) of PUHCA. The option will be transferable or assignable; however, the assignee or transferee will remain subject to these restrictions.

III. The Arrangements Satisfy the Commission's Ownership Criteria.

The statutory ownership criteria governing Qualifying Facilities appear in Section 3(17)(C)(ii) of the Federal Power Act. Under that section, a Qualifying Facility must be owned:

by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).<sup>17/</sup>

The Commission's regulation implementing Section 3(17)(C)(ii) states that:

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<sup>16/</sup> In addition, during the term of outstanding loans from Credit Suisse First Boston to Sky River Partnership and Victory Garden Phase IV Partnership, the option may not be exercised if such exercise would have a material adverse effect on the regulatory status of the Sky River Partnership or Victory Garden Phase IV Partnership facilities.

<sup>17/</sup> 16 U.S.C. § 796(18)(B)(ii) (1994).

a . . . small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.<sup>18</sup>

The Commission's regulations thus equate "ownership interest" with "equity interest." The Commission evaluates the control of the venture and each owner's entitlement to the "stream of benefits" from the venture to determine each participant's equity interest.<sup>19</sup>

A. Control

The arrangements described herein satisfy the Commission's requirement that electric utilities, electric utility holding companies, or their subsidiaries exercise no more than 50 percent control of a QF.<sup>20</sup> Under the new ownership arrangements, a non-utility, RADR ZWS, will hold 50 percent of the voting interest in ZWHC. Zond Systems will not be able to alter allocation of the stream of benefits from the Facility. Accordingly, Zond Systems will not exercise greater than 50 percent control of ZWHC, and ZWHC meets the criteria for control under section 292.206 of the Commissions relations and the interpreting cases.<sup>21</sup>

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<sup>18</sup> 18 C.F.R. § 292.206(b) (1996).

<sup>19</sup> See, e.g., Ultrapower 3.

<sup>20</sup> Other than their indirect interest in the Zond Facilities, none of the RADR ZWS Owners has any affiliation with Enron, FPL Group, or any affiliate of either.

<sup>21</sup> See, e.g., Ultrapower 3 and CMS Midland, Inc., 38 FERC ¶ 61,244 (1987).

With respect to Zond Systems' role as managing member in ZWHC, the Commission has held that an electric utility subsidiary may be the sole general partner or managing general partner of a partnership, provided that the non-utility owner retains the right to approve any decisions that affect the distribution of the stream of benefits from the facility, including approval of loans and service agreements with affiliates of the utility owner. As noted above, the ZWHC Limited Liability Company Agreement will satisfy these requirements.

B. The Ownership Arrangements Satisfy the Commission's Requirements for Allocation of the Stream Benefits.

As stated above, the ZWHC Limited Liability Company Agreement will provide that Zond Systems and RADR ZWS are each entitled to 50 percent of the profits, losses, tax benefits, and surplus on liquidation of ZWHC. The new ownership arrangements thus will satisfy the Commission's criteria that no more than 50 percent of the stream of benefits from a QF flow to electric utilities, electric utility holding companies, or their subsidiaries.

1. The O&M, Easement, and Consulting Agreements

In evaluating the stream of benefits from a QF, the Commission has held that it will consider whether payments to an electric utility owner or its affiliate under a service agreement or other arrangement reflect additional equity payments. Where such payments exceed the compensation that would have been paid to an unaffiliated entity for the same services, the Commission will consider the payments to be part of the recipient's entitlement to the stream of benefits. On the other hand, where such payments approximate the compensation that would have been paid to an unaffiliated entity, the Commission will find that the payments are not part of the stream of benefits.<sup>22</sup>

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<sup>22</sup> See *Acme POSDEF*, 72 FERC ¶ 62,264, at 64,830 (1995).

Under the O&M Agreement and the Easement Agreements, affiliates of Zond will receive payments from ZWHC. The payments are at market rates, and they will be ratified by RADR ZWS.

## 2. The Loan Agreement

As noted above, EREC will provide a loan to RADR ZWS to finance the purchase of 50 percent of the member interest in ZWHC. The Commission has held that the repayment of a loan by an electric utility to a non-electric utility owner of a QF is not included in the stream of benefits where the loan contains a reasonable rate of interest for the risks assumed and conveys no management control or entitlement to profits or losses to the electric utility.<sup>23</sup> The Commission has also held that its concern regarding loans is further mitigated where the non-utility borrower is not prevented from borrowing funds elsewhere to finance the acquisition.<sup>24</sup>

The interest rate for the loan to RADR ZWS will be consistent with rates for projects with similar risk profiles. The loan will convey no management control or entitlement to profits or losses from ZWHC to the lender. Moreover, RADR ZWS was not precluded from borrowing the funds from an alternative lender. Accordingly, the loan and the payments thereunder should not be included in the stream of benefits from the Facility.

## 3. Indemnity

An affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of the interest of RADR ZWS in the Zond Facilities.

<sup>23</sup> East Syracuse Generating Co., L.P., 65 FERC ¶ 62,224, at 64,553 (1993); s.f. Brooklyn Navy Yard Cogeneration Partners, L.P., 74 FERC ¶ 61,015, at 61,047-48 (1996).

<sup>24</sup> Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084, at 64,229 (1995).

The Commission has held that, in determining ownership interests under section 292.206, it does not consider capital contributions and has approved arrangements in which the utility affiliate's future contributions would cause its contributions to exceed 50 percent.<sup>247</sup> The examination focuses instead "on that which is derived from the partnership, i.e., the stream of benefits."<sup>248</sup> Payments, if any, pursuant to the indemnity agreement are similar to capital contributions that convey no management control and do not affect the distribution of profits or gains,<sup>249</sup> and therefore are not included in the stream of benefits.<sup>250</sup>

#### 4. Purchase Option

The Commission has held that the existence of a purchase option does not constitute a present ownership interest and thus does not affect a facility's qualifying status.<sup>251</sup> Prior to the

<sup>247</sup> See, e.g., Ultrapower 3, 27 FERC at 61,184; Beowawe Geothermal Power Co., 33 FERC ¶ 62,205 (1985).

<sup>248</sup> CMS Midland Inc., 50 FERC ¶ 61,098 at 61,288 (1990).

<sup>249</sup> Id.

<sup>250</sup> See also, East Syracuse, 65 FERC at 64,553 (principal amount of loan by utility owner to non-utility owner subject to downward adjustment to the extent non-utility owner incurs loss in subsequent resale of its interest); Lake Cogen Ltd., 79 FERC ¶ 62,054 (1997); Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084.

<sup>251</sup> See, e.g., City of Burlington, Vt. Elec. Dept., 45 FERC ¶ 61,009, at 61,035 n.32 (1988) (option held by utility affiliate to purchase non-utility owner's interest in QF in year 11 or 21 of operation not treated as present ownership by utility); Turbo Gas & Elec. Ltd., 30 FERC ¶ 61,273, at 61,565 (1985) (option by subsidiary of electric utility holding company to purchase either 51 or 100 percent of QF not treated as current utility ownership interest). Similarly, the Commission determined that provisions permitting a utility affiliate to assume 99 percent of voting interest in a QF upon an event of a default under its lease or deferral of payments under its power purchase agreement to be "unexercised rights" that do not bar QF status. Midland Cogeneration Venture, L.P., 50 FERC ¶ 61,259, at 61,802 (1990), reh'g denied, 56

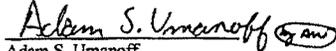
exercise of the option, the interest in ZWHC held by an electric utility or an electric utility holding company will not exceed 50 percent. As described above, the option can only be exercised by a utility interest after the QF Period has ended, whereupon, absent a change in law or regulations as described above, the Facility would no longer enjoy the benefits of QF status and would seek to obtain status as an exempt wholesale generator. The Commission has recognized that a facility may be a QF during one period and not be a QF during another period. When this happens the lack of qualifying status during one period does not affect the facility's qualifying status during the period of compliance. In the instant case, the basis for ceasing to be a Qualifying Facility would be a deliberate business decision based on the expiration of power purchase agreements, rather than an unintended failure to meet technical standards. However, the legal consequences in both types of cases should be the same. Here, as in the above-cited cases, the fact that a period of non-QF status may follow the QF Period should not affect the qualifying status of the Facility during the prior period of compliance.<sup>20/</sup>

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FERC ¶ 61,361 (1991), petition for review denied sub nom. Michigan Mun. Coop. Group v. FERC, 990 F.2d 1377 (D.C. Cir. 1993).

<sup>20/</sup> See, e.g., Pepperill Power Associates L.P., 64 FERC ¶ 61,286 (1993) (facility which operated as a Qualifying Facility from 1987 through 1992 subsequently lost qualifying facility status and became an EWG in 1993, based on loss of steam host); Medina Power Co., 71 FERC ¶ 61,264 (1995), reh'g denied, 72 FERC ¶ 61,224 (1995) (following a period of non-compliance in 1992-1994, applicant might become a Qualifying Facility for calendar year 1995 and beyond). See also LG&E Westmoreland Southampton, 76 FERC ¶ 61,116 (1996) (establishing rates and exemptions for period of non-compliance with QF regulations).

1d. **Authorized individual evidencing accuracy of information:**

  
Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation

2. **Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation  
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Los Angeles, CA 90071-2946  
(213) 236-9544

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6533  
Counsel to Zond Corporation

3a. **Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93581

3b. **Utility:**

The Facility interconnects with the transmission system of SCE. SCE purchases the output of the Facility and provides it with separate electric service.

4a. **Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

See Prior Certifications.

**4c. Initial Operations:**

The Facility commenced operations in June 1987.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

See Prior Certifications.

**6. Additional Characteristics:**

None.

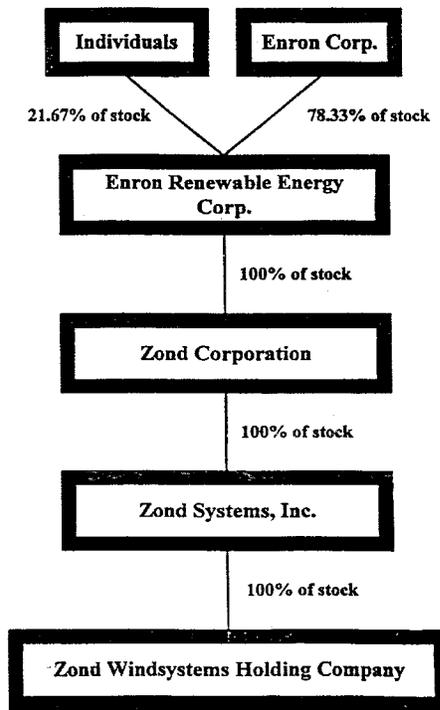
**7. Fossil Fuel Use:**

See Prior Certifications.

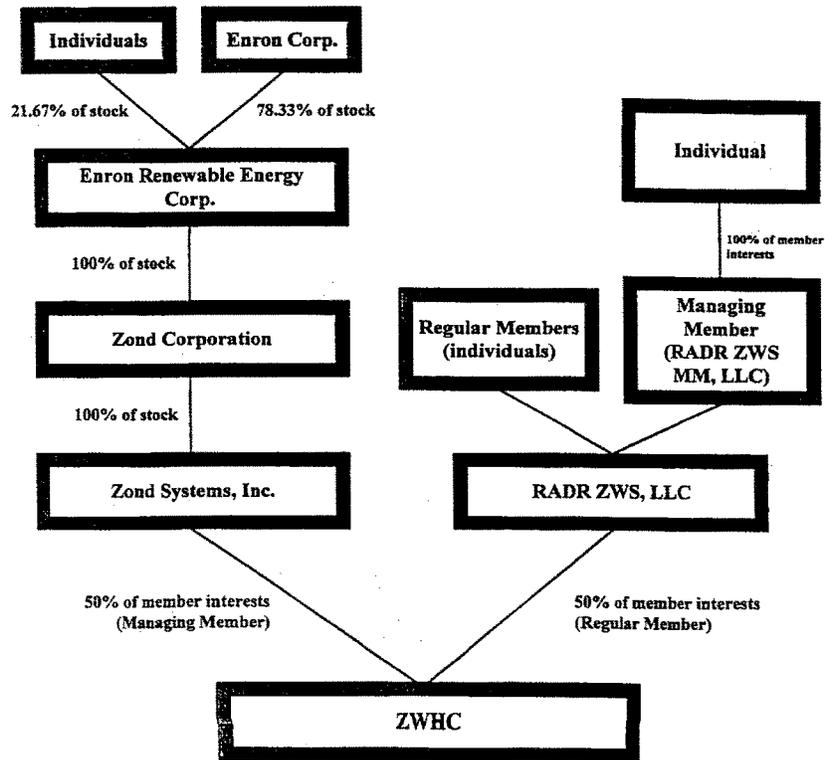
**8. Eligible Facility:**

See Prior Certifications.

## 251 Project (existing)



## 251 Project (proposed)



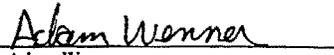
\*These individuals may invest directly or indirectly, through an intermediate entity



CERTIFICATE OF SERVICE

I hereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon all parties on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

Dated at Washington, D.C. this 14<sup>th</sup> day of May, 1997.



Adam Wenner

Attorney for Zond Windsystems Holding Company

79 FERC ¶ 62, 236

Committee on Governmental Affairs  
EXHIBIT #A-11b

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Zond Windsystems	)	
Holding Company	)	
Small Power Production and	)	Docket No. QF87-365-003
Cogeneration Facilities	)	
-- Qualifying Status	)	

ORDER GRANTING APPLICATION FOR RECERTIFICATION  
AS A QUALIFYING SMALL POWER PRODUCTION FACILITY

(Issued June 30, 1997)

Summary:

On May 14, 1997, Zond Windsystems Holding Company (Zond Windsystems or Applicant) filed an application for recertification of a small power production facility as a qualifying facility (QF) pursuant to 18 C.F.R. 292.207(b). 1/

According to the Applicant, the instant recertification is to ensure that the facility will retain its qualifying status following a change in the upstream ownership of the facility. The Applicant represents that no other material changes have occurred with respect to the facility.

Notice of the application was published in the Federal Register with comments, protests or motions to intervene due on

1/ The facility is a wind energy small power production facility located in the Tehachapi Mountains, Kern County, California. The facility consists of 225 wind turbines with an aggregate capacity of 20 MW. Power from the facility is sold to Southern California Edison Company pursuant to several power purchase agreements, the last of which expires in 2017. The facility commenced commercial operation in June 1987, and was initially certified in Docket No. QF87-365-000, Zond Systems, Inc., 41 FERC ¶ 62,079 (1987). On May 6, 1991, the Applicant filed, in Docket No. QF87-365-001, a clarification of the electric power production capacity of the facility. On September 8, 1992, a notice of self-recertification was filed (Docket No. QF87-365-002) to reflect a change in the ownership, a reduction in the facility's capacity and the inclusion of an undivided ownership interest in certain transmission and interconnection facilities within the definition of the facility. (Zond Windsystems owns these transmission and interconnection facilities through a wholly-owned subsidiary, Sagebrush Partner Twenty Inc.)

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or before June 17, 1997. <sup>2/</sup> On June 13, 1997, Southern California Edison Company (Edison) filed a motion to intervene but did not raise any issues. Pursuant to Rule 214(c)(1) of the Commission's Rules of Practice and Procedure (18 C.F.R. 385.214), if no answer in opposition to Edison's intervention is filed within fifteen days, Edison's motion to intervene serves to make it a party to the proceeding. No other comments were received.

Discussion:

Under 18 C.F.R. 292.203(a), a qualifying small power production facility must comply with the size criteria and fuel use criteria specified in 18 C.F.R. 292.204 and the ownership criteria contained in 18 C.F.R. 292.206.

A. Ownership:

Under 18 C.F.R. 292.206, no more than 50 percent of the equity interest in a QF may be held, directly or indirectly through subsidiaries, by electric utilities and/or electric utility holding companies (collectively, electric utility entities).

Zond Windsystems, the owner of the facility, is currently owned by Zond Systems, Inc. (Zond Systems). Under the proposed transaction, Zond Systems will sell 50 percent of its interest in Zond Windsystems to RADR ZWS, LLC (RADR ZWS). Consequently, Zond Windsystems will become a limited liability company (Partnership) consisting of two partners, Zond Systems and RADR ZWS, each with a 50 percent interest. <sup>3/</sup> Pursuant to the Limited Liability Company Agreement between the parties, Zond Systems and RADR ZWS each will be entitled to 50 percent of Zond Windsystems' profits, losses, tax benefits, and surplus on liquidation.

1. Zond Systems

Enron Corporation (Enron), through subsidiaries, owns 78.33 percent of Zond Systems. Other individuals and entities own the remaining 21.67 percent of Zond Systems. On February 26, 1997, the Commission issued an order approving the merger of Enron and

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<sup>2/</sup> 62 Fed. Reg. 29725 (1997).

<sup>3/</sup> Zond Windsystems states that prior to the sale, it will merge with and into ZWHC LLC, a Delaware limited liability company, and that its stock will be converted into "member interests."

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Portland General Corporation (Portland General). 4/ Portland General is the parent company of Portland General Electric Company, an electric utility. In order to ensure that Zond Windsystems will remain in compliance with 18 C.F.R. 292.206, prior to the merger of Enron and Portland General, Zond Systems will sell 50 percent of its interest in Zond Windsystems to RADR ZWS. Accordingly, after the sale of Zond Systems' 50 percent interest in Zond Windsystems, Enron will have a derivative 39.2 percent interest in the facility, which will be considered as ownership by an electric utility entity under the Commission's ownership criteria. Zond Windsystems states that none of the individuals that indirectly own Zond Systems is engaged in the generation or sale of electric power, or has any ownership or operating interest in any electric facilities, other than QFs, foreign utilities, 5/ and exempt wholesale generators (EWGs). 6/ In addition, none of these individuals own 10 percent or more of the stock of Zond Systems' upstream affiliates.

## 2. RADR ZWS

RADR ZWS is owned by a Managing Member and Regular Members. The Managing Member, RADR ZWS MM, LLC (a limited liability company) is owned by three individuals and the Regular Members are also individuals. The Applicant states that, other than foreign utilities, EWGs and QFs, neither RADR ZWS nor its upstream owners are engaged in the generation or sale of electric power, or has any ownership or operating interest in any electric facilities. Accordingly, RADR ZWS is not an electric utility entity under the Commission's ownership criteria. Therefore, the only electric utility interest in the facility is held by Enron.

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- 4/ Enron Corporation, *et al.*, 78 FERC ¶ 61,179 (1997). Following the completion of the merger, Enron will become an exempt public utility holding company under Section 3(a)(1) of the Public Utility Holding Company Act of 1935 (PUHCA).
- 5/ Ownership of foreign electric facilities has no effect on whether the facility satisfies the Commission's ownership criteria. General Electric Capital Corporation, 70 FERC ¶ 61,141 (1995).
- 6/ An EWG is not considered an electric utility company under Section 2(a)(3) of PUHCA, as amended by the Energy Policy Act of 1992, and ownership of an EWG does not result in an entity being considered to be primarily engaged in the generation or sale of electric power under Sections 3(17)(C)(ii) and 3(18)(B)(ii) of the Federal Power Act. *See* Sections 32(e) and 32(j) of PUHCA.

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B. Loans and Service Agreements:

Zond Systems and RADR ZWS will each hold 50 percent of the voting interests in Zond Windsystems. Zond Windsystems also asserts that any major decision, including service agreements made with or loans made to the partnership by Zond Systems or its affiliates, or allocation of the stream of benefits, will be subject to the approval of a majority vote of the Members. Hence, any loans or service agreements or allocation of the stream of benefits, requires the approval of RADR ZWS, the non-electric utility partner.

Zond Systems will be the Managing Member of Zond Windsystems with responsibility for the day-to-day operation of the facility and will also provide operation and maintenance service to the facility pursuant to the Windsystem Management Agreement (O&M Agreement). Zond Systems also leases or owns the land on which the facility is located, and will receive payments from Zond Windsystems for the use of property pursuant to two Easement Agreements. <sup>7/</sup> Both the O&M Agreement and the Easement Agreements were executed on June 30, 1992; however, the application states that these Agreements will be ratified by the new non-electric utility partner, RADR ZWS, and the payments made under these Agreements will be at market rates.

The Applicant states that Enron Renewable Energy Corp., an upstream affiliate of Zond Systems, will provide a loan to RADR ZWS to assist in its acquisition of a 50 percent interest in the facility. The Applicant states that the interest rate on this loan will be at a market rate, and that RADR ZWS will be free to seek alternate sources of financing. Since there is no evidence that the loan contains an unreasonable rate of interest, and it conveys no management control or entitlement to profits and losses to the electric utility, the loan and the payments are not included in the stream of benefits from the facility. <sup>8/</sup>

In addition, an affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of RADR ZWS' interest in the facility. The

<sup>7/</sup> Zond Windsystems states that the fees Zond Systems will receive for managing and operating the facility and for the easement, do not exceed the compensation that would have been paid to an unaffiliated entity. Citing Acme POSDEF Partners, L.P., 72 FERC ¶ 62,264 (1995), Zond Windsystems states that these fees should thus not be included in the stream of benefits.

<sup>8/</sup> See, e.g., East Syracuse Generating Co., L.P., 65 FERC ¶ 62,224.

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Applicant claims that any payments made by Zond Systems' affiliate pursuant to this agreement are similar to capital contributions that convey no management control to the utility interest and do not affect the distribution of profits or gains, and should thus not be included in the stream of benefits. <sup>2/</sup>

Furthermore, RADR ZWS will grant Zond Systems an option to purchase its member interest in Zond Windsystems. The Applicant states that this option may only be exercised if doing so would not adversely affect the QF status of the facility. The Applicant further represents that, if Zond Systems decides to exercise this option following the merger, it would first seek Commission authorization to change the facility status from a QF to an EWG under Section 32(a)(1) of PUHCA.

In view of the above review process and partnership terms, Zond Systems, the electric utility affiliated partner, may not dictate the terms and conditions of loans or service agreements made by RADR ZWS or its affiliates. Thus, revenues that Zond Systems or its affiliates may receive from loans or service agreements are viewed as resulting from arm's-length negotiations. Accordingly, such revenues need not be considered in determining Zond Systems' entitlement to the stream of benefits from the facility.

C. Control and Stream of Benefits:

Zond Windsystems states that Zond Systems and RADR ZWS are entitled to 50 percent of the total stream of benefits (e.g., profits, losses, gains and surplus, and tax benefits) from the facility. Since Zond Systems will receive no more than 50 percent of the stream of benefits from the facility and will have no more than 50 percent control of Zond Windsystems, the facility meets the ownership criteria of 18 C.F.R. 292.206 and the interpreting cases. See Ultrapower 3, 27 FERC ¶ 61,094 (1984), and CMS Midland, Inc., 38 FERC ¶ 61,244 (1987).

Finding:

The small power production facility, as described in the application submitted by Zond Windsystems, meets the requirements established in 18 C.F.R. 292.203(a) regarding certification as a qualifying small power production facility.

The Director:

Grants recertification of qualifying status to the facility referenced in the submittal filed on May 14, 1997, by Zond

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<sup>2/</sup> See, e.g., Ultrapower 3, 27 FERC ¶ 61,094 at 61,184 (1984).

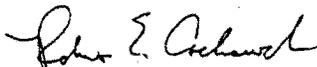
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Windsystems, pursuant to 18 C.F.R. 292.207(b) and Section 3(17)(C) of the Federal Power Act, as amended by Section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), and the Incentives Act, provided that the facility is owned and operated in the manner described in the application and this order. 10/ To the extent that facts or representations which form the basis for this order change, this order cannot be relied upon. While the facility might still be a QF under the changed circumstances, self- or Commission-recertification at that point will be necessary. 11/

Authorities:

Authority to act on this matter is delegated to the Director, Division of Opinions and Corporate Applications, pursuant to 18 C.F.R. 375.308.

This order constitutes final agency action. Requests for rehearing by the Commission may be filed within thirty (30) days of the date of issuance of this order, pursuant to 18 C.F.R. 385.713.



Robert E. Cackowski  
Director, Division of Opinions  
and Corporate Applications

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10/ Certification as a QF serves only to establish eligibility for benefits provided by PURPA, as implemented by the Commission's Regulations, 18 C.F.R. Part 292. It does not relieve a facility of any other requirements of local, state or federal law, including those regarding siting, construction, operation, licensing and pollution abatement. Certification does not establish any property rights, resolve competing claims for a site, or authorize construction.

11/ See *Citizens for Clean Air and Reclaiming our Environment v. Newbay Corporation*, 56 FERC ¶ 61,428 (1991), and *Midland Cogeneration Venture Limited Partnership and CMS Midland, Inc.*, 56 FERC ¶ 61,361 (1991).

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August 3, 2000

Committee on Governmental Affairs  
**EXHIBIT #A-11c**

Honorable David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

RE: Notice of Self-Recertification of Qualifying Facility Status for  
Small Power Production Facility  
Zond Windsystems Holding Co., Docket No. QF87-365 *004*

Dear Mr. Boergers:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292 (1999), please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to the ZWHC LLC wind turbine facility. As discussed in the notice, the recertification is based on changes in the upstream ownership of ZWHC LLC.

Please date and stamp the enclosed extra copies of this notice and return them to our messenger. Thank you for your attention to this matter.

Sincerely,

*Adam Wenner*  
Adam Wenner  
Attorney for Enron Wind Systems, Inc.

Enclosure

cc: California Public Utilities Commission

DC:94127.1

*0008070296-1*

*CS*  
FILED DOCKETED  
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UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL ENERGY  
REGULATORY COMMISSION

Zond Windsystems Holding Co. )  
)  
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Docket No. QF87-365-

**NOTICE OF SELF-RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY**

Pursuant to Section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> ZWHC LLC ("ZWHC" or "Applicant") hereby submits this Notice of Self-Recertification that its wind energy facility remains a qualifying small power production facility based on a change in its upstream ownership. The Facility is a qualifying small power production facility ("Qualifying Facility" or "QF") under Subpart B of Part 292 of the Commission's regulations.

**Form 556**

**1a. Name:**

The full name of the Applicant is ZWHC LLC. The Docket Number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF87-365-003, in the name of Zond Windsystems Holding Co., which has since merged into ZWHC LLC.

<sup>1</sup> 18 C.F.R. § 292.207(a) (1999).

Pursuant to an application dated April 8, 1987, as amended July 1, 1987 and August 12, 1987, the Commission granted certification as a qualifying small power production facility to the wind energy facility (the "Facility") then being developed by Zond Systems, Inc. (Zond Systems, Inc. has changed its name to Enron Wind Systems, Inc.) at a site in the Tehachapi Mountains, Kern County, California (the "Initial Certification").<sup>2</sup> As described in the initial application, Zond Systems, Inc. ultimately formed Zond Windsystems Holding Co. to own the Facility. Zond Windsystems Holding Co. has subsequently merged into ZWHC. On September 8, 1992, Zond Windsystems Holding Co. filed a Notice of Self-Recertification to reflect the change in ownership, a reduction in the Facility's capacity, and the inclusion of an undivided ownership interest in privately and cooperatively owned transmission and interconnection facilities within the definition of the Facility.<sup>3</sup> Pursuant to a Request for Recertification dated May 14, 1997,<sup>4</sup> the Commission granted recertification of the Facility's qualifying facility status reflecting the purchase by RADR ZWS, LLC ("RADR ZWS") of 50 percent interest in ZWHC.<sup>5</sup> (These above-referenced filings and orders are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications

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<sup>2</sup> Zond Systems, Inc., 41 FERC ¶ 62,079 (1987).

<sup>3</sup> Docket No. QF87-365-002. ZWHC owns these facilities through its wholly-owned subsidiary Sagebrush Partner Twenty Inc.

<sup>4</sup> Docket No. QF87-365-003.

<sup>5</sup> Zond Windsystems Holding Co., 79 F.E.R.C. ¶ 62,236 (1997).

changes as described herein, ZWHC hereby incorporates by reference the Prior Certifications with respect to its Notice of Self-Recertification as a Qualifying Facility under Section 292.207 of the Commission's regulations.

The purpose of this Notice is to recertify the Facility as a QF following a change in upstream ownership of the Facility.

**1b. Full Address of Applicant**

ZWHC LLC  
P.O. Box 1910  
13000 Jameson Road  
Tebachapi, California 93561  
(805) 822-6835

**1c. Ownership**

ZWHC is a Delaware limited liability company. Prior to the change in ownership described herein, Enron Wind Systems, Inc. was the Managing Member, owning 50 percent of member interests, and RADR ZWS was a Regular Member, owning the remaining 50 percent of member interests in ZWHC.<sup>6</sup> Enron Wind Systems, Inc. has purchased RADR ZWS's interest in ZWHC (the "Transaction"). As a result of the Transaction, Enron Wind Systems, Inc. holds a direct 100 percent ownership interest in ZWHC. Enron Wind Systems, Inc. is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp., which, in turn, is a wholly-owned subsidiary of Enron Wind Corp., which, in turn, is a wholly-owned subsidiary of Enron Renewable Energy Corp. ("EREC"). EREC is a wholly-owned subsidiary of Smith Street Land Company, which is a wholly-owned subsidiary

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<sup>6</sup> The prior ownership of ZWHC is depicted on the chart attached as Exhibit A.

of Enron Corp. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. The new ownership of ZWHC after the Transaction is depicted on the chart attached as Exhibit B.

On April 14, 2000 Enron Corp., the ultimate parent of Enron Wind Systems, Inc., filed an application with the Securities and Exchange Commission ("SEC") for an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 ("PUHCA").<sup>7</sup> Under the Commission's regulations, 18 C.F.R. § 292.206(c), in conjunction with the "good faith" filing provisions of Section 3(c) of PUHCA, upon filing of an application for exemption under Section 3(a)(3) or Section 3(a)(5) of PUHCA, an applicant is not considered an "electric utility holding company" under the QF ownership test of the Commission's regulations for purposes of the utility ownership limitations under PURPA. Doswell Limited Partnership and Diamond Energy, 56 FERC ¶ 61,170, 61,590 (1991). Accordingly, as of April 14, 2000, neither Enron Corp. nor any of its affiliates is deemed to be an electric utility holding company for purposes of the ownership limitation under the Commission's regulations.

In addition, Enron Corp. now is in the process of selling Portland General Electric ("PGE") to Sierra Pacific Resources.<sup>8</sup> Upon completion of the sale, Enron Corp. and its affiliate will no

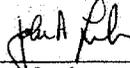
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<sup>7</sup> 15 U.S.C. § 79c(a)(1) (1994).

<sup>8</sup> In the application filed in Docket No. EC00-63-000 on March 3, 2000, Enron Corp. and Sierra Pacific, et al. have sought approval of Enron Corp.'s proposed sale and Sierra Pacific's proposed acquisition of PGE under Section 203 of the FPA.

longer be a "holding company" under PUHCA and thus will no longer be an "electric utility holding company" under the Commission's regulations.

**1d. Signature of authorized individual evidencing accuracy and authenticity of information:**



John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this notice should be addressed to the following persons:

John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.  
444 South Flower Street  
Suite 4545  
Los Angeles, CA 90071-2946  
213-452-4884

Stephen H. Friedlander  
Enron Corp.  
333 Clay Street  
Suite 2100  
Houston, TX 77002  
713-646-6525

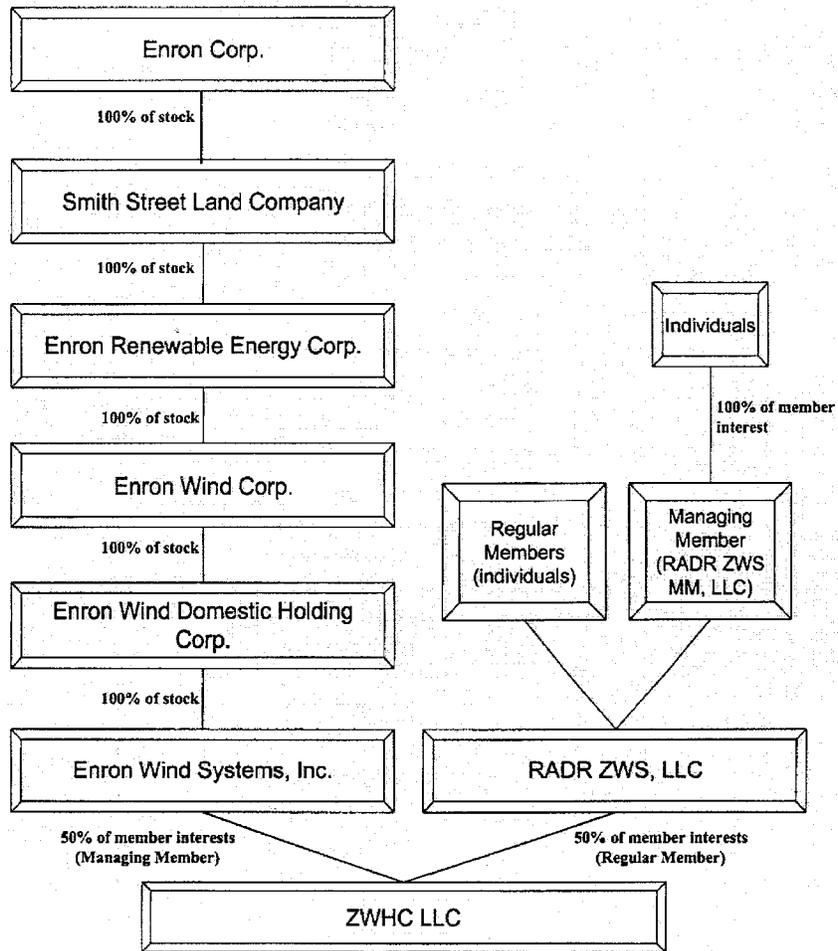
Adam Wenner  
The Willard Office Building  
Vinson & Elkins, L.L.P.  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
202-639-6533

**3a. Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93561

- 3b. **Utility:**  
See Prior Certifications.
- 4a. **Facility Components:**  
See Prior Certifications.
- 4b. **Power Production Capacity:**  
See Prior Certifications.
- 4c. **Initial Operations:**  
See Prior Certifications.
- 4d. **Primary Energy Input:**  
See Prior Certifications.
- 5. **Average Annual Hourly Energy Inputs:**  
See Prior Certifications.
- 6. **Additional Characteristics:**  
None.
- 7. **Fossil Fuel Use:**  
See Prior Certifications.
- 8. **Eligible Facility:**  
See Prior Certifications.

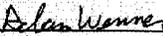
### Exhibit A Zond Windsystems Holding Co. LLC (previous)



## CERTIFICATE OF SERVICE

Pursuant to Sections 292.207(a)(ii) and 385.2010 of the Commission's regulations, I hereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon (1) each electric utility to which applicant expects to interconnect, transmit, or sell electric energy or from which applicant expects to purchase supplementary standby, back-up, and maintenance power, (2) the state regulatory authority of each state where the facility and each affected utility is located, and (3) each person designated on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

Dated at Washington, D.C. this 3<sup>rd</sup> day of August, 2000.

  
\_\_\_\_\_  
Adam Wenner  
Attorney for Enron Wind Systems, Inc.

Committee on Governmental Affairs  
**EXHIBIT #A-12**

**QF 91-59**

**Sky River Partnership**

**Vinson & Elkins**

ATTORNEYS AT LAW

VINSON & ELKINS LLP  
THE WILLARD OFFICE BUILDING  
1155 PENNSYLVANIA AVE., N.W.  
WASHINGTON, D.C. 20004-1068  
TELEPHONE (202) 439-4500  
FAX (202) 639-6644

**ORIGINAL**

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FEDERAL ENERGY REGULATORY COMMISSION

WRITER'S TELEPHONE  
(202) 639-6533

May 14, 1997

Ms. Lois D. Cashell, Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Dockets Room 1A  
Washington, D.C. 20426

Committee on Governmental Affairs  
**EXHIBIT #A-12a**

RE: Sky River Partnership, Docket No. QF91-59-003

Dear Ms. Cashell:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292, please find enclosed an original and fourteen copies of a "Request for Certification of Qualifying Facility Status for Small Power Production Facility" relating to the Sky River wind turbine facility. As discussed in the application, the recertification is based on changes in the ownership of Sky River Partnership, necessitated by the changes in status that result from the proposed merger of Enron Corp., an indirect owner of the Sky River Partnership, with Portland General Corporation, as described in the Commission's order in Enron Corp., 78 FERC ¶ 61,179 (1997).

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,

*Adam Wenner*

Adam Wenner

Enclosures  
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OFFICE OF THE SECRETARY  
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FEDERAL ENERGY  
REGULATORY  
COMMISSION

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Sky River Partnership )  
 ) Docket No. QF91-59- 003  
 )

REQUEST FOR RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY

Pursuant to section 292.207(b) of the Commission's regulations,<sup>1/</sup> Sky River Partnership ("Sky River" or "Applicant") hereby applies for recertification that the wind energy facility described herein, subsequent to a change in upstream ownership, is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.<sup>2/</sup>

Form 556

1a. Name:

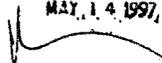
The full name of the Applicant is Sky River Partnership. The Docket Number assigned to the immediately preceding submittal filed with the Commission in connection with the instant

<sup>1/</sup> 18 C.F.R. § 292.207(b) (1996).

<sup>2/</sup> Victory Garden Phase IV Partnership, Docket No. QF90-43-\_\_\_, and Zond Windsystems Holding Company, Docket No. QF87-365-\_\_\_, are concurrently filing applications for recertification of qualifying facility status of small power production facilities regarding similar upstream ownership changes. (The facilities described in these applications, together with the facility described herein, are referred to as the "Zond Facilities.")

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facility is QF91-59-002. Pursuant to an application dated January 17, 1991, as amended October 8, 1991, the Commission granted certification as a qualifying small power production facility to the wind energy facility (the "Facility") then being developed by Zond Sky River Development Corporation ("Sky River Dev. Corp.") and ESI Sky River Limited Partnership ("ESI Sky River") at a site in the Tehachapi Mountains, Kern County, California (the "Initial Certification").<sup>3/</sup> As described in the initial application, Sky River Dev. Corp. and ESI Sky River ultimately formed Sky River to be the owner of the Facility.<sup>4/</sup> On December 30, 1991, Sky River filed a Notice of Self-Recertification regarding a change in the capacity of the Facility.<sup>5/</sup> Sky River also filed an Application for Recertification to reflect the installation of an additional wind turbine generator to the Facility, and on April 17, 1992, the Commission granted recertification.<sup>6/</sup> (The Initial Certification, the Notice of Self-Recertification, and the Recertification Order are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, Sky River hereby incorporates by reference the Prior Certifications with

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<sup>3/</sup> Zond Sky River Dev. Corp., 57 FERC ¶ 62,019 (1991).

<sup>4/</sup> Sky River, through its wholly owned subsidiary Sagebrush Partner Fifteen Inc., also owns an undivided interest in certain privately and cooperatively owned transmission facilities and interconnection facilities used to transmit power from QFs to the purchasing utility. Id. at 63,027-28.

<sup>5/</sup> Docket No. QF91-59-001.

<sup>6/</sup> Sky River Partnership, 59 FERC ¶ 62,057 (1992) ("Recertification Order").

respect to its Application for Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.

**1b. Full Address of Applicant**

Sky River Partnership  
P.O. Box 1910  
13000 Jameson Road  
Tehachapi, California 93561  
(805) 822-6835

**1c. Ownership**

**I. Sky River Ownership**

Sky River is a California general partnership with Sky River Dev. Corp. as the managing general partner and ESI Sky River as the other general partner.<sup>7/</sup> ESI Sky River is a Delaware limited partnership with ESI Sky River, Inc. as its sole general partner and ESI LP, Inc. as its sole limited partner. ESI Sky River, Inc. is a wholly owned subsidiary of ESI California Holdings, Inc. which in turn, is a wholly owned subsidiary of ESI Energy, Inc. ("ESI Energy"). ESI LP, Inc. is a wholly-owned subsidiary of ESI Energy. ESI Energy is a wholly owned subsidiary of FPL Group, Inc. ("FPL Group"), an "electric utility holding company" as defined in section 292.202(n) of the Commission's regulations.<sup>8/</sup>

Sky River Dev. Corp. is a wholly owned subsidiary of Zond Systems, Inc. ("Zond Systems"), which is a wholly owned subsidiary of Zond Corporation ("Zond"). Zond is a wholly owned subsidiary of Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent

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<sup>7/</sup> The current ownership of Sky River is depicted on the chart attached as Exhibit A.

<sup>8/</sup> 18 C.F.R. § 292.202(n) (1996).

of the outstanding stock of EREC.<sup>2/</sup> On February 27, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation ("PGC") (the "Merger") under Section 203 of the Federal Power Act.<sup>10/</sup> PGC is the sole parent company of Portland General Electric Company, an electric utility. Following the completion of the Merger, Enron will become an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>11/</sup> As a result, Enron's 39.165 percent derivative interest in Sky River<sup>12/</sup> will be considered ownership by an "electric utility holding company" for purposes of section 292.206.<sup>13/</sup>

In order to ensure that Sky River will remain in compliance with section 292.206, prior to the Merger, Zond Systems will sell 100 percent of its interest in Sky River Dev. Corp.<sup>14/</sup> (which, as

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<sup>2/</sup> The remaining 21.67% of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC's stock or is an "electric utility" or an "electric utility holding company." None of these individuals or entities is engaged in the generation or sale of electric power or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities; "eligible facilities" as "exempt wholesale generators" under Section 32(a) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994); or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>10/</sup> Enron Corp., 78 FERC ¶ 61,179 (1997).

<sup>11/</sup> 15 U.S.C. § 79c(a)(1) (1994).

<sup>12/</sup> 50 percent x 78.33 percent.

<sup>13/</sup> See Dominion Resources, Inc., 43 FERC ¶ 61,079 (1988).

<sup>14/</sup> Prior to the sale, Sky River Dev. Corp. will merge with and into Sky River, LLC, a Delaware limited liability company, and Sky River Dev. Corp.'s stock will be converted to a "member interest" that will be owned by Zond Systems. This change in corporate form does not affect the determination of ownership of the Facility under

described in footnote 14, will be converted to Sky River, LLC prior to the sale) to RADR ZWS, LLC ("RADR ZWS"), a Delaware limited liability company owned by a Managing Member and Regular Members.<sup>15/</sup> As a result, RADR ZWS will hold an indirect 50 percent partnership interest in Sky River.<sup>16/</sup> The Managing Member of RADR ZWS will be RADR ZWS MM, LLC, a limited liability company owned by three individuals, and the Regular Members will be individuals. (The Managing Member, its upstream owners, and the Regular Members are referred to collectively as the "RADR ZWS Owners.") None of RADR ZWS or the RADR ZWS Owners is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA.<sup>17/</sup>

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section 292.206.

<sup>15/</sup> The new ownership of Sky River is depicted on the chart included in Exhibit A.

<sup>16/</sup> In the Initial Certification, the Commission found that ESI Sky River would own no more than a 50 percent interest in the Facility. Zond Sky River Dev. Corp., 57 FERC at 63,027. Except for the designation of ESI Sky River as the managing general partner, there are no substantive changes to the Sky River Partnership First Amended and Restated Agreement of General Partnership, dated October 13, 1990 ("Sky River Partnership Agreement").

<sup>17/</sup> The individuals who will own RADR ZWS MM, LLC, as well as the Regular Members, may invest directly or indirectly, through investment entities that they control. If they invest through such entities, the entities will also satisfy the above-described restrictions respecting utility-related activities and ownership.

## II. Description of Sky River's Operations

Sky River sells all of the output of the Facility to Southern California Edison Company ("SCE") pursuant to three power purchase agreements, each originally executed on January 30, 1985 and expiring in 2021. SCE also supplies electrical service to the Facility.

Zond Systems, a wholly owned subsidiary of Zond Corporation, provides operations and maintenance service to Sky River pursuant to a Windsystem Management Agreement ("O&M Agreement") executed on November 30, 1990. Zond Systems receives a fee based on a percentage of costs incurred for direct labor and benefits for services provided under the O&M Agreement plus reimbursement of direct and indirect costs. The O&M Agreement was the product of arm's-length bargaining between Zond Systems and ESI Sky River, and the payments thereunder do not exceed the market price for such services. RADR ZWS will ratify the O&M Agreement.

Zond Systems also leases or owns the land on which the Facility is located and provides an easement to Sky River for use of the property pursuant to a Grant of Windpark Easement and Easement Agreement executed on June 7, 1990 ("Easement Agreement"). The Easement Agreement was the product of arm's-length bargaining between Zond Systems and ESI Sky River, and the payments thereunder do not exceed the market rate for such an easement. RADR ZWS will ratify the Easement Agreement.

Zond Systems will provide consulting services to Sky River, LLC pursuant to a Windsystem Consulting Services Agreement to be entered into by Zond Systems and RADR ZWS. The Consulting Agreement will be the product of arm's-length negotiations between Zond Systems and RADR ZWS, owner of Sky River, LLC. Payments for consulting services will be \$10,000 per year.

adjusted in accordance with changes to the Consumer Price Index. The payments will not exceed the market price of such services.

EREC will provide a loan to RADR ZWS, the proceeds of which will be used to finance the acquisition of Zond Systems' interest in Sky River, LLC. The interest rate will be at a market rate, and RADR ZWS will be free to seek alternative sources of financing. The loan will convey no management control or entitlement to profits or losses from the Facility to EREC.

ESI Sky River will replace Sky River Dev. Corp. as the managing general partner of Sky River. The change in the identity of the managing general partner will not alter the duties of, or compensation to, the managing general partner, which were established in arm's-length negotiations between Sky River Dev. Corp. and ESI Sky River in October 1990, when these parties entered into the First Amended and Restated Sky River Partnership Agreement (the "Partnership Agreement"). RADR ZWS will ratify these changes to the Partnership Agreement.

To address a potential discrepancy between cash flows from the Facility and income tax liability in respect of the Facility in years 1999-2008, an affiliate of Zond Systems will indemnify RADR ZWS for any amount by which the aggregate income tax liability of the Members in respect of Sky River for each of these years exceeds distributable cash flow from Sky River to the Members for such year. Also, an affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of the interest of RADR ZWS in the Zond Facilities.

RADR ZWS will grant Zond Systems an option to purchase its member interest in Sky River, LLC. The option agreement will provide that during the term of the existing power purchase

agreements, the option may only be exercised if the exercise would not adversely affect the QF status of the Facility, unless there has been a change in law or Commission regulations, or a change to the agreements that would permit the option to be exercised without materially and adversely affecting Sky River's rights under these power purchase agreements (the "QF Period").<sup>18/</sup> As noted above, Sky River's existing power purchase agreements, which require the Facility to be a QF, extend through year 2021. Consequently, the effect of this provision is that, absent such a change, the Facility will remain a QF through 2021. Following the Merger, if Zond Systems were to exercise the option after the expiration of the power purchase agreements, the Facility would cease to be a QF; prior to that time Sky River will seek a Commission determination that it is an "exempt wholesale generator" under Section 32(a)(1) of PUHCA.<sup>19/</sup> The option will be transferable or assignable; however the assignee or transferee will remain subject to these restrictions.<sup>20/</sup>

### III. The Arrangements Satisfy the Commission's Ownership Criteria

The statutory ownership criteria governing Qualifying Facilities appear in Section 3(17)(C)(ii) of the Federal Power Act. Under that section, a Qualifying Facility must be owned:

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<sup>18/</sup> In addition, during the term of an outstanding loans from Credit Suisse First Boston to Sky River, the option may not be exercised if such exercise would have a material adverse effect on the regulatory status of the Facility.

<sup>19/</sup> 15 U.S.C. § 79z-5a(a).

<sup>20/</sup> Depending on the timing of the Merger, it may be necessary to implement some of the changes described herein, such as the transfer of an ownership interest to RADR ZWS and the loan, prior to the issuance of a final order in the instant proceeding.

by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).<sup>21/</sup>

The Commission's regulation implementing Section 3(17)(C)(ii) states that:

a . . . small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.<sup>22/</sup>

The Commission's regulations thus equate "ownership interest" with "equity interest." The Commission evaluates the control of the venture and each owner's entitlement to the "stream of benefits" from the venture to determine each participant's equity interest.<sup>23/</sup>

A. Control

The arrangements described herein satisfy the Commission's requirement that electric utilities, electric utility holding companies, or their subsidiaries exercise no more than 50 percent control of a QF. As stated above, RADR ZWS will have the same rights to control Sky River that Zond Systems had when the Commission determined, in the Initial Certification, that Sky River's

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<sup>21/</sup> 16 U.S.C. § 796(18)(B)(ii) (1994).

<sup>22/</sup> 18 C.F.R. § 292.206(b) (1996).

<sup>23/</sup> See, e.g., Ultrapower 3, 27 FERC ¶ 61,094 (1984).

ownership structure satisfies the Commission's QF ownership criteria.<sup>24/</sup> The only change to that structure is that ESI Sky River will become the managing general partner.

The Commission has held that an electric utility subsidiary may be the sole general partner or managing general partner of a partnership, provided that the non-utility owner retains the right to approve any decisions that affect the distribution of the stream of benefits from the facility, including approval of loans and service agreements with affiliates of the utility owner.<sup>25/</sup> Under the new ownership arrangements described herein, Sky River, LLC will retain one-half control of the Management Committee. In the Prior Certifications the Commission determined that under the terms of the Partnership Agreement, neither partner nor the Management Committee has the authority to alter the allocation of the stream of benefits from the Facility.<sup>26/</sup> These terms have not been changed. Accordingly, ESI Sky River will not exercise greater than 50 percent control of Sky River. In approving similar arrangements, Commission orders have noted that the utility affiliate

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<sup>24/</sup> Other than as a result of their indirect interest in the Zond Facilities, none of the RADR ZWS Owners has any affiliation with Enron, FPL Group, or any affiliate of either.

<sup>25/</sup> See Burney Forest Products, a Joint Venture, 76 FERC ¶ 62,263, at 64,476 (1996) (utility affiliate sole general partner); see also Crockett Cogeneration, a Cal. Ltd. Partnership, 72 FERC ¶ 62,078, at 64,135 (1995); ONSITE/Molokai Limited Partnership, 49 FERC ¶ 61,333 (1989); Onondaga Cogeneration Limited Partnership, 62 FERC ¶ 62,140 (1993); Acme POSDEF Partners, L.P., 72 FERC ¶ 62,264 (1995); Geothermal Energy Partners Ltd., 50 FERC ¶ 62,006 (1990) (utility affiliate managing partner).

<sup>26/</sup> Zond Sky River Dev. Corp., *supra*, 57 FERC at 63,027.

is simply taking over duties as the managing general partner under arrangements established when a non-utility entity performed that same role.<sup>27</sup>

B. The Ownership Arrangements Satisfy the Commission's Requirements for Allocation of the Stream of Benefits.

The new ownership arrangements satisfy the Commission's criteria that no more than 50 percent of the stream of benefits from a QF flow to electric utilities, electric utility holding companies, or their subsidiaries. As noted above, RADR ZWS will have the same rights to the stream of benefits from the Facility as Zond Systems had under the arrangements that the Commission determined, in the Initial Certification, satisfy the Commission's QF ownership criteria.<sup>28</sup> No aspect of the new ownership arrangements will affect RADR ZWS's right to receive 50 percent of the stream of benefits from Sky River.

1. The O&M, Easement, and Consulting Agreements.

In evaluating the stream of benefits from a QF, the Commission has held that it will consider whether payments to an electric utility owner or its affiliate under a service agreement or other arrangement reflect additional equity payments. Where such payments exceed the compensation that would have been paid to an unaffiliated entity for the same services, the Commission will consider the payments to be part of the recipient's entitlement to the stream of benefits. On the other hand, where such payments result from arm's-length negotiations, the Commission will find that the

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<sup>27</sup> See Brady Power Partners, 61 FERC ¶ 62,113, at 63,184 n.7 (1992).

<sup>28</sup> See supra note 16.

payments reflect the market and are not part of the stream of benefits.<sup>29/</sup> If control of a Qualifying Facility is shared equally between a utility and non-utility owners, the Commission will presume any such arrangements to be at arm's length.<sup>30/</sup>

At the time that the O&M Agreement and the Easement Agreement were negotiated, Sky River Dev. Corp. was a 50 percent, non-utility partner in Sky River, and ESI Sky River was a 50 percent utility partner. The O&M and Easement Agreements thus satisfy the Commission's criteria for presuming that the agreements were the result of arm's-length bargaining and that the compensation paid to the Zond affiliates reflects market rates.<sup>31/</sup> Moreover, RADR ZWS will ratify the O&M and Easement Agreements.

Similarly, Zond Systems will provide consulting services to Sky River, LLC pursuant to the Consulting Agreement. The payments under the Consulting Agreement will not exceed market rates, and the agreement will be the result of arm's-length bargaining between Zond Systems and RADR ZWS. The arrangement thus will satisfy the Commission's criteria for holding that Zond Systems' revenues are not included in the stream of benefits from the Facility.<sup>32/</sup>

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<sup>29/</sup> See Acme POSDEF Partners, L.P., 72 FERC at 64,830 (1995).

<sup>30/</sup> Id.; see also Brooklyn Navy Yard Cogeneration Partners, L.P., 74 FERC ¶ 61,015, at 61,047 (1996) ("Brooklyn Navy Yard").

<sup>31/</sup> See Clear Lake Cogeneration Ltd. Partnership, 78 FERC ¶ 62,178 (1997) ("Clear Lake"); Cogenron Inc., 78 FERC ¶ 62,152 (1997).

<sup>32/</sup> With respect to any future contracts, the Partnership Agreement provides that approval of any contract between the Partnership and any partner or affiliate of any partner is determined by the representative of the unaffiliated partner on the Management Committee. Thus, the electric utility affiliated entity with an interest in the Facility may not dictate the terms or conditions of service agreements with Sky

2. The Loan Agreement

As noted above, EREC will provide a loan to RADR ZWS to finance the purchase of the member interest in Sky River, LLC. The Commission has held that the repayment of a loan by an electric utility to a non-electric utility owner of a QF is not included in the stream of benefits where the loan contains a reasonable rate of interest for the risks assumed and conveys no management control or entitlement to profits or losses to the electric utility.<sup>13/</sup> The Commission has also held that its concern regarding loans is further mitigated where the non-utility borrower is not prevented from borrowing funds elsewhere to finance the acquisition.<sup>14/</sup>

The interest rate for the loan to RADR ZWS will be consistent with rates for projects with similar risk profiles. The loan will convey no management control or entitlement to profits or losses from Sky River to the lender. Moreover, RADR ZWS was not precluded from borrowing the funds from an alternative lender. Accordingly, the loan and the payments thereunder should not be included in the stream of benefits from the Facility.

3. Managing General Partner

ESI Sky River will receive a fee for the performance of its duties as the managing general partner of Sky River. The amount of the fee is the same that Sky River Dev. Corp., the non-utility owner, received under the Sky River Partnership Agreement during its term as managing general

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River. See Cogenron Inc., 78 FERC at 64,570.

<sup>13/</sup> East Syracuse Generating Co., L.P., 65 FERC ¶ 62,224, at 64,553 (1993) ("East Syracuse"); cf. Brooklyn Navy Yard, 74 FERC at 61,047-48.

<sup>14/</sup> Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084, at 64,229 (1995).

partner. The amount of the fee was negotiated at arm's length and was implemented in 1990, well before the new ownership arrangements were contemplated. Moreover, RADR ZWS will ratify the revised Sky River Partnership Agreement. Accordingly, the management fee should not be included in the stream of benefits from the Facility received by ESI Sky River.<sup>35/</sup>

#### 4. Indemnity

Under the indemnity agreements described above, an affiliate of Zond Systems may, in certain circumstances, be required to make payments to the non-utility owners of Sky River. The Commission has held that, in determining ownership interests under section 292.206, it does not consider capital contributions and has approved arrangements in which the utility affiliate's future contributions would cause its contributions to exceed 50 percent.<sup>36/</sup> The examination focuses instead "on that which is derived from the partnership, i.e., the stream of benefits."<sup>37/</sup> Payments, if any, pursuant to the indemnity agreements are similar to capital contributions that convey no management control and do not affect the distribution of profits or gains,<sup>38/</sup> and therefore are not included in the stream of benefits.<sup>39/</sup>

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<sup>35/</sup> See Brady Power Partners, 61 FERC ¶ 62,113 (1992). The Commission has previously approved a similar arrangement involving another affiliate of ESI. Id.

<sup>36/</sup> See, e.g., Ultrpower 3, 27 FERC at 61,184; Beowawe Geothermal Power Co., 33 FERC ¶ 62,205 (1985).

<sup>37/</sup> CMS Midland, Inc., 50 FERC ¶ 61,098 at 61,288 (1990).

<sup>38/</sup> Id.

<sup>39/</sup> See also, East Syracuse, 65 FERC at 64,553 (principal amount of loan by utility owner to non-utility owner subject to downward adjustment to the extent non-utility owner incurs loss in subsequent resale of its interest); Lake Cogen, Ltd., 79 FERC

5. Purchase Option

The Commission has held that the existence of a purchase option does not constitute a present ownership interest and thus does not affect a facility's qualifying status.<sup>40/</sup> Prior to the exercise of the option, the interest in Sky River held by an electric utility or an electric utility holding company will not exceed 50 percent. As described above, the option can only be exercised by a utility interest after the QF Period has ended, whereupon, absent a change in law or regulations as described above, the Facility would no longer enjoy the benefits of QF status and would seek to obtain status as an exempt wholesale generator. The Commission has recognized that a facility may be a QF during one period and not be a QF during another period. When this happens, the lack of qualifying status during one period does not affect the facility's qualifying status during the period of compliance.<sup>41/</sup> In the instant case, the basis for ceasing to be a Qualifying Facility would be a

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¶ 62,054 (1997); Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084.

<sup>40/</sup> See, e.g., City of Burlington, Vt. Elec. Dep't, 45 FERC ¶ 61,009, at 61,035 n.32 (1988) (option held by utility affiliate to purchase non-utility owner's interest in QF in year 11 or 21 of operation not treated as present ownership by utility); Turbo Gas & Elec., Ltd., 30 FERC ¶ 61,273 at 61,565 (1985) (option by subsidiary of electric utility holding company to purchase either 51 or 100 percent of QF not treated as current utility ownership interest). Similarly, the Commission determined that provisions permitting a utility affiliate to assume 99 percent of voting interest in a QF upon an event of a default under its lease or deferral of payments under its power purchase agreement to be "unexercised rights" that do not bar QF status. Midland Cogeneration Venture, L.P., 50 FERC ¶ 61,259 at 61,802 (1990), *reh'g denied*, 56 FERC ¶ 61,361 (1991), *petition for review denied sub nom. Michigan Mun. Coop. Group v. FERC*, 990 F.2d 1377 (D.C. Cir. 1993).

<sup>41/</sup> See, e.g., Pepperill Power Associates, L.P., 64 FERC ¶ 61,286 (1993) (facility which operated as a Qualifying Facility from 1987 through 1992 subsequently lost qualifying facility status and became an EWG in 1993, based on loss of steam host); Medina Power Co., 71 FERC ¶ 61,264 (1995), *reh'g denied*, 72 FERC ¶ 61,224

deliberate business decision based on the expiration of power purchase agreements, rather than an unintended failure to meet technical standards. However, the legal consequences in both types of cases should be the same. Here, as in the above-cited cases, the fact that a period of non-QF status may follow the QF Period should not affect the qualifying status of the Facility during the prior period of compliance.

**Id. Authorized individual evidencing accuracy of information:**

  
Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation

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(1995) (following a period of non-compliance in 1992-1994, applicant might become a Qualifying Facility for calendar year 1995 and beyond). See also LG&E Westmoreland Southampton, 76 FERC ¶ 61,116 (1996) (establishing rates and exemptions for period of non-compliance with QF regulations).

**2. Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 236-9544

Dean Gosselin  
ESI Energy, Inc.  
11760 US Highway 1  
Sixth Floor  
North Palm Beach, FL 33408  
(561) 691-3619

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6533  
Counsel to Zond Corporation

Michael D. Hornstein  
Reid & Priest LLP  
701 Pennsylvania Avenue, N.W.  
Suite 800  
Washington, D.C. 20004-1008  
(202) 508-4133  
Counsel to ESI Energy, Inc.

**3a. Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93581

**3b. Utility:**

The Facility interconnects with the transmission system of SCE. SCE purchases the output of the Facility and provides it with separate electric service.

**4a. Facility Components:**

See Prior Certifications.

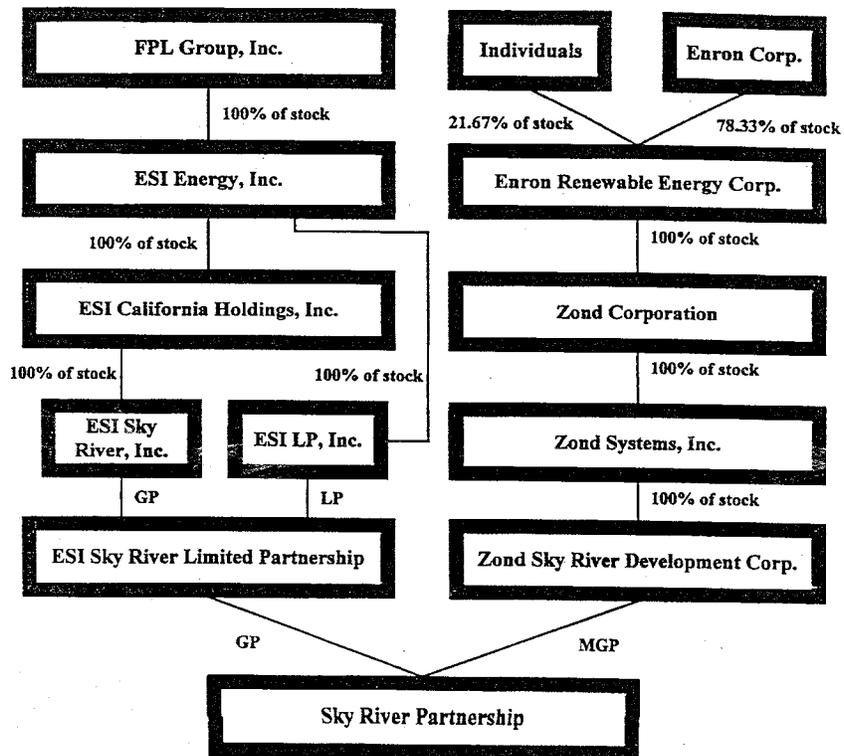
**4b. Power Production Capacity:**

See Prior Certifications.

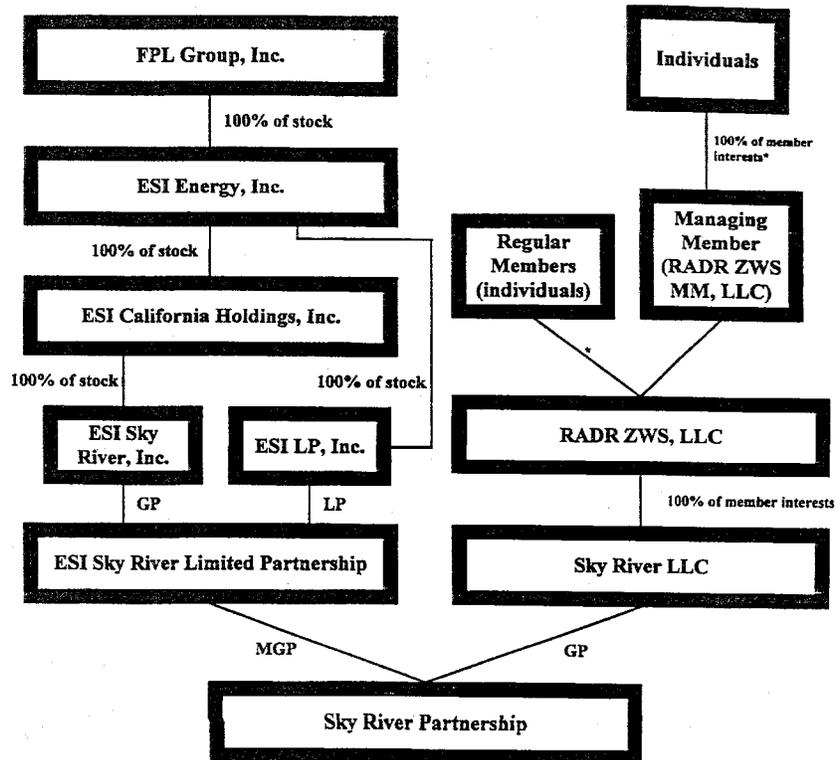
- 4c. **Initial Operations:**  
The Facility commenced operations on February 12, 1991.
- 4d. **Primary Energy Input:**  
See Prior Certifications.
- 5. **Average Annual Hourly Energy Inputs:**  
See Prior Certifications.
- 6. **Additional Characteristics:**  
None.
- 7. **Fossil Fuel Use:**  
See Prior Certifications.
- 8. **Eligible Facility:**  
See Prior Certifications.

EXHIBIT A

## Sky River Partnership (existing)



## Sky River Partnership (proposed)



\*These individuals may invest directly or indirectly, through an intermediate entity.

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Sky River Partnership

§  
§  
§

Docket No. QF91-59-

**NOTICE OF APPLICATION FOR COMMISSION  
RECERTIFICATION OF QUALIFYING STATUS  
OF A SMALL POWER PRODUCTION FACILITY**

On May \_\_, 1997, Sky River Partnership (Sky River), P.O. Box 1910, 13000 Jameson Road, Tehachapi, California 93561 submitted for filing an application for Commission recertification as a qualifying small power production facility pursuant to Section 292.207(b) of the Commission's Regulations. No determination has been made that the submittal constitutes a complete filing.

According to the applicant, the facility is a wind energy small power production facility located in the Tehachapi Mountains, Kern County California. The Commission previously certified the facility as a qualifying facility in Zond Sky River Dev. Corp., 57 FERC ¶ 62,109 (1991), and Sky River Partnership, 59 FERC ¶ 62,057 (1992). The facility consists of 343 wind turbines with an aggregate capacity of 77.45 MW. Power from the facility is sold to Southern California Edison Company. According to the applicant, the instant recertification is requested to assure that the facility will remain a qualifying facility following a change in the ownership of Zond Sky River Development Corp., one of the general partners in Sky River.

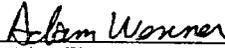
Any person who wishes to be heard or to object to granting qualifying status should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure. A motion or protest must be filed within \_\_ days after the date of publication of this notice and must be served on the applicant. Protests will be considered by the Commission in determining the appropriate action to be taken but will not serve to make protestants parties to the proceeding. A person who wishes to become a party must file a motion to intervene. Copies of these filings are on file with the Commission and are available for public inspection.

Lois D. Cashell  
Secretary

CERTIFICATE OF SERVICE

I hereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon all parties on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

Dated at Washington, D.C. this 14th day of May, 1997.



Adam Wenner  
Attorney for Sky River Partnership

79 FERC ¶ 62,237

Committee on Governmental Affairs  
EXHIBIT #A-12b

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Sky River Partnership )  
Small Power Production and )  
Cogeneration Facilities ) Docket No. QF91-59-003  
-- Qualifying Status )

ORDER GRANTING APPLICATION FOR RECERTIFICATION  
AS A QUALIFYING SMALL POWER PRODUCTION FACILITY

(Issued June 30, 1997)

Summary:

On May 14, 1997, Sky River Partnership (Sky River or Applicant) filed an application for recertification of a small power production facility as a qualifying facility (QF) pursuant to 18 C.F.R. 292.207(b). 1/

According to the application, the instant recertification is requested to ensure that the facility will retain its qualifying status following a change in the upstream ownership of Zond Sky River Development Corp., one of the general partners in Sky River. According to Sky River, no other material changes have occurred with respect to the facility.

Notice of the application was published in the Federal Register with comments, protests or motions to intervene due on or before June 24, 1997. 2/ No responses were received.

Discussion:

Under 18 C.F.R. 292.203(a), a qualifying small power production facility must comply with the size criteria and fuel

1/ The 77.5 MW wind-powered small power production facility is located in Kern County, California. It consists of 343 wind turbine generators and certain transmission and interconnection facilities. Electricity produced by the facility is sold to Southern California Edison Company. The facility was certified in Docket No. QF91-59-000, Zond Sky River Development Corporation and ESI Sky River Limited Partnership, 57 FERC ¶ 62,019 (1991). On December 30, 1991, a notice of self-recertification was filed in Docket No. QF91-59-001. The facility was recertified in Docket No. QF91-59-002, Sky River Partnership, 59 FERC ¶ 62,057 (1992).

2/ 62 Fed. Reg. 31,424 (1997).

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use criteria specified in 18 C.F.R. 292.204 and the ownership criteria contained in 18 C.F.R. 292.206.

A. Ownership:

Under 18 C.F.R. 292.206, no more than 50 percent of the equity interest in a QF may be held, directly or indirectly through subsidiaries, by electric utilities and/or electric utility holding companies (collectively, electric utility entities).

Various subsidiaries of FPL Group, Inc. (an electric utility holding company) currently own 50 percent of Sky River. The remaining 50 percent ownership of Sky River is currently divided between entities and individuals (21.67 percent) and subsidiaries of Enron Corporation (Enron) (78.33 percent). 3/ Under the proposed transaction, Zond Systems (a subsidiary of Enron) will sell 100 percent of its interest in Sky River to RADR ZWS, LLC (RADR ZWS). 4/ As a result, RADR ZWS will hold an indirect 50 percent interest in Sky River.

On February 26, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation (Portland General). 5/ Portland General is the parent of Portland General Electric Company, an electric utility. Due to the proposed merger, Enron's derivative interest of 39.2 percent (*i.e.*, 78.33 percent of 50 percent) in the facility will be considered ownership by an electric utility entity under the Commission's Section 292.206 ownership criteria. However, in order to ensure that Sky River will remain in compliance with the ownership criteria, Zond Systems will sell 100 percent of its interest in Sky River to RADR ZWS prior to the merger.

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- 3/ Specifically, Enron owns 78.33 percent of Enron Renewable Energy Corp., which wholly owns Zond Corporation, which wholly owns Zond Systems, Inc. (Zond Systems) which wholly owns Zond Sky River Development Corporation which owns 50 percent of the Applicant.
- 4/ Prior to the sale, Zond Sky River Development Corporation will merge with and into Sky River, LLC, a Delaware limited liability company, and the stock will be converted into "member interests."
- 5/ Enron Corporation, *et al.*, 78 FERC ¶ 61,179 (1997). Following the completion of the merger, Enron will become an exempt public utility holding company under Section 3(a)(1) of the Public Utility Holding Company Act of 1935 (PUHCA).

Sky River represents that neither RADR ZWS nor any of its upstream owners (the individuals) will be engaged in the generation or sale of electric power, or have any ownership or operating interest in any electric facilities other than QFs and EWGs. <sup>6/</sup> Accordingly, no more than a 50 percent interest in the facility will be held by electric utility entities.

B. Loans and Service Agreements:

Sky River states that Enron Renewable Energy Corporation will provide a loan to RADR ZWS to finance the purchase of the member interest in Sky River, LLC. The interest rate to RADR ZWS will be consistent with rates for projects with similar risk profiles. The loan will convey no management control or entitlement to profits or losses from Sky River to the lender. Accordingly, since there is no evidence that the loan contains an unreasonable rate of interest, and it conveys no management control or entitlement to profits and losses to the electric utility, the loan and payments should not be included in the stream of benefit from the facility. <sup>7/</sup>

Zond Systems, a wholly-owned subsidiary of Zond Corporation, performs operation and maintenance services to Sky River pursuant to a Windsystem Management Agreement (O&M Agreement). Zond Systems receives a fee based on a percentage of costs incurred for direct labor and benefits for services provided under the O&M Agreement plus reimbursement of direct and indirect costs. The O&M Agreement was the product of arm's-length bargaining between the parties, and the payment thereunder do not exceed the market price for such services. RADR ZWS will ratify the O&M Agreement. Zond Systems also leases or owns the land on which the facility is located and provides an easement to Sky River for use pursuant to an Easement Agreement. The Easement Agreement was the product of arm's-length bargaining between the parties, and the payment thereunder do not exceed the market rate for such an easement. RADR ZWS will ratify the Easement Agreement.

In view of the above review process, Enron and its electric utility affiliated entities, Enron Renewable Energy Corporation

<sup>6/</sup> An EWG is not considered an electric utility company under Section 2(a)(3) of the Public Utility Holding Company Act of 1935 (PUHCA), as amended by the Energy Policy Act of 1992, and ownership of an EWG does not result in an entity being considered as primary engagement in the generation or sale of electric power under Sections 3(17)(C)(ii) and 3(18)(B)(ii) of the Federal Power Act. See Sections 32(e) and 32(j) of PUHCA.

<sup>7/</sup> See, e.g., East Syracuse Generating Co., L.P., 65 FERC ¶ 62,224 (1993).

and Zond Systems, may not dictate the terms and conditions of the loans or service agreements made with RADR ZWS and Sky River. Thus, revenues that Enron's subsidiaries may receive from loans or service agreements are viewed as resulting from arm's-length negotiations. Accordingly, such revenues need not be considered in determining Enron's entitlement to the stream of benefits from the facility.

C. Control and Stream of Benefits:

Under the new ownership arrangements, RADR ZWS will have the same rights to control Sky River that Zond Systems had when the Commission determined in the initial certification, that Sky River's ownership structure satisfies the Commission's ownership criteria. The only change is that ESI Sky River Limited Partnership (ESI) will become the managing general partner. Sky River, LLC will retain one-half of control of the Management Committee. Neither partner nor the Management Committee has the authority to alter the allocation of the stream of benefits from the facility. Accordingly, ESI will not have greater than 50 percent control of Sky River. Since ESI will receive no more than 50 percent of the stream of benefits from the facility and will have no more than 50 percent control of Sky River, the facility meets the ownership criteria of 18 C.F.R. 292.206 and the interpreting cases. See *Ultrapower 3*, 27 FERC ¶ 61,094 (1984), and *CMS Midland, Inc.*, 38 FERC ¶ 61,244 (1987).

Finding:

The small power production facility, as described in the application submitted by Sky River, meets the requirements established in 18 C.F.R. 292.203(a) regarding certification as a qualifying small power production facility.

The Director:

Grants recertification of qualifying status to the facility referenced in the submittal filed on May 14, 1997, by Sky River, pursuant to 18 C.F.R. 292.207(b) and Section 3(17)(C) of the Federal Power Act, as amended by Section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), and the Incentives Act, provided that the facility is owned and operated in the manner described in the application and this order. §/ To

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§/ Certification as a QF serves only to establish eligibility for benefits provided by PURPA, as implemented by the Commission's Regulations, 18 C.F.R. Part 292. It does not relieve a facility of any other requirements of local, state or Federal law, including those regarding siting, construction, operation, licensing and pollution abatement.  
(continued...)

Docket No. QF91-59-003

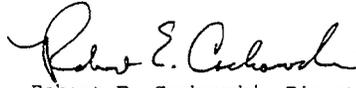
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the extent that facts or representations which form the basis for this order change, this order cannot be relied upon. While the facility might still be a QF under the changed circumstances, self or Commission recertification at that point will be necessary. 9/

Authorities:

Authority to act on this matter is delegated to the Director, Division of Opinions and Corporate Applications, pursuant to 18 C.F.R. 375.308.

This order constitutes final agency action. Requests for rehearing by the Commission may be filed within thirty (30) days of the date of issuance of this order, pursuant to 18 C.F.R. 385.713.



Robert E. Cackowski, Director  
Division of Opinions  
and Corporate Applications

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8/ (...continued)

Certification does not establish any property rights, resolve competing claims for a site, or authorize construction.

9/ See Citizens for Clean Air and Reclaiming our Environment v. Newbay Corporation, 56 FERC ¶ 61,428 (1991), and Midland Cogeneration Venture Limited Partnership and CMS Midland, Inc., 56 FERC ¶ 61,361 (1991).

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Vinson & Elkins  
ATTORNEYS AT LAW

Committee on Governmental Affairs  
EXHIBIT #A-12c

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E-Mail: [etf@elkins.com](mailto:etf@elkins.com)  
Web: [www.vinson.com](http://www.vinson.com)

August 3, 2000

Honorable David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

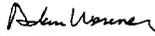
RE: Notice of Self-Recertification of Qualifying Facility Status for  
Small Power Production Facility  
Sky River Partnership, Docket No. QF91-59 - 004

Dear Mr. Boergers:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292 (1999), please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to the Sky River wind turbine facility. As discussed in the notice, the recertification is based on changes in the upstream ownership of Sky River Partnership.

Please date and stamp the enclosed extra copies of this notice and return them to our messenger. Thank you for your attention to this matter.

Sincerely,



Adam Wenner  
Attorney for Enron Wind Systems, Inc.

Enclosure

cc: California Public Utilities Commission

DC: 93664.2

FILED  
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UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL ENERGY  
REGULATORY COMMISSION

Sky River Partnership )  
)  
)

Docket No. QF91-59-004

**NOTICE OF SELF-RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY**

Pursuant to Section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> Sky River Partnership ("Sky River" or "Applicant") hereby submits this Notice of Self-Recertification that its wind energy facility remains a qualifying small power production facility based on a change in its upstream ownership. The Facility is a qualifying small power production facility ("Qualifying Facility" or "QF") under Subpart B of Part 292 of the Commission's regulations.

Form 556

**1a. Name:**

The full name of the Applicant is Sky River Partnership. The Docket Number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF91-59-003.

Pursuant to an application dated January 17, 1991, as amended October 8, 1991, the Commission granted certification as a qualifying small power production facility to the wind energy

<sup>1</sup> 18 C.F.R. § 292.207(a) (1999).

facility (the "Facility") then being developed by Zond Sky River Development Corporation ("Sky River Dev. Corp.") and ESI Sky River Limited Partnership ("ESI Sky River") at a site in the Tehachapi Mountains, Kern County, California (the "Initial Certification").<sup>2</sup> As described in the initial application, Sky River Dev. Corp. and ESI Sky River ultimately formed Sky River to be the owner of the Facility.<sup>3</sup> On December 30, 1991, Sky River filed a Notice of Self-Recertification regarding a change in the capacity of the Facility.<sup>4</sup> Sky River also filed an Application for Recertification to reflect the installation of an additional wind turbine generator to the Facility, and on April 17, 1992, the Commission granted recertification.<sup>5</sup> Pursuant to an Application for Recertification dated May 14, 1997,<sup>6</sup> the Commission granted recertification of the Facility's qualifying facility status reflecting a change in the upstream ownership of Sky River Dev. Corp., one of the general partners in Sky River.<sup>7</sup> Sky River Dev. Corp. merged into Sky River LLC. (These above-referenced filings and orders are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications

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<sup>2</sup> Zond Sky River Dev. Corp., 57 FERC ¶ 62,019 (1991).

<sup>3</sup> Sky River, through its wholly-owned subsidiary Sagebrush Partner Fifteen Inc., also owns an undivided interest in certain privately and cooperatively owned transmission facilities and interconnection facilities used to transmit power from QFs to the purchasing utility. Id. at 63,027-28.

<sup>4</sup> Docket No. QF91-59-001.

<sup>5</sup> Sky River Partnership, 59 FERC ¶ 62,057 (1992).

<sup>6</sup> Docket No. QF91-59-003.

<sup>7</sup> Sky River Partnership, 79 F.E.R.C. ¶ 62,237 (1997).

changes as described herein, Sky River hereby incorporates by reference the Prior Certifications with respect to its Notice of Self-Recertification as a Qualifying Facility under Section 292.207 of the Commission's regulations.

The purpose of this Notice is to recertify the Facility as a QF following a change in upstream ownership of the Facility.

**1b. Full Address of Applicant**

Sky River Partnership  
P.O. Box 1910  
13000 Jameson Road  
Tehachapi, California 93561  
(805) 822-6835

**1c. Ownership**

Prior to the change in ownership described herein, Sky River was a California general partnership in which ESI Sky River was the managing general partner and Sky River LLC was a general partner. ESI Sky River is a Delaware limited partnership in which ESI Sky River, Inc. is its sole general partner and ESI LP, Inc. is its sole limited partner. ESI Sky River, Inc. is a wholly-owned subsidiary of ESI California Holdings, Inc., which in turn is a wholly-owned subsidiary of ESI Energy, LLC ("ESI Energy"). ESI LP, Inc. is also a wholly-owned subsidiary of ESI Energy. ESI Energy is a wholly-owned subsidiary of FPL Energy, LLC, which is a wholly-owned subsidiary of FPL Group Capital Inc., which in turn is a wholly-owned subsidiary of FPL Group, Inc. The ownership of Sky River prior to the change in ownership described herein is depicted on the chart attached as Exhibit A. FPL Group, Inc. is an "electric utility holding company" as defined in Section

292.202(n) of the Commission's regulations.<sup>8</sup> ESI Sky River's ownership of the Facility constituted ownership by a subsidiary of an electric utility holding company for the purposes of the Commission's ownership criteria set forth in Section 292.206 of the Commission's regulations.<sup>9</sup> Sky River LLC was a wholly-owned subsidiary of RADR ZWS, LLC ("RADR ZWS"), a Delaware limited liability company owned by a Managing Member and Regular Members. Therefore, prior to the change in ownership, RADR ZWS held an indirect 50 percent partnership interest in Sky River.<sup>10</sup>

Enron Wind Systems, Inc. has purchased RADR ZWS's interest in Sky River (the "Transaction"). As a result of the Transaction, Enron Wind Systems, Inc. holds an indirect 50 percent partnership interest in Sky River. Enron Wind Systems, Inc. is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp., which in turn is a wholly-owned subsidiary of Enron Wind Corp., which is a wholly-owned subsidiary of Enron Renewable Energy Corp. ("EREC"). EREC is a wholly-owned subsidiary of Smith Street Land Company, which is a wholly-owned subsidiary of Enron Corp. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. The new ownership of Sky River after the Transaction is depicted on the chart attached as Exhibit B.

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<sup>8</sup> 18 C.F.R. § 292.202(n) (1999).

<sup>9</sup> 18 C.F.R. § 292.206 (1999).

<sup>10</sup> In the Initial Certification, the Commission found that ESI Sky River would own no more than a 50 percent interest in the Facility. Zond Sky River Dev. Corp., 57 FERC at 63,027.

On April 14, 2000, Enron Corp., the ultimate parent of Enron Wind Systems, Inc., filed an application with the Securities and Exchange Commission for an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 ("PUHCA").<sup>11</sup> Under the Commission's regulations, "... a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, in whole or in any combination thereof."<sup>12</sup> The Commission's regulations further provide that "electric utility holding company" "does not include any holding company which is exempt by rule or order adopted or issued pursuant to sections 3(a)(3) or 3(a)(5) of [PUHCA]."<sup>13</sup> The Commission has determined that, upon the filing of a "good faith" application for exemption under Section 3(a)(3) or Section 3(a)(5) of PUHCA, an applicant is not considered an "electric utility holding company" under the QF ownership test of the Commission's regulations for purposes of the utility ownership limitations under the Public Utility Regulatory Policies Act of 1978 ("PURPA."). Doswell Limited Partnership and Diamond Energy, 56 FERC ¶ 61,170, 61,590 (1991). Accordingly, as of April 14, 2000, neither Enron Corp. nor any of its affiliates is deemed to be an electric utility holding company for purposes of the ownership limitation under the Commission's regulations.

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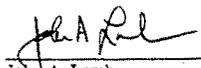
<sup>11</sup> 15 U.S.C. § 79e(a)(1) (1994).

<sup>12</sup> 18 C.F.R. § 292.206(b) (1999).

<sup>13</sup> 18 C.F.R. § 292.202(n) (1999).

In addition, Enron Corp. now is in the process of selling Portland General Electric ("PGE") to Sierra Pacific Resources.<sup>14</sup> Upon completion of the sale, neither Enron Corp. nor any of its affiliates will be a "holding company" under PUHCA, and thus neither Enron Corp. nor any of its affiliates will be an "electric utility holding company" under the Commission's regulations.

**1d. Signature of authorized individual evidencing accuracy and authenticity of information:**

  
\_\_\_\_\_  
John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this notice should be addressed to the following persons:

John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.  
444 South Flower Street  
Suite 4545  
Los Angeles, CA 90071-2946  
213-452-4884

Stephen H. Friedlander  
Enron Corp.  
333 Clay Street  
Suite 2100  
Houston, TX 77002  
713-646-6525

Adam Wenner  
The Willard Office Building  
Vinson & Elkins, L.L.P.  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
202-639-6533

Clifford M. Naeve  
Skadden, Arps, Slate, Meagher & Flom LLP  
1440 New York Avenue, NW  
Washington, DC 20005  
202-371-7070

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<sup>14</sup> In the application filed in Docket No. EC00-63-000 on March 3, 2000, Enron Corp. and Sierra Pacific, et al. have sought approval of Enron Corp.'s proposed sale and Sierra Pacific's

with copies to:

Michael L. Leighton  
Vice President  
ESI Sky River, Inc.  
c/o FPL Energy, LLC  
700 Universe Blvd.  
Juno Beach, FL 33408  
561-691-7159

Edward F. Tancer  
Corporate Secretary  
ESI Sky River, Inc.  
c/o FPL Energy, LLC  
700 Universe Blvd.  
Juno Beach, FL 33408  
561-691-7087

**3a. Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93561

**3b. Utility:**

See Prior Certifications.

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

See Prior Certifications.

**4c. Initial Operations:**

See Prior Certifications.

**4d. Primary Energy Input:**

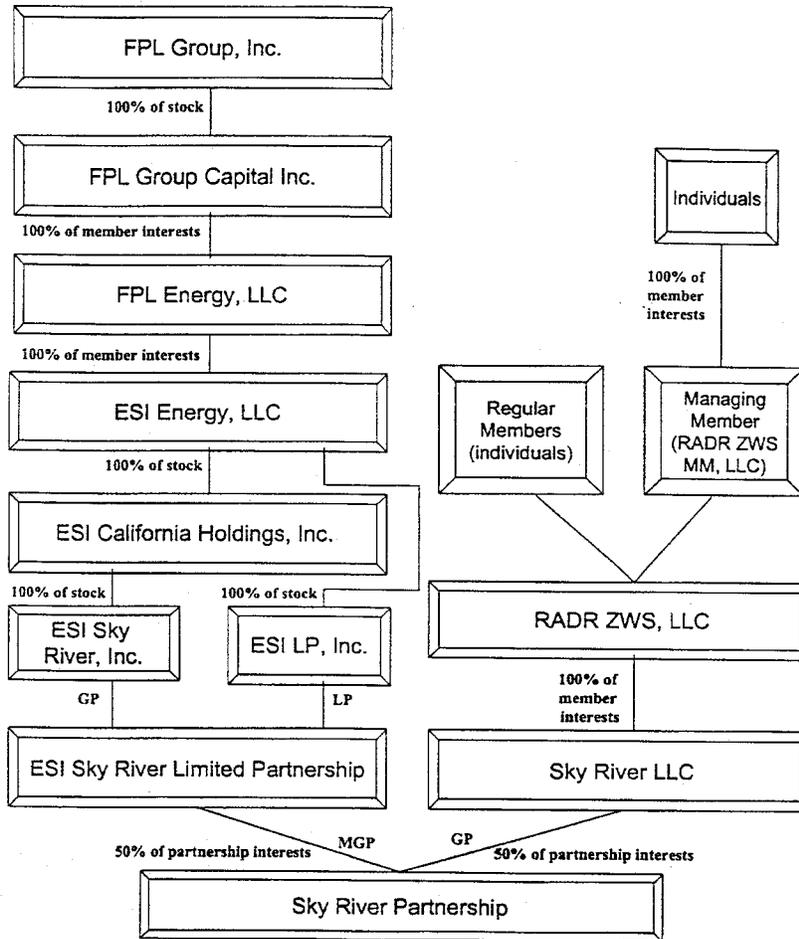
See Prior Certifications.

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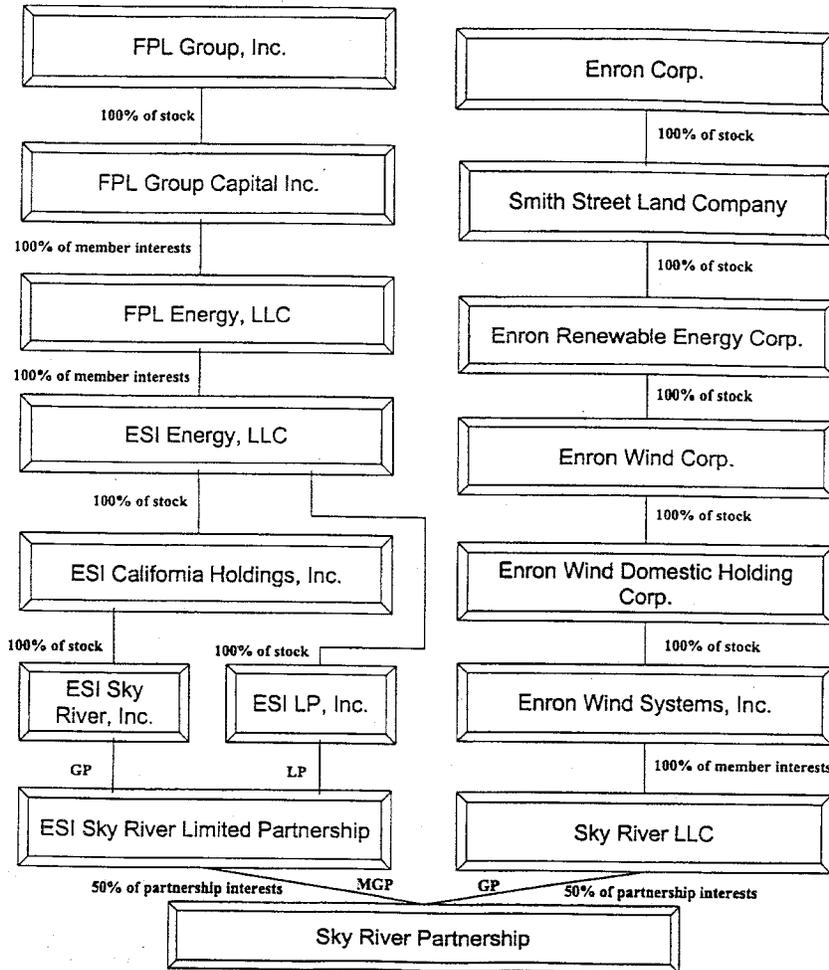
proposed acquisition of PGE under Section 203 of the FPA.

5. **Average Annual Hourly Energy Inputs:**  
See Prior Certifications.
6. **Additional Characteristics:**  
None.
7. **Fossil Fuel Use:**  
See Prior Certifications.
8. **Eligible Facility:**  
See Prior Certifications.

Exhibit A  
 Sky River Partnership  
 (previous)



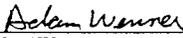
### Exhibit B Sky River Partnership (current)



CERTIFICATE OF SERVICE

Pursuant to Sections 292.207(a)(ii) and 385.2010 of the Commission's regulations, I hereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon (1) each electric utility to which applicant expects to interconnect, transmit, or sell electric energy or from which applicant expects to purchase supplementary standby, back-up, and maintenance power, (2) the state regulatory authority of each state where the facility and each affected utility is located, and (3) each person designated on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings.

Dated at Washington, D.C. this 3<sup>rd</sup> day of August, 2000.

  
\_\_\_\_\_  
Adam Wenner  
Attorney for Enron Wind Systems, Inc.

**Vinson & Elkins**

ATTORNEYS AT LAW

VINSON & ELKINS L.L.P.  
THE WILLARD OFFICE BUILDING  
1425 PENNSYLVANIA AVE. N.W.  
WASHINGTON, D.C. 20004-1008  
TELEPHONE (202) 439-4500  
FAX (202) 439-4604

**ORIGINAL**

Committee on Governmental Affairs  
**EXHIBIT #A-13a**

WRITER'S TELEPHONE  
(202) 639-6533

May 14, 1997

FILED  
OFFICE OF THE SECRETARY  
MAY 14 PM 2:59  
FEDERAL ENERGY REGULATORY COMMISSION

Ms. Lois D. Cashell, Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Dockets Room 1A  
Washington, D.C. 20426

RE: Victory Garden Partnership, Docket No. QF90-43- 002

Dear Ms. Cashell:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292, please find enclosed an original and fourteen copies of a "Request for Certification of Qualifying Facility Status for Small Power Production Facility" relating to the Victory Garden wind turbine facility. As discussed in the application, the recertification is based on changes in the ownership of Victory Garden Partnership, necessitated by the changes in status that result from the proposed merger of Enron Corp., an indirect owner of the Victory Garden Partnership, with Portland General Corporation, as described in the Commission's order in Enron Corp., 78 FERC ¶ 61,179 (1997).

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,

*Adam Wenner*

Adam Wenner

Enclosures  
KENEAW1341ENRONZONDIVCLT.WPD

*Wendy  
7/1/97*

9705220105

FERC DOCKETED  
MAY 14 1997

HOUSTON DALLAS WASHINGTON, D.C. AUSTIN MOSCOW LONDON SINGAPORE

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

FILED  
OFFICE OF THE SEC.  
97 MAY 14 PM 2:55  
FEDERAL ENERGY  
REGULATORY  
COMMISSION

Victory Garden Phase IV Partnership ) Docket No. QF90-43 - 002  
)  
)

REQUEST FOR RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY

Pursuant to section 292.207(b) of the Commission's regulations,<sup>1/</sup> Victory Garden Phase IV Partnership ("Victory Garden IV" or "Applicant") hereby applies for recertification that the wind energy facility described herein, subsequent to a change in upstream ownership,<sup>2/</sup> is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.

Form 556

1a. Name:

The full name of the Applicant is Victory Garden Phase IV Partnership. The Docket Number assigned to the immediately preceding submittal filed with the Commission in connection with the

<sup>1/</sup> 18 C.F.R. § 292.207(b) (1996).

<sup>2/</sup> Sky River Partnership, Docket No. QF91-59-\_\_\_ and Zond Windsystems Holding Company, Docket No. QF87-365-\_\_\_ are concurrently filing applications for recertification of qualifying facility status of small power production facilities regarding similar upstream ownership changes. (The facilities described in these applications, together with the facility described herein, are referred to as the "Zond Facilities.")

FILED  
MAY 14 1997

instant facility is QF90-43-001. A Notice of Self-Certification that the wind energy facility (the "Facility") then being developed by Zond Victory Garden Phase IV Development Corporation ("VG Dev. Corp.") and ESI VG Limited Partnership ("ESI VG") at a site in the Tehachapi Mountains, Kern County, California, would be a qualifying small power production facility was filed on December 13, 1989.<sup>3/</sup> Subsequently, VG Dev. Corp. and ESI VG filed an application for Commission certification of the Facility on January 25, 1991, as revised on February 1, 1991, and October 1, 1991. The Commission granted certification as a qualifying small power production facility to the Facility on October 9, 1991 (the "Initial Certification").<sup>4/</sup> As described in the initial application, VG Dev. Corp. and ESI VG ultimately formed Victory Garden IV to be the owner of the Facility.<sup>5/</sup> (The Notice of Self-Certification and the Initial Certification are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, Victory Garden IV hereby incorporates by reference the Prior Certifications with respect to its Application for Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.

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<sup>3/</sup> Docket No. QF90-43-000.

<sup>4/</sup> Zond Victory Garden Phase IV Dev. Corp., 57 FERC ¶ 62,018 (1991) ("Zond Victory Garden").

<sup>5/</sup> Victory Garden IV, through its wholly owned subsidiary Sagebrush Partner Sixteen Inc., also owns an undivided interest in certain privately and cooperatively owned transmission facilities and interconnection facilities used to transmit power from QFs to the purchasing utility. Id. at 63,025.

**1b. Full Address of Applicant**

Victory Garden Phase IV Partnership  
 P.O. Box 1910  
 13000 Jameson Road  
 Tehachapi, California 93561  
 (805) 822-6835

**1c. Ownership**

Victory Garden IV is a California general partnership with VG Dev. Corp. and ESI VG as general partners.<sup>6/</sup> ESI VG is a Delaware limited partnership with ESI Victory, Inc. as its sole general partner and ESI LP, Inc. as its sole limited partner. ESI Victory, Inc. and ESI LP, Inc. are wholly owned subsidiaries of ESI Energy, Inc., which, in turn, is a wholly owned subsidiary of FPL Group, Inc., an "electric utility holding company" as defined in section 292.202(n) of the Commissions regulations.<sup>7/</sup> ESI VG's indirect ownership of the Facility constitutes ownership by a subsidiary of an electric utility holding company for the purposes of the Commission's ownership criteria set forth in section 292.206 of the Commission's regulations.<sup>8/</sup>

VG Dev. Corp. is a wholly-owned subsidiary of Zond Mesa-VGIV Corporation ("Zond Mesa"), which, in turn, is a wholly owned subsidiary of Zond Systems, Inc. ("Zond Systems"), a wholly owned subsidiary of Zond Corporation ("Zond"). Zond is a wholly owned subsidiary of Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent of the

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<sup>6/</sup> The current ownership of Victory Garden IV is depicted on the chart attached as Exhibit A.

<sup>7/</sup> 18 C.F.R. § 292.202(n) (1996).

<sup>8/</sup> 18 C.F.R. § 292.206 (1996).

outstanding stock of EREC.<sup>9/</sup> On February 27, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation ("PGC") (the "Merger") under Section 203 of the Federal Power Act.<sup>10/</sup> PGC is the sole parent company of Portland General Electric Company, an electric utility. Following the completion of the Merger, Enron will become an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>11/</sup> As a result, Enron's 39.165 percent derivative interest in Victory Garden IV <sup>12/</sup> will be considered ownership by an "electric utility holding company" for purposes of section 292.206.

In order to ensure that Victory Garden IV will remain in compliance with section 292.206, prior to the Merger, Zond Mesa will sell 100 percent of its interest in VG Dev. Corp. (which, as described in footnote 13, will be converted to Victory Garden, LLC prior to the sale) to RADR ZWS, LLC ("RADR ZWS"),<sup>13/</sup> a Delaware limited liability company owned by a Managing Member and

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<sup>9/</sup> The remaining 21.67% of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC's stock or is an "electric utility" or an "electric utility holding company." None of these individuals or entities is engaged in the generation or sale of electric power or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities; "eligible facilities" as "exempt wholesale generators" under Section 32(a) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994); or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>10/</sup> Enron Corp., 78 FERC ¶ 61,179 (1997).

<sup>11/</sup> 15 U.S.C. § 79c(a)(1) (1994).

<sup>12/</sup> 50 percent x 78.33 percent. See Dominion Resources, Inc., 43 FERC ¶ 61,079 (1988).

<sup>13/</sup> Prior to the sale to RADR II, VG Dev. Corp. will merge with and into Victory Garden, LLC, a Delaware limited liability company, and VG Dev. Corp.'s stock will

Regular Members.<sup>14/</sup> As a result, RADR ZWS will hold an indirect 50 percent partnership interest in Victory Garden IV.<sup>15/</sup> The Managing Member of RADR ZWS will be RADR ZWS MM, LLC, a limited liability company owned by three individuals, and the Regular Members will be individuals. (The Managing Member, its upstream owners, and the Regular Members are referred to collectively as the "RADR ZWS Owners.") None of RADR ZWS or the RADR ZWS Owners is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA.<sup>16/</sup>

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be converted to a "member interest" that will be owned by Zond Mesa. This change in corporate form does not affect the determination of ownership of the Facility under section 292.206.

<sup>14/</sup> The new ownership of Victory Garden IV is depicted on the chart included in Exhibit A.

<sup>15/</sup> In the Initial Certification, the Commission found that ESI VG would own no more than a 50 percent interest in the Facility. Zond Victory Garden, 57 FERC at 63,027. Except for the designation of ESI VG as the managing general partner, there are no substantive changes to the Victory Garden Phase IV Partnership Second Amended and Restated Agreement of General Partnership, dated January 1, 1991 ("Victory Garden IV Partnership Agreement").

<sup>16/</sup> The individuals who will own RADR ZWS MM, LLC, as well as the Regular Members, may invest directly or indirectly, through investment entities that they control. If they invest through such entities, the entities will also satisfy the above-described restrictions respecting utility-related activities and ownership.

II. Description of Victory Garden IV's Operations

Victory Garden IV sells all of the output of the Facility to Southern California Edison Company ("SCE") pursuant to four power purchase agreements, one of which expires in 2017 and the other three of which expire in 2020. SCE also supplies electrical service to the Facility.

Zond Victory Garden Phase IV Maintenance Corp. ("VGIV Maintenance") and Victory Garden IV entered into a Windsystem Management Agreement, dated as of June 15, 1989 (the "O&M Agreement"). Pursuant to a Windsystem Management Subcontract dated June 15, 1989, between VGIV Maintenance and Zond Systems, VGIV Maintenance subcontracted its rights and obligations under the O&M Agreement to Zond Systems, the effect of which is that Zond Systems provides operations and maintenance service to Victory Garden IV. Zond Systems receives a fee based on a percentage of costs incurred for direct labor and benefits for services provided under the O&M Agreement plus reimbursement of direct and indirect costs. The O&M Agreement was the product of arm's-length bargaining between Zond Systems and ESI VG, and the payments thereunder do not exceed the market price for such services. RADR ZWS will ratify the O&M Agreement.

Zond Systems also leases or owns the land on which the Facility is located and provides an easement to Victory Garden IV for use of the property pursuant to a Grant of Windpark Easement and Easement Agreement executed on August 24, 1989 ("Easement Agreement"). The Easement Agreement was the product of arm's-length bargaining between Zond Systems and ESI VG, and payments thereunder do not exceed the market rate for such an easement. RADR ZWS will ratify the Easement Agreement.

Zond Systems will provide consulting services to Victory Garden, LLC pursuant to a Windsystem Consulting Services Agreement to be entered into by Zond Systems and RADR ZWS. The Consulting Agreement will be the product of arm's-length negotiations between Zond Systems and RADR ZWS, the owner of Victory Garden, LLC. Payments for consulting services will be \$10,000 per year, adjusted in accordance with changes to the Consumer Price Index. The payments will not exceed the market price of such services.

EREC will provide a loan to RADR ZWS, the proceeds of which will be used to finance the acquisition of Zond Mesa's interest in Victory Garden, LLC. The interest rate will be at a market rate, and RADR ZWS will be free to seek alternative sources of financing. The loan will convey no management control or entitlement to profits or losses from the Facility to EREC.

ESI VG will replace VG Dev. Corp. as the managing general partner of Victory Garden IV. The change in the identity of the managing general partner will not alter the duties of, or compensation to, the managing general partner, which were established in arm's-length negotiations between VG Dev. Corp. and ESI VG in January 1991, when these parties entered into the Second Amended and Restated Victory Garden IV Partnership Agreement (the "Partnership Agreement"). RADR ZWS will ratify these changes to the Partnership Agreement.

An affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of the interest of RADR ZWS in the Zond Facilities.

RADR ZWS will grant Zond Systems an option to purchase its member interest in Victory Garden, LLC. The option agreement will provide that during the term of the existing power

purchase agreements, the option may only be exercised if the exercise would not adversely affect the QF status of the Facility, unless there has been a change in law or Commission regulations, or a change to the agreements that would permit the option to be exercised without materially and adversely affecting Victory Garden IV's rights under these power purchase agreements (the "QF Period").<sup>17/</sup> As noted above, Victory Garden IV's existing power purchase agreements, which require the Facility to be a QF, extend through year 2020.<sup>18/</sup> Consequently, the effect of this provision is that, absent such a change, the Facility will remain a QF through 2020. Following the Merger, if Zond Systems were to exercise the option after the expiration of the power purchase agreements, the Facility would cease to be a QF; prior to that time Victory Garden IV will seek a Commission determination that it is an "exempt wholesale generator" under Section 32(a)(1) of PUHCA. The option will be transferable or assignable; however, the assignee or transferee will remain subject to these restrictions.<sup>19/</sup>

### III. The Arrangements Satisfy the Commission's Ownership Criteria.

The statutory ownership criteria governing Qualifying Facilities appear in Section 3(17)(C)(ii) of the Federal Power Act. Under that section, a Qualifying Facility must be owned:

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<sup>17/</sup> In addition, during the term of an outstanding loan from Credit Suisse First Boston to Victory Garden IV, the option may not be exercised if such exercise would have a material adverse effect on the regulatory status of the Facility.

<sup>18/</sup> Victory Garden IV's contracts apply to specific wind turbines and one of the contracts expires in 2017; however, since all of the turbines are owned by Victory Garden IV, the option could not be exercised until all of the turbines had fulfilled their obligations to be QFs -- namely in 2020.

<sup>19/</sup> Depending on the timing of the Merger, it may be necessary to implement some of the changes described herein, such as the transfer of an ownership interest to RADR ZWS and the loan, prior to the issuance of a final order in the instant proceeding.

by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).<sup>20/</sup>

The Commission's regulation implementing Section 3(17)(C)(ii) states that:

a . . . small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.<sup>21/</sup>

The Commission's regulations thus equate "ownership interest" with "equity interest." The Commission evaluates the control of the venture and each owner's entitlement to the "stream of benefits" from the venture to determine each participant's equity interest.<sup>22/</sup>

A. Control

The arrangements described herein satisfy the Commission's requirement that electric utilities, electric utility holding companies, or their subsidiaries exercise no more than 50 percent control of a QF. As stated above, RADR ZWS will have the same rights to control Victory Garden IV that Zond Mesa had when the Commission determined, in the Initial Certification, that Victory

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<sup>20/</sup> 16 U.S.C. § 796(18)(B)(ii) (1994).

<sup>21/</sup> 18 C.F.R. § 292.206(b) (1996).

<sup>22/</sup> See, e.g., Ultrapower 3, 27 FERC ¶ 61,094 (1984).

Garden IV's ownership structure satisfies the Commission's QF ownership criteria.<sup>22/</sup> The only change to that structure is that ESI VG will become the managing general partner.

The Commission has held that an electric utility subsidiary may be the sole general partner or the managing general partner of a partnership, provided that the non-utility owner retains the right to approve any decisions that affect the distribution of the stream of benefits from the facility, including approval of loans and service agreements with affiliates of the utility owner.<sup>24/</sup> Under the ownership arrangements described herein, Victory Garden, LLC will retain one-half control of the Management Committee. In the Prior Certifications the Commission determined that under the terms of the Partnership Agreement, neither partner nor the Management Committee has the authority to alter the allocation of the stream of benefits from the Facility.<sup>25/</sup> These terms have not been changed. Accordingly, ESI VG will not exercise greater than 50 percent control of Victory Garden IV. In approving similar arrangements, Commission orders have noted that the utility

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<sup>22/</sup> See supra note 15. Other than their indirect interest in the Zond Facilities, none of the RADR ZWS Owners has any affiliation with Enron, FPL Group, or any affiliate of either.

<sup>24/</sup> See Burney Forest Products, a Joint Venture, 76 FERC ¶ 62,263, at 64,476 (1996) (utility affiliate sole general partner); see also Crockett Cogeneration, a Cal. Ltd. Partnership, 72 FERC ¶ 62,078, at 64,135 (1995); ONSITE/Molokai Limited Partnership, 49 FERC ¶ 61,333 (1989); Onondaga Cogeneration Limited Partnership, 62 FERC ¶ 62,140 (1993); Acme POSDEF Partners, L.P., 72 FERC ¶ 62,264 (1995); Geothermal Energy Partners Ltd., 50 FERC ¶ 62,006 (1990) (utility affiliate managing partner).

<sup>25/</sup> Zond Victory Garden, supra, 57 FERC at 63,025.

affiliate is simply taking over duties as the managing general partner under arrangements established when a non-utility entity performed that same role.<sup>26/</sup>

**B. The Ownership Arrangements Satisfy the Commission's Requirements for Allocation of the Stream of Benefits**

The new ownership arrangements satisfy the Commission's criteria that no more than 50 percent of the stream of benefits from a QF flow to electric utilities, electric utility holding companies, or their subsidiaries. As noted above, RADR ZWS will have the same rights to the stream of benefits from the Facility as Zond Mesa had under the arrangements that the Commission determined, in the Initial Certification, satisfy the Commission's QF ownership criteria.<sup>27/</sup> No aspect of the new ownership arrangements will affect RADR ZWS's right to receive 50 percent of the stream of benefits from Victory Garden IV.

**1. The O&M, Easement and Consulting Agreements**

In evaluating the stream of benefits from a QF, the Commission has held that it will consider whether payments to an electric utility owner or its affiliate under a service agreement or other arrangement reflect additional equity payments. Where such payments exceed the compensation that would have been paid to an unaffiliated entity for the same services, the Commission will consider the payments to be part of the recipient's entitlement to the stream of benefits. On the other hand, where such payments result from arm's-length negotiations, the Commission will find that the payments reflect the market and are not part of the stream of benefits.<sup>28/</sup> If control of a Qualifying

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<sup>26/</sup> See Brady Power Partners, 61 FERC ¶ 62,113, at 63,184 n.7 (1992).

<sup>27/</sup> See supra note 15.

<sup>28/</sup> See Acme POSDEF Partners, L.P., 72 FERC at 64,830 (1995).

Facility is shared equally between a utility and non-utility owners, the Commission will presume any such arrangements to be at arm's length.<sup>29/</sup>

At the time that the O&M Agreement and the Easement Agreement were negotiated, VG Dev. Corp. was a 50 percent, non-utility partner in Victory Garden IV, and ESI VG was a 50 percent utility partner. The O&M and Easement Agreements thus satisfy the Commission's criteria for presuming that the agreements were the result of arm's-length bargaining and that the compensation paid to the Zond affiliates reflects market rates.<sup>30/</sup> Moreover, RADR ZWS will ratify the O&M and Easement Agreements.

Similarly, Zond Systems will provide consulting services to Victory Garden, LLC pursuant to the Consulting Agreement. The payments under the Consulting Agreement will not exceed market rates, and the agreement will be the result of arm's-length bargaining between Zond Systems and RADR ZWS. The arrangement thus will satisfy the Commission's criteria for holding that Zond Systems' revenues are not included in the stream of benefits from the Facility.<sup>31/</sup>

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<sup>29/</sup> Id.; see also Brooklyn Navy Yard Cogeneration Partners, L.P., 74 FERC ¶ 61,015, at 61,047 (1996) ("Brooklyn Navy Yard").

<sup>30/</sup> See Clear Lake Cogeneration Ltd. Partnership, 78 FERC ¶ 62,178 (1997); Cogenron Inc., 78 FERC ¶ 62,152 (1997).

<sup>31/</sup> With respect to future contracts, the Partnership Agreement provides that approval of any contract between the Partnership and any partner or affiliate of any partner is determined by the representative of the unaffiliated partner on the Management Committee. Thus, the electric utility affiliated entity with an interest in the Facility may not dictate the terms or conditions of service agreements with Victory Garden IV. See Cogenron Inc., 78 FERC at 64,570.

## 2. The Loan Agreement

As noted above, EREC will provide a loan to RADR ZWS to finance the purchase of the member interest in Victory Garden, LLC. The Commission has held that the repayment of a loan by an electric utility to a non-electric utility owner of a QF is not included in the stream of benefits where the loan contains a reasonable rate of interest for the risks assumed and conveys no management control or entitlement to profits or losses to the electric utility.<sup>32/</sup> The Commission has also held that its concern regarding loans is further mitigated where the non-utility borrower is not prevented from borrowing funds elsewhere to finance the acquisition.<sup>33/</sup>

The interest rate for the loan to RADR ZWS will be consistent with rates for projects with similar risk profiles. The loan will convey no management control or entitlement to profits or losses from Victory Garden IV to the lender. Moreover, RADR ZWS was not precluded from borrowing the funds from an alternative lender. Accordingly, the loan and the payments thereunder should not be included in the stream of benefits from the Facility.

## 3. Managing General Partner

ESI VG will receive a fee for the performance of its duties as the managing general partner of Victory Garden IV. The amount of the fee is the same that VG Dev. Corp., the non-utility owner, received under the Victory Garden IV Partnership Agreement during its term as managing general partner. The amount of the fee was negotiated at arm's length and was implemented in 1990, well before the new ownership arrangements were contemplated. Moreover, RADR ZWS will ratify the

<sup>32/</sup> East Syracuse Generating Co., L.P., 65 FERC ¶ 62,224, at 64,553 (1993) ("East Syracuse"); c.f. Brooklyn Navy Yard, 74 FERC at 61,047-48.

<sup>33/</sup> Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084, at 64,229 (1995).

revised Victory Garden IV Partnership Agreement. Accordingly, the management fee should not be included in the stream of benefits from the Facility received by ESI VG.<sup>34/</sup>

#### 4. Indemnity

As noted above, an affiliate of Zond Systems will indemnify the Members of RADR ZWS for certain tax liabilities that may arise from the disposition of the interest of RADR ZWS in the Zond Facilities. The Commission has held that, in determining ownership interests under section 292.206, it does not consider capital contributions and has approved arrangements in which the utility affiliate's future contributions would cause its contributions to exceed 50 percent.<sup>35/</sup> The examination focuses instead "on that which is derived from the partnership, i.e., the stream of benefits."<sup>36/</sup> Payments, if any, pursuant to the indemnity agreement are similar to capital contributions that convey no management control and do not affect the distribution of profits or gains,<sup>37/</sup> and therefore are not included in the stream of benefits.<sup>38/</sup>

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<sup>34/</sup> See Brady Power Partners, 61 FERC ¶ 62,113 (1992). The Commission has previously approved a similar arrangement involving another affiliate of ESI VG. Id.

<sup>35/</sup> See, e.g., Ultrpower 3, 27 FERC at 61,184; Beowawe Geothermal Power Co., 33 FERC ¶ 62,205 (1985).

<sup>36/</sup> CMS Midland, Inc., 50 FERC ¶ 61,098 at 61,288 (1990).

<sup>37/</sup> Id.

<sup>38/</sup> See also, East Syracuse, 65 FERC at 64,553 (principal amount of loan by utility owner to non-utility owner subject to downward adjustment to the extent non-utility owner incurs loss in subsequent resale of its interest); Lake Cogen, Ltd., 79 FERC ¶ 62,054 (1997); Selkirk Cogen Partners, L.P., 70 FERC ¶ 62,084.

5. Purchase Option

The Commission has held that the existence of a purchase option does not constitute a present ownership interest and thus does not affect a facility's qualifying status.<sup>39/</sup> Prior to the exercise of the option, the interest in Victory Garden IV held by an electric utility or an electric utility holding company will not exceed 50 percent. As described above, the option can only be exercised by a utility interest after the QF Period has ended, whereupon, absent a change in law or regulations as described above, the Facility would no longer enjoy the benefits of QF status and would seek to obtain status as an exempt wholesale generator. The Commission has recognized that a facility may be a QF during one period and not be a QF during another period. When this happens, the lack of qualifying status during one period does not affect the facility's qualifying status during the period of compliance.<sup>40/</sup> In the instant case, the basis for ceasing to be a Qualifying Facility

<sup>39/</sup> See, e.g., City of Burlington, Vt. Elec. Dep't, 45 FERC ¶ 61,009, at 61,035 n.32 (1988) (option held by utility affiliate to purchase non-utility owner's interest in QF in year 11 or 21 of operation not treated as present ownership by utility); Turbo Gas & Elec., Ltd., 30 FERC ¶ 61,273 at 61,565 (1985) (option by subsidiary of electric utility holding company to purchase either 51 or 100 percent of QF not treated as current utility ownership interest). Similarly, the Commission determined that provisions permitting a utility affiliate to assume 99 percent of voting interest in a QF upon an event of a default under its lease or deferral of payments under its power purchase agreement to be "unexercised rights" that do not bar QF status. Midland Cogeneration Venture, L.P., 50 FERC ¶ 61,259 at 61,802 (1990), reh'g denied, 56 FERC ¶ 61,361 (1991), petition for review denied sub nom. Michigan Mun. Coop. Group v. FERC, 990 F.2d 1377 (D.C. Cir. 1993).

<sup>40/</sup> See, e.g., Pepperill Power Associates L.P., 64 FERC ¶ 61,286 (1993) (facility which operated as a Qualifying Facility from 1987 through 1992 subsequently lost qualifying facility status and became an EWG in 1993, based on loss of steam host); Medina Power Co., 71 FERC ¶ 61,264 (1995), reh'g denied, 72 FERC ¶ 61,224 (1995) (following a period of non-compliance in 1992-1994, applicant might become a Qualifying Facility for calendar year 1995 and beyond). See also LG&E Westmoreland Southampton, 76 FERC ¶ 61,116 (1996) (establishing rates and

would be a deliberate business decision based on the expiration of power purchase agreements, rather than an unintended failure to meet technical standards. However, the legal consequences in both types of cases should be the same. Here, as in the above-cited cases, the fact that a period of non-QF status may follow the QF Period should not affect the qualifying status of the Facility during the prior period of compliance.

**1d. Authorized individual evidencing accuracy of information:**

Adam S. Umanoff *ASU*  
Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation

**2. Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Zond Corporation  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 236-9544

Dean Gosselin  
ESI Energy, Inc.  
11760 US Highway 1  
Sixth Floor  
North Palm Beach, FL 33408  
(561) 691-3619

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6533  
Counsel to Zond Corporation

Michael D. Hornstein  
Reid & Priest, LLP  
701 Pennsylvania Avenue, N.W.  
Suite 800  
Washington, D.C. 20004-1008  
(202) 508-4133  
Counsel to ESI Energy, Inc.

**3a. Location of Facility:**

State: California  
County: Kern

exemptions for period of non-compliance with QF regulations).

City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93581

**3b. Utility:**

The Facility interconnects with the transmission system of SCE. SCE purchases the output of the Facility and provides it with separate electric service.

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

See Prior Certifications.

**4c. Initial Operations:**

The Facility commenced operations on January 2, 1990.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

See Prior Certifications.

**6. Additional Characteristics:**

None.

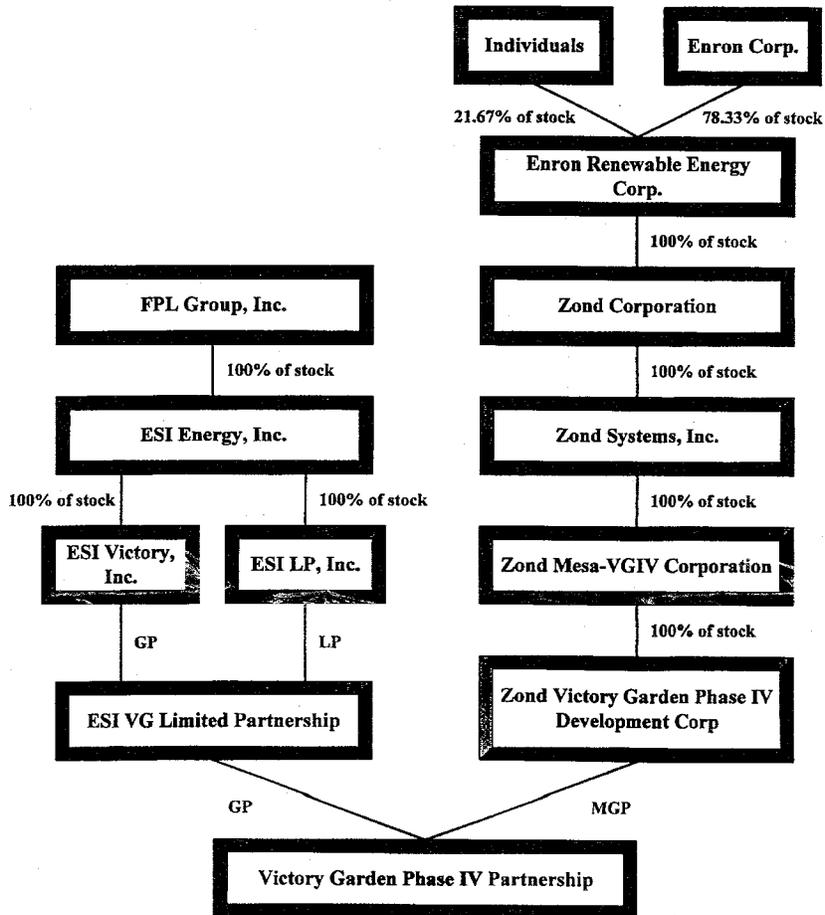
**7. Fossil Fuel Use:**

See Prior Certifications.

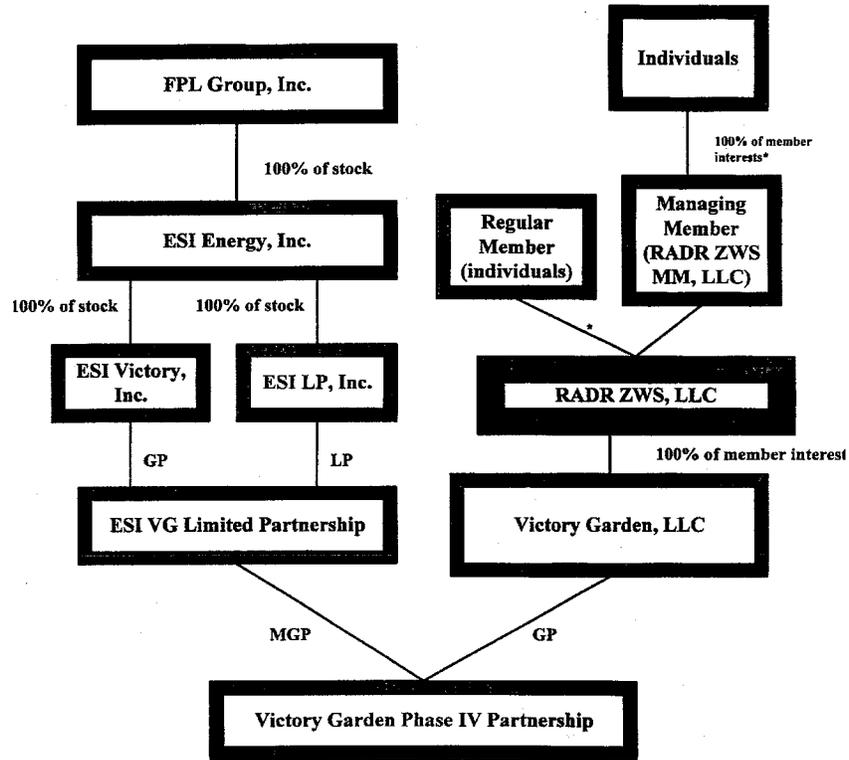
**8. Eligible Facility:**

See Prior Certifications.

## Victory Garden Phase IV Partnership (existing)



## Victory Garden Phase IV Partnership (proposed)



\*These individuals may invest directly or indirectly, through an intermediate entity.



79 FERC ¶ 62,238

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Committee on Governmental Affairs  
EXHIBIT #A-13b

Victory Garden Phase IV Partnership )

Small Power Production and )  
Cogeneration Facilities ) Docket No. QF90-43-002  
-- Qualifying Status )

ORDER GRANTING APPLICATION FOR RECERTIFICATION  
AS A QUALIFYING SMALL POWER PRODUCTION FACILITY

(Issued June 30, 1997)

Summary:

On May 14, 1997, Victory Garden Phase IV Partnership (Victory Garden IV) filed an application for recertification of a small power production facility as a qualifying facility (QF) pursuant to 18 C.F.R. § 292.207(b). <sup>1</sup>

The instant application for recertification was submitted to ensure that the facility will retain its qualifying status following a change in its upstream ownership. According to Victory Garden IV, no other material changes have occurred with respect to the facility.

Notice of the application was published in the Federal Register with comments, protests or motions to intervene due on or before June 24, 1997. <sup>2</sup> No responses were received.

Discussion:

Under 18 C.F.R. § 292.203(a), a qualifying small power production facility must comply with the size criteria and fuel use criteria specified in 18 C.F.R. § 292.204 and the ownership criteria contained in 18 C.F.R. § 292.206.

<sup>1</sup>/ The approximately 22 MW wind-powered small power production facility is located in the Tehachapi Mountains, Kern County, California. It consists of 98 wind turbines as well as certain transmission facilities. Electric power produced by the facility is sold to Southern California Edison Company. The facility was certified in Docket No. QF90-43-001, 57 FERC ¶ 62,018 (1991). A notice of certification was filed on December 13, 1989 in Docket No. QF90-43-000.

<sup>2</sup>/ 62 Fed. Reg. 31,424 (1997).

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A. Ownership:

Under 18 C.F.R. § 292.206, no more than 50 percent of the equity interest in a QF may be held, directly or indirectly through subsidiaries, by electric utilities and/or electric utility holding companies (collectively, electric utility entities).

Victory Garden IV, the owner of the facility, currently is owned by two general partners, ESI VG Limited Partnership (ESI VG) and Zond Victory Garden Phase IV Development Corporation (VG Development). FPL Group, Inc., an electric utility holding company, through subsidiaries owns ESI VG. Enron Corporation (Enron), and certain individuals, through subsidiaries own 78.33 percent and 21.67 percent, respectively, of VG Development.

On February 26, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation (Portland General). Portland General is the parent of Portland General Electric Company, an electric utility. <sup>3/</sup> As a result, Enron's derivative 39.165 percent ownership interest in Victory Garden IV would be considered ownership by an electric utility entity.

In order to ensure that Victory Garden IV will remain in compliance with 18 C.F.R. 292.206, prior to the merger of Enron and Portland General, Zond Mesa-VGIV Corporation (Zond Mesa), Enron's indirect subsidiary and parent company of VG Development, will sell 100 percent of its interest in VG Development to RADR ZWS, LLC (RADR ZWS). <sup>4/</sup> The managing member of RADR ZWS will be RADR ZWS MM, LLC, a limited liability company owned by three individuals, and the regular members will be individuals. Consequently, once it merges with Portland General, Enron will no longer own a share of Victory Garden IV; rather, RADR ZWS will hold a 50 percent general partnership interest in Victory Garden IV through Victory Garden, LLC.

Victory Garden IV states that neither RADR ZWS nor any of its upstream owners will be engaged in the generation or sale of electric power, or have any ownership or operating interest in

<sup>3/</sup> Enron Corporation, et al., 78 FERC ¶ 61,179 (1997). Following the completion of merger, Enron will become an exempt holding company under section 3(a)(1) of the Public Utility Holding Company Act of 1935 (PUHCA).

<sup>4/</sup> Victory Garden IV states that prior to Zond Mesa's sale to RADR ZWS, VG Development will merge with and into Victory Garden, LLC, a Delaware limited liability company, and VG Development's stock will be converted into a "member interest" that will be owned by Zond Mesa.

any electric facilities other than QFs and exempt wholesale generators (EWGs). <sup>5/</sup> Accordingly, no more than a 50 percent interest in the facility will be held by electric utility entities.

B. Loans and Service Agreements:

Victory Garden IV states that Enron Renewable Energy Corporation will provide a loan to RADR ZWS to finance the purchase of the member interest in Victory Garden, LLC. The interest rate on the loan to RADR ZWS will be consistent with rates for projects with similar risk profiles. The loan will convey no management control or entitlement to profits or losses from Victory Garden IV to the lender. Accordingly, the loan and payments should not be included in the stream of benefits from the facility.

Zond Systems, Inc. (Zond Systems), an indirect subsidiary of Enron, performs operation and maintenance services for Victory Garden IV pursuant to a Windsystem Management Agreement (O&M Agreement). Zond Systems receives a fee based on a percentage of costs incurred for direct labor and benefits for services provided under the O&M Agreement plus reimbursement of direct and indirect costs. The O&M Agreement was the product of arm's-length bargaining between the parties, and the payment thereunder does not exceed the market price for such services. Moreover, RADR ZWS states that it will ratify the O&M Agreement.

Zond Systems also leases or owns the land on which the facility is located and provides an easement to Victory Garden IV for use pursuant to a Windpark Easement Agreement (Easement Agreement). The Easement Agreement was the product of arm's-length bargaining between the parties, and the payment thereunder does not exceed the market rate for such an easement. RADR ZWS states that it will ratify the Easement Agreement. Zond Systems will also provide consulting services to Victory Garden, LLC pursuant to a Consulting Agreement which will not exceed market rates. The Consulting Agreement will be the result of arm's-length bargaining between Zond Systems and RADR ZWS.

In view of the above review process, Enron and its electric utility-affiliated entities may not dictate the terms and conditions of loans or service agreements made with RADR ZWS and

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<sup>5/</sup> An EWG is not considered an electric utility company under Section 2(a)(3) of PUHCA, as amended by the Energy Policy of 1992, and ownership of an EWG does not result in an entity being considered as being primarily engaged in the generation or sale of electric power under sections 3(17)(C)(ii) and 3(18)(B)(ii) of the Federal Power Act. See Sections 32(e) and 32(j) of PUHCA.

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- 4 -

Victory Garden IV. Thus, revenues that Enron's subsidiaries may receive from loans or service agreements are viewed as resulting from arm's-length negotiations. Accordingly, such revenues need not be considered in determining Enron's entitlement to the stream of benefits from the facility.

C. Control and Stream of Benefits:

Victory Garden IV states that, under the new ownership arrangements, RADR ZWS will have the same rights to control Victory Garden IV that Zond Mesa had when the Commission determined in the original certification that Victory Garden IV's ownership structure satisfies the Commission's ownership criteria. The only change to the structure is that ESI VG will become the managing general partner of Victory Garden IV. Victory Garden, LLC will retain one-half control of the Management Committee. Neither partner nor the Management Committee has the right to alter the allocations of the stream of benefits from the facility. Accordingly, ESI VG will not exercise greater than 50 percent control of Victory Garden IV. Since ESI VG will not receive more than 50 percent of the stream of benefits from the facility and will have no more than 50 percent control of Victory Garden IV, the facility meets the ownership criteria of 18 C.F.R. § 292.206 and the interpreting cases. See *Ultrapower 3*, 27 FERC ¶ 61,094 (1984), and *CMS Midland, Inc.*, 38 FERC ¶ 61,244 (1987).

Finding:

The small power production facility, as described in the application submitted by Victory Garden IV, meets the requirements established in 18 C.F.R. § 292.203(a) regarding certification as a qualifying small power production facility.

The Director:

Grants recertification of qualifying status to the facility referenced in the submittal filed on May 14, 1997, by Victory Garden IV pursuant to 18 C.F.R. § 292.207(b) and section 3(18)(B) of the Federal Power Act, as amended by section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), provided that the facility is owned and operated in the manner described in the application and this order. §/ To the extent that facts or

§/ Certification as a QF serves only to establish eligibility for benefits provided by PURPA, as implemented by the Commission's Regulations, 18 C.F.R. Part 292. It does not relieve a facility of any other requirements of local, state or federal law, including those regarding siting, construction, operation, licensing and pollution abatement.

(continued...)

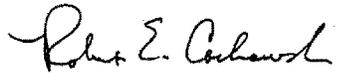
Docket No. QF90-43-002

- 5 -

representations which form the basis for this order change, this order cannot be relied upon. While the facility might still be a QF under the changed circumstances, self-or Commission-recertification at that point will be necessary. <sup>2/</sup>

Authorities:

Authority to act on this matter is delegated to the Director, Division of Opinions and Systems Analysis, pursuant to 18 C.F.R. § 375.308. This order constitutes final agency action. Requests for rehearing by the Commission may be filed within thirty (30) days of the date of issuance of this order, pursuant to 18 C.F.R. § 385.713.



Robert E. Cackowski  
Director, Division of Opinions  
and Corporate Analysis

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6/(...continued)

Certification does not establish any property rights, resolve competing claims for a site, or authorize construction.

7/ See Citizens for Clean Air and Reclaiming our Environment v. Newbay Corporation, 56 FERC ¶ 61,428 (1991), and Midland Cogeneration Venture Limited Partnership and CMS Midland, Inc., 56 FERC ¶ 61,361 (1991).

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Committee on Governmental Affairs  
**EXHIBIT #A-13c**

E-Mail: [awenner@velaw.com](mailto:awenner@velaw.com)  
Web: [www.velaw.com](http://www.velaw.com)

August 3, 2000

Honorable David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

RE: Notice of Self-Recertification of Qualifying Facility Status for  
Small Power Production Facility  
Victory Garden Phase IV Partnership, Docket No. QF90-43-003

Dear Mr. Boergers:

Pursuant to Part 292 of the Commission's Regulations, 18 C.F.R. Part 292 (1999), please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to the Victory Garden Phase IV Partnership wind turbine facility. As discussed in the notice, the recertification is based on changes in the upstream ownership of Victory Garden Phase IV Partnership.

Please date and stamp the enclosed extra copies of this notice and return them to our messenger. Thank you for your attention to this matter.

Sincerely,  
*Adam Wenner*  
Adam Wenner  
Attorney for Enron Wind Systems, Inc.

Enclosure

cc: California Public Utilities Commission

DC: 93666.2

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production facility.<sup>2</sup> Subsequently, VG Dev. Corp. and ESI VG filed an application for Commission certification of the Facility on January 25, 1991, as amended February 1, 1991 and October 1, 1991. The Commission granted certification as a qualifying small power production facility to the Facility on October 9, 1991 (the "Initial Certification").<sup>3</sup> As described in the initial application, VG Dev. Corp. and ESI VG ultimately formed Victory Garden IV to be the owner of the Facility.<sup>4</sup> VG Dev. Corp. subsequently merged into Victory Garden LLC. Pursuant to an Application for Recertification dated May 14, 1997,<sup>5</sup> the Commission granted recertification of the Facility's qualifying facility status reflecting a change in the upstream ownership of Victory Garden LLC, a general partner in Victory Garden IV.<sup>6</sup> (These above-referenced filings and orders are referred to collectively as the "Prior Certifications.")

Other than as described herein, none of the information contained in the Prior Certifications has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, Victory Garden IV hereby incorporates by reference the Prior Certifications with respect to its Notice of Self-Recertification as a Qualifying Facility under Section 292.207 of the Commission's regulations.

The purpose of this Notice is to recertify the Facility as a QF following a change in upstream ownership of the Facility.

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<sup>2</sup> Docket No. QF90-43-000.

<sup>3</sup> Zond Victory Garden Phase IV Dev. Corp., 57 FERC ¶ 62,018 (1991).

<sup>4</sup> Victory Garden IV, through its wholly-owned subsidiary Sagebrush Partner Sixteen Inc., also owns an undivided interest in certain privately and cooperatively owned transmission facilities and interconnection facilities used to transmit power from QFs to the purchasing utility. Id. at 63,025.

<sup>5</sup> Docket No. QF90-43-002.

<sup>6</sup> Victory Garden Phase IV Partnership, 79 F.E.R.C. ¶ 62,238 (1997).

**1b. Full Address of Applicant**

Victory Garden Phase IV Partnership  
 P.O. Box 1910  
 13000 Jameson Road  
 Tehachapi, California 93561  
 (805) 822-6835

**1c. Ownership**

Prior to the change in ownership described herein, Victory Garden IV was a California general partnership in which ESI VG was the managing general partner and Victory Garden LLC was a general partner. ESI VG is a Delaware limited partnership in which ESI Victory, Inc. is its sole general partner and ESI LP, Inc. is its sole limited partner. ESI Victory, Inc. and ESI LP, Inc. are wholly-owned subsidiaries of ESI Energy, LLC. ESI Energy, LLC is a wholly-owned subsidiary of FPL Energy, LLC, which is a wholly-owned subsidiary of FPL Group Capital Inc., which in turn is a wholly-owned subsidiary of FPL Group, Inc. FPL Group, Inc. is an "electric utility holding company" as defined in Section 292.202(n) of the Commission's regulations.<sup>7</sup> ESI VG's ownership of the Facility constituted ownership by a subsidiary of an electric utility holding company for the purposes of the Commission's ownership criteria set forth in Section 292.206 of the Commission's regulations.<sup>8</sup> Victory Garden LLC, a Delaware limited liability company, was a wholly-owned subsidiary of RADR ZWS, LLC ("RADR ZWS"). Therefore, prior to the change in ownership, RADR ZWS, a Delaware limited liability company owned by a Managing Member and Regular Members, held an indirect 50 percent partnership interest in Victory Garden IV.<sup>9</sup> The ownership of

<sup>7</sup> 18 C.F.R. § 292.202(n) (1999).

<sup>8</sup> 18 C.F.R. § 292.206 (1999).

<sup>9</sup> In the Initial Certification, the Commission found that ESI VG would own no more than a 50 percent interest in the Facility. Zond Victory Garden Phase IV Dev. Corp., 57 FERC at 63,027.

Victory Garden IV prior to the change in ownership described herein is depicted on the chart attached as Exhibit A.

Enron Wind Systems, Inc. has purchased RADR ZWS's interest in Victory Garden LLC (the "Transaction"). As a result of the Transaction, Enron Wind Systems, Inc. holds an indirect 50 percent partnership interest in Victory Garden IV. Enron Wind Systems, Inc. is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp., which is a wholly-owned subsidiary of Enron Wind Corp., which in turn is a wholly-owned subsidiary of Enron Renewable Energy Corp. ("EREC"). EREC is a wholly-owned subsidiary of Smith Street Land Company, which is a wholly-owned subsidiary of Enron Corp. Enron Corp. is an Oregon corporation, with its principal place of business in Houston, Texas. The new ownership of Victory Garden IV after the Transaction is depicted on the chart attached as Exhibit B.

On April 14, 2000, Enron Corp., the ultimate parent of Enron Wind Systems, Inc., filed an application with the Securities and Exchange Commission for an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 ("PUHCA").<sup>10</sup> Under the Commission's regulations, "... a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof."<sup>11</sup> The Commission's regulations further provide that "electric utility holding company" "does not include any holding company which is exempt by rule or order adopted or issued pursuant

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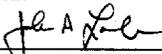
<sup>10</sup> 15 U.S.C. § 79c(a)(1) (1994).

<sup>11</sup> 18 C.F.R. § 292.206(b) (1999).

to sections 3(a)(3) or 3(a)(5) of [PUHCA].<sup>12</sup> The Commission has determined that, upon the filing of a "good faith" application for exemption under Section 3(a)(3) or Section 3(a)(5) of PUHCA, an applicant is not considered an "electric utility holding company" under the QF ownership test of the Commission's regulations for purposes of the utility ownership limitations under the Public Utility Regulatory Policies Act of 1978 ("PURPA.") Doswell Limited Partnership and Diamond Energy, Inc., 56 FERC ¶61,170, 61,590 (1991). Accordingly, as of April 14, 2000, neither Enron Corp. nor any of its affiliates is deemed to be an "electric utility holding company" for purposes of the ownership limitation under the Commission's regulations.

In addition, Enron Corp. now is in the process of selling Portland General Electric ("PGE") to Sierra Pacific Resources.<sup>13</sup> Upon completion of the sale, neither Enron Corp. nor any of its affiliates will be a "holding company" under PUHCA, and thus neither Enron Corp. nor any of its affiliates will be an "electric utility holding company" under the Commission's regulations.

**1d. Signature of authorized individual evidencing accuracy and authenticity of information:**

  
 \_\_\_\_\_  
 John A. Lamb  
 Assistant General Counsel  
 Enron Wind Corp.

<sup>12</sup> 18 C.F.R. § 292.202(n) (1999).

<sup>13</sup> In the application filed in Docket No. EC00-63-000 on March 3, 2000 Enron Corp. and Sierra Pacific, et al. have sought approval of Enron Corp.'s proposed sale and Sierra Pacific's proposed acquisition of PGE under Section 203 of the FPA.

**2. Communications:**

Correspondence concerning this notice should be addressed to the following persons:

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Enron Wind Corp.  
444 South Flower Street  
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Washington, D.C. 20004-1008  
202-639-6533

Clifford M. Naeve  
Skadden, Arps, Slate, Meagher & Flom LLP  
1440 New York Avenue, NW  
Washington, DC 20005  
202-371-7070

with copies to:

Michael L. Leighton  
Vice President  
ESI Sky River, Inc.  
c/o FPL Energy, LLC  
700 Universe Blvd.  
Juno Beach, FL 33408  
561-691-7159

Edward F. Tancer  
Corporate Secretary  
ESI Sky River, Inc.  
c/o FPL Energy, LLC  
700 Universe Blvd.  
Juno Beach, FL 33408  
561-691-7087

**3a. Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: 13000 Jameson Road, Tehachapi, California 93561  
Mailing Address: P.O. Box 1910, Tehachapi, California 93561

**3b. Utility:**

See Prior Certifications.

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

See Prior Certifications.

**4c. Initial Operations:**

See Prior Certifications.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

See Prior Certifications.

**6. Additional Characteristics:**

None.

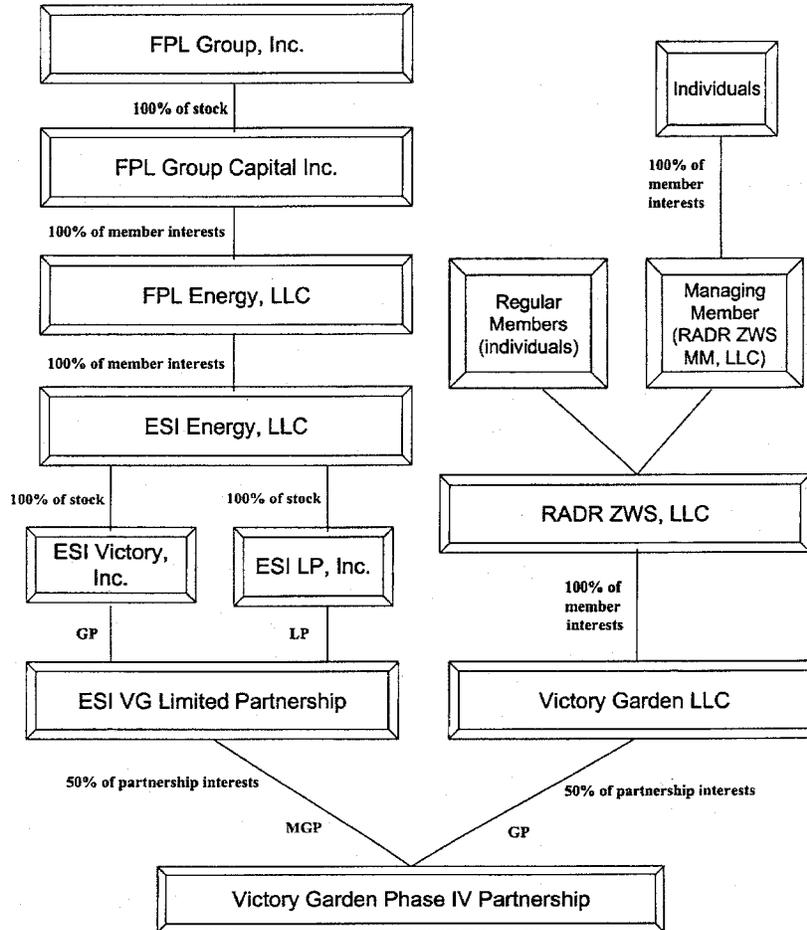
**7. Fossil Fuel Use:**

See Prior Certifications.

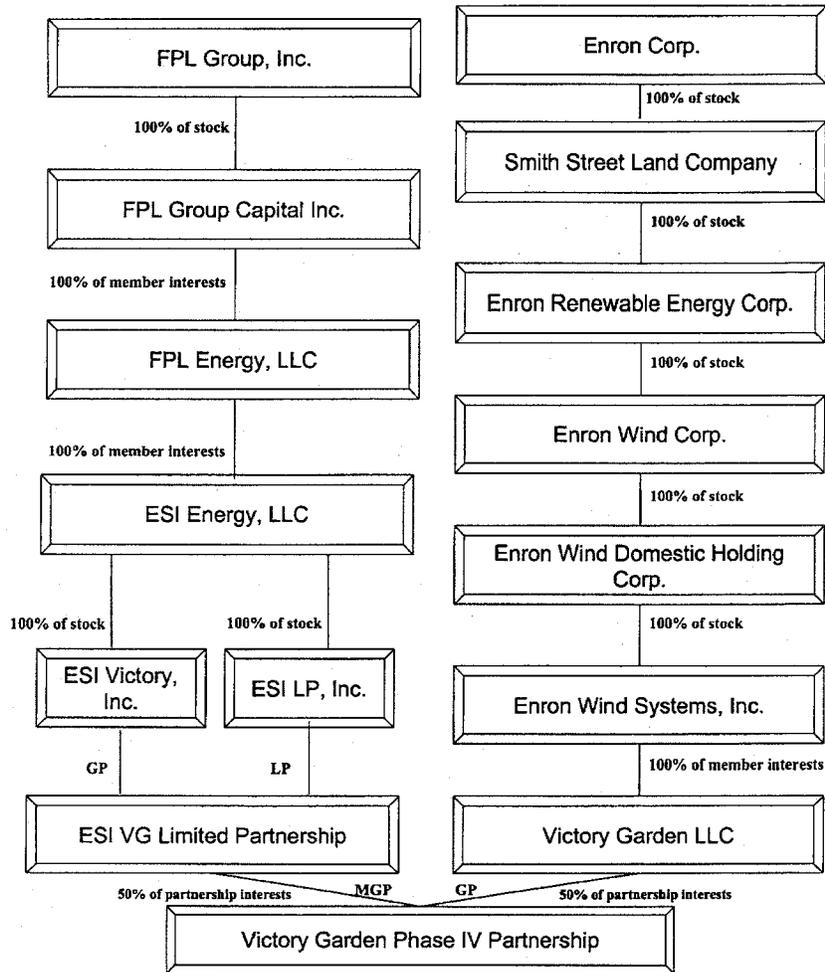
**8. Eligible Facility:**

See Prior Certifications.

### Exhibit A Victory Garden Phase IV Partnership (previous)



### Exhibit B Victory Garden Phase IV Partnership (current)



Committee on Governmental Affairs

**EXHIBIT #A-14**

**QF 95-186**

**Cabazon Power Partners LLC**

**Vinson & Elkins**  
ATTORNEYS AT LAW

VINSON & ELKINS L.L.P.  
THE WILLARD OFFICE BUILDING  
1455 PENNSYLVANIA AVE., N.W.  
WASHINGTON, D.C. 20004-1008  
TELEPHONE (202) 639-6500  
FAX (202) 639-6604

WRITER'S TELEPHONE  
(202) 639-6533

November 30, 1998

**ORIGINAL**

FILED  
OFFICE OF THE SECRETARY  
98 NOV 30 PM 2:53  
FEDERAL ENERGY  
REGULATORY COMMISSION

Committee on Governmental Affairs  
**EXHIBIT #A-14a**

Hon. David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

Re: Zond Cabazon Development Corporation  
Docket No. QF95-186-001

Dear Mr. Boergers:

Pursuant to section 292.207(a)(1) of the Commission's regulations, please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to Zond Cabazon Development Corporation ("Zond Cabazon").

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,

*Adam Wenner*  
Adam Wenner

981202.0114.1

NOV 30 1998

ORIGINAL

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

FILED  
OFFICE OF THE SECRETARY  
98 NOV 30 PM 2:53

Zond Cabazon Development Corporation )  
 ) Docket No. QF95-186- 001  
 )

FEDERAL ENERGY  
REGULATORY COMMISSION

**NOTICE OF SELF-RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY**

Pursuant to section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> Zond Cabazon Development Corporation ("Zond Cabazon") hereby files a Notice of Self-Recertification that the wind energy facility described herein, subsequent to a change in upstream ownership, is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.

**FORM 556**

**1a. Name:**

The full name of Zond Cabazon is Zond Cabazon Development Corporation. The Docket number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF95-186-000. Pursuant to a notice of self-certification dated December 29, 1994, Zond Cabazon's predecessor-in-interest, Cabazon Wind Developers, filed a notice of self-certification that the wind energy facility (the "Facility") then being developed by Cabazon Wind Developers would be a qualifying small power production facility ("Self-Certification"). The Self-Certification also stated that the Facility would be an "eligible . . . wind . . . facility," as defined in

<sup>1</sup> 18 C.F.R. § 292.207(a) (1997).

Section 3(17)(E) of the Federal Power Act, as amended by the Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990.<sup>2</sup>

Other than as described herein, none of the information contained in the Self-Certification has changed. Accordingly, except to the extent the information contained in the Self-Certification changes as described herein, Zond Cabazon incorporates by reference the Self-Certification with respect to this notice of Self-Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.<sup>3</sup>

Zond Cabazon submits this notice to inform the Commission of a change in the ownership of the Facility. Details of the ownership are described herein.

**1b. Full Address of Applicant**

Zond Cabazon Development Corporation  
1300 Jameson Road  
Tehachapi, California 93561  
(805) 822-6853

**1c. Ownership**

Zond Cabazon and The Nature Conservancy each have a 50 percent ownership interest in the Facility, within the meaning of 18 C.F.R. § 292.206. Cabazon Wind Developers, a joint venture consisting of Zond Cabazon and an entity controlled by an individual, initially planned to remove the older, obsolete wind turbines at the Facility site and replace such wind turbines with new, state-of-the-art wind turbines in connection with the development of the Facility. Subsequent to the filing of the Self-Certification, Zond Cabazon acquired a 100% interest in the venture, dissolved Cabazon

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<sup>2</sup>Pub. L. 101-575, 104 Stat. 2834 (1990), codified at, 16 U.S.C. § 796(17)(A).

<sup>3</sup>18 C.F.R. § 292.207 (1997).

Wind Developers, and caused the transfer of contract rights relating to the Facility to Zond Cabazon. On November 18, 1998, Zond Cabazon transferred a 50 percent interest in the Facility to The Nature Conservancy.

Zond Cabazon is a California corporation. Zond Cabazon is a wholly-owned subsidiary of Enron Wind Development Corp., which is a wholly owned subsidiary of Enron Wind Corp. ("EWC") (formerly Zond Corporation). EWC is a wholly owned subsidiary of Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent of the outstanding stock of EREC.<sup>4</sup> Enron is an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>5</sup>

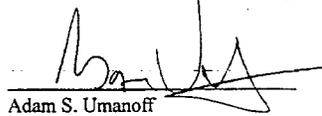
The Nature Conservancy is a charitable organization dedicated to preserving habitats and species through purchases of lands and waters. The Nature Conservancy is not an electric utility, an electric utility holding company, or a subsidiary thereof; is not engaged in the generation or sale of electric power; and has no ownership or operating interest, within the meaning of section 292.206 or Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA.

---

<sup>4</sup>The remaining 21.67% of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC's stock or is in "electric utility" or an "electric utility holding company." None of these individuals or entities is engaged in the generation or sale of electric power or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities; "eligible facilities" as exempt wholesale generators" under Section 32(a) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994); or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>5</sup>15 U.S.C. § 79c(a)(1) (1994).

**1d. Authorized individual evidencing accuracy of information:**



Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 452-4881

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6696  
Counsel to Enron Wind Corp.

**3a. Location of Facility:**

State: California  
County: Riverside  
City or Town: Cabazon  
Street Address: None  
Mailing Address: None

**3b. Utility:**

Southern California Edison Company

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

The power production capacity of the Facility is approximately 39.75 MW.

**4c. Initial Operations:**

The Facility was placed in service in 1985 and removed from service in 1997. Zond Cabazon is in the process of installing new state-of-the-art wind turbines at the Facility site. Commercial operation is expected to take place in early 1999.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

Not applicable.

**6. Additional Characteristics:**

None.

**7. Fossil Fuel Use:**

Not applicable.

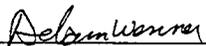
**8. Eligible Facility:**

The Facility is an eligible wind facility under Section 3(17)(E) of the Federal Power Act.

CERTIFICATE OF SERVICE

Thereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon all parties on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings. Pursuant to section 292.207(a)(ii) of the Commission's regulations, I have also served the foregoing document on Southern California Edison Company and the California Public Utilities Commission.

Dated at Washington, D.C. this 30<sup>th</sup> day of November, 1998.

  
\_\_\_\_\_  
Adam Wenner  
Attorney for Zond Cabazon Development Corporation

**Vinson & Elkins**  
ATTORNEYS AT LAW

VINSON & ELKINS LLP  
THE WILLARD OFFICE BUILDING  
1455 PENNSYLVANIA AVE, N.W.  
WASHINGTON, D.C. 20004-1008  
TELEPHONE (202) 639-4500  
FAX (202) 639-6604

WRITER'S TELEPHONE  
(202) 639-4599

January 7, 1999

Hon. David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

Re: Cabazon Power Partners LLC  
Docket No. QF95-186-003

Dear Mr. Boergers:

Pursuant to section 292.207(a)(1) of the Commission's regulations, please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to Cabazon Power Partners LLC.

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,

John S. Decker  
Attorney for Cabazon Power Partners LLC

**ORIGINAL**

FILED  
OFFICE OF THE SECRETARY  
99 JAN -7 PM 4:06  
FEDERAL ENERGY  
REGULATORY  
COMMISSION

Committee on Governmental Affairs  
**EXHIBIT #A-14b**

N

AJ  
**FERC DOCKETED**

JAN - 7 1999

990111-0031-1

UNITED STATES OF AMERICA FILED  
 BEFORE THE OFFICE OF THE SECRETARY  
 FEDERAL ENERGY REGULATORY COMMISSION 99 JAN -7 PM 4: 06  
FEDERAL ENERGY  
 Cabazon Power Partners LLC ) REGULATORY  
 ) Docket No. QF95-186-001 COMMISSION  
 )

**NOTICE OF SELF-RECERTIFICATION OF  
 QUALIFYING FACILITY STATUS FOR  
 SMALL POWER PRODUCTION FACILITY**

Pursuant to section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> Cabazon Power Partners LLC ("Cabazon Power Partners") hereby files a Notice of Self-Recertification that the wind energy facility described herein, subsequent to a change in upstream ownership, is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.

**FORM 556**

**1a. Name:**

The full name of Cabazon Power Partners is Cabazon Power Partners LLC. The Docket number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF95-186-001. On December 29, 1994, Cabazon Power Partners' predecessor-in-interest, Cabazon Wind Developers, filed a notice of self-certification that the wind energy facility (the "Facility") then being developed by Cabazon Wind Developers would be a qualifying small power production facility ("Self-Certification"). The Self-Certification also stated that the Facility would be an "eligible . . . wind . . . facility," as defined in Section 3(17)(E) of the

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<sup>1</sup>18 C.F.R. § 292.207(a) (1997).

Federal Power Act, as amended by the Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990.<sup>2</sup>

Cabazon Wind Developers was a joint venture consisting of Zond Cabazon Development Corporation ("Zond Cabazon") and an entity controlled by an individual. On November 30, 1998, Zond Cabazon filed a notice of self-recertification stating that Zond Cabazon had acquired a 100% interest in the venture ("Self-Recertification"). The Self-Recertification also stated that Zond Cabazon and The Nature Conservancy each have a 50 percent ownership interest in the Facility, within the meaning of 18 C.F.R. § 292.206.

Other than as described herein, none of the information contained in the Self-Certification and the Self-Recertification (collectively, the "Prior Certifications") has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, Cabazon Power Partners incorporates by reference the Prior Certifications with respect to this notice of Self-Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.<sup>3</sup>

Cabazon Power Partners submits this notice to inform the Commission of a change in the ownership of the Facility. Details of the change are described herein.

**1b. Full Address of Applicant**

Cabazon Power Partners LLC  
1300 Jameson Road  
Tehachapi, California 93561  
(805) 822-6853

---

<sup>2</sup>Pub. L. 101-575, 104 Stat. 2834 (1990), codified at, 16 U.S.C. § 796(17)(A).

<sup>3</sup>18 C.F.R. § 292.207 (1997).

**1c. Ownership**

The ownership of the Facility remains as described in the Self-Recertification except that, in December 1998, Zond Cabazon merged with its affiliate Cabazon Power Partners as part of a corporate reorganization. Cabazon Power Partners is the surviving entity. Thus, following the merger, Cabazon Power Partners and The Nature Conservancy each have a 50 percent ownership interest in the Facility within the meaning of 18 C.F.R. § 292.206.

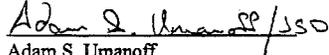
Cabazon Power Partners is a Delaware limited liability company that is a wholly-owned subsidiary of Enron Wind Cabazon LLC. Enron Wind Cabazon LLC is a wholly-owned subsidiary of Enron Wind Development Corp., which is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp. ("EWDHC"). EWDHC is a wholly-owned subsidiary of Enron Wind Corp., which is wholly-owned by Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent of the outstanding stock of EREC.<sup>4</sup> Enron is an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>5</sup>

---

<sup>4</sup>The remaining 21.67 percent of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC stock or is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as exempt wholesale generators" under Section 32(a) of the Public utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994), or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>5</sup>15 U.S.C. § 79c(a)(1) (1994).

~~1d.~~ **Authorized individual evidencing accuracy of information:**

  
Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 452-4881

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6696  
Counsel to Enron Wind Corp.

**3a. Location of Facility:**

State: California  
County: Riverside  
City or Town: Cabazon  
Street Address: None  
Mailing Address: None

**3b. Utility:**

Southern California Edison Company

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

The power production capacity of the Facility is approximately 39.75 MW.

**4c. Initial Operations:**

The Facility was placed in service in 1985 and removed from service in 1997. Zond Cabazon is in the process of installing new equipment at the Facility site. Commercial operation is expected to take place in early 1999.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

Not applicable.

**6. Additional Characteristics:**

None.

**7. Fossil Fuel Use:**

Not applicable.

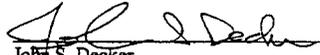
**8. Eligible Facility:**

The Facility is an eligible wind facility under Section 3(17)(E) of the Federal Power Act.

CERTIFICATE OF SERVICE

Thereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon all parties on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings. Pursuant to section 292.207(a)(ii) of the Commission's regulations, I have also served the foregoing document on Southern California Edison Company and the California Public Utilities Commission.

Dated at Washington, D.C. this 7th day of January, 1999.



John S. Decker  
Attorney for Cabazon Power Partners LLC

ORIGINAL

**Vinson & Elkins**  
ATTORNEYS AT LAW

VINSON & ELKINS LLP  
THE WILLARD OFFICE BUILDING  
1455 PENNSYLVANIA AVE, N.W.  
WASHINGTON, D.C. 20004-1008  
TELEPHONE (202) 639-6500  
FAX (202) 639-6604

Committee on Governmental Affairs  
**EXHIBIT #A-14c**

WRITER'S TELEPHONE  
(202) 639-6599

January 8, 1999

Hon. David P. Boergers  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

N

OFFICE OF THE SECRETARY  
FEDERAL ENERGY  
REGULATORY COMMISSION  
99 JAN - 8 PM 4: 24

Re: Cabazon Power Partners LLC  
Docket No. QF95-186-009

Dear Mr. Boergers:

Pursuant to section 292.207(a)(1) of the Commission's regulations, please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to Cabazon Power Partners LLC.

I appreciate your attention to this matter and would be pleased to answer any questions you may have.

Sincerely,  
  
John S. Decker  
Attorney for Cabazon Power Partners LLC

990111-0004-1

FERC DOCKETED

JAN - 8 1999

AM

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Cabazon Power Partners LLC                    )  
                                                          ) Docket No. QF95-186-\_\_\_\_  
                                                          )

**NOTICE OF SELF-RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY**

Pursuant to section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> Cabazon Power Partners LLC ("Cabazon Power Partners") hereby files a Notice of Self-Recertification that the wind energy facility described herein, subsequent to a change in upstream ownership, is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.

**FORM 556**

**Ia. Name:**

The full name of Cabazon Power Partners is Cabazon Power Partners LLC. The Docket number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF95-186-002. On December 29, 1994, Cabazon Power Partners' predecessor-in-interest, Cabazon Wind Developers, filed a notice of self-certification that the wind energy facility (the "Facility") then being developed by Cabazon Wind Developers would be a qualifying small power production facility ("Self-Certification"). The Self-Certification also stated that the Facility would be an "eligible . . . wind . . . facility," as defined in Section 3(17)(E) of the

---

<sup>1</sup>18 C.F.R. § 292.207(a) (1997).

Federal Power Act, as amended by the Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990.<sup>2</sup>

Cabazon Wind Developers was a joint venture consisting of Zond Cabazon Development Corporation ("Zond Cabazon") and an entity controlled by an individual. On November 30, 1998, Zond Cabazon filed a notice of self-recertification stating that Zond Cabazon had acquired a 100% interest in the venture ("First Self-Recertification"). The Self-Recertification also stated that Zond Cabazon and The Nature Conservancy each have a 50 percent ownership interest in the Facility, within the meaning of 18 C.F.R. § 292.206.

On January 7, 1999, Cabazon Power Partners filed a notice of self-recertification stating that Zond Cabazon had merged with its affiliate Cabazon Power Partners, with Cabazon Power Partners being the surviving entity ("Second Self-Recertification").

Other than as described herein, none of the information contained in the Self-Certification, the First Self-Recertification and the Second Self-Recertification (collectively, the "Prior Certifications") has changed. Accordingly, except to the extent the information contained in the Prior Certifications changes as described herein, Cabazon Power Partners incorporates by reference the Prior Certifications with respect to this notice of Self-Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.<sup>3</sup>

Cabazon Power Partners submits this notice to reflect a change in the ownership of the Facility as described below.

---

<sup>2</sup>Pub. L. 101-575, 104 Stat. 2834 (1990), codified at, 16 U.S.C. § 796(17)(A).

<sup>3</sup>18 C.F.R. § 292.207 (1997).

**1b. Full Address of Applicant**

Cabazon Power Partners LLC  
 13000 Jameson Road  
 Tehachapi, California 93561  
 (805) 822-6853

**1c. Ownership**

Cabazon Power Partners, a Delaware limited liability company, owns the Facility. Enron Wind Cabazon LLC ("Enron Wind Cabazon") owns a 1 percent managing member interest in Cabazon Power Partners; Enron Wind Cabazon Funding LLC ("EWCF") owns a 39 percent non-managing member interest, and VIFW1, Inc. owns a 60 percent non-managing member interest in Cabazon Power Partners. Each of Enron Wind Cabazon, a Delaware limited liability company, and EWCF, a Delaware limited liability company, is a wholly-owned subsidiary of Enron Wind Development Corp., which is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp. ("EWDHC"). EWDHC is a wholly-owned subsidiary of Enron Wind Corp., which is wholly owned by Enron Renewable Energy Corp. ("EREC"). Enron Corp. ("Enron") owns 78.33 percent of the outstanding stock of EREC.<sup>4</sup> Enron is an exempt public utility holding company under Section 3(a)(1) of PUHCA.<sup>5</sup>

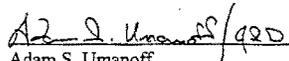
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<sup>4</sup>The remaining 21.67% of EREC's stock is held by individuals and entities, none of whom or which owns 10 percent or more of EREC's stock or is in "electric utility" or an "electric utility holding company." None of these individuals or entities is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as exempt wholesale generators" under Section 32(a) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994), or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

<sup>5</sup>15 U.S.C. § 79c(a)(1) (1994).

VIFW1, Inc., a Delaware corporation, is owned by an individual. Neither VIFW1, Inc. nor its owner is an electric utility, an electric utility holding company, or a subsidiary thereof; is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of section 292.206 and Form 556, 18 C.F.R. § 131.80, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as exempt wholesale generators" under Section 32(a) of the Public utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(a) (1994), or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(a) (1994).

**1d. Authorized individual evidencing accuracy of information:**



Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this application should be addressed to the following persons:

Adam S. Umanoff  
Senior Vice President and General Counsel  
Enron Wind Corp.  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 452-4881

Adam Wenner  
Vinson & Elkins, L.L.P.  
The Willard Office Building  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6696  
Counsel to Enron Wind Corp.

**3a. Location of Facility:**

State: California  
County: Riverside  
City or Town: Cabazon  
Street Address: None  
Mailing Address: None

**3b. Utility:**

Southern California Edison Company

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

The power production capacity of the Facility is approximately 39.75 MW.

**4c. Initial Operations:**

The Facility was placed in service in 1985 and removed from service in 1997. Cabazon Power Partners is in the process of installing new equipment at the Facility site. Commercial operation is expected to take place in early 1999.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

Not applicable.

**6. Additional Characteristics:**

None.

**7. Fossil Fuel Use:**

Not applicable.

**8. Eligible Facility:**

The Facility is an eligible wind facility under Section 3(17)(E) of the Federal Power Act.

CERTIFICATE OF SERVICE

Thereby certify that I have served, by first-class mail, postage prepaid, a copy of the foregoing document upon all parties on the official service lists compiled by the Secretary of the Federal Energy Regulatory Commission in these proceedings. Pursuant to section 292.207(a)(ii) of the Commission's regulations, I have also served the foregoing document on Southern California Edison Company and the California Public Utilities Commission.

Dated at Washington, D.C. this 8th day of January, 1999.



John S. Decker  
Attorney for Cabazon Power Partners LLC

ORIGINAL

FILED  
OFFICE OF THE SECRETARY  
01 JAN 24 PM 4:52  
FEDERAL ENERGY REGULATORY COMMISSION  
Washington, D.C. 20426

**Vinson & Elkins**  
ATTORNEYS AT LAW  
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Committee on Governmental Affairs

**EXHIBIT #A-14d**

January 24, 2001

David P. Boergers, Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

Re: Cabazon Power Partners LLC  
Docket No. QF95-186-004

Dear Mr. Boergers:

Pursuant to section 292.207(a)(1) of the Commission's regulations, please find enclosed an original and fourteen copies of a "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" relating to Cabazon Power Partners LLC.

Please contact me if you have any questions about this Notice.

Sincerely,

Donna J. Bobbish  
Attorney for Cabazon Power Partners LLC

cc: Southern California Edison Company  
California Public Utilities Commission

03  
FEDERAL DOCKET BOARD  
JAN 24 2001

010126-0333-1

WASHINGTON, D.C. AUSTIN BEIJING DALLAS HOUSTON LONDON MOSCOW NEW YORK SINGAPORE

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

OFFICE OF THE SECRETARY  
01 JAN 24 PM 4: 52

Cabazon Power Partners LLC )  
)  
)

Docket No. QF95-186-004

REGULATORY COMMISSION

**NOTICE OF SELF-RECERTIFICATION OF  
QUALIFYING FACILITY STATUS FOR  
SMALL POWER PRODUCTION FACILITY**

Pursuant to section 292.207(a)(1) of the Commission's regulations,<sup>1</sup> Cabazon Power Partners LLC ("Cabazon Power Partners") hereby files a Notice of Self-Recertification that the 39.75 megawatt wind energy facility described herein (the "Facility"), subsequent to a change in upstream ownership, is a qualifying small power production facility ("Qualifying Facility" or "QF") under subpart B of part 292 of the Commission's regulations.

**FORM 556**

**PART A -- GENERAL INFORMATION**

**Ia. Name:**

The full name of Cabazon Power Partners is Cabazon Power Partners LLC. The Docket number assigned to the immediately preceding submittal filed with the Commission in connection with the instant facility is QF95-186-003.

Other than as described herein, none of the information contained in prior certifications ("Prior Certifications") has changed. Accordingly, except to the extent the information contained in such Prior Certifications changes as described herein, Cabazon Power Partners incorporates by

<sup>1</sup> 18 C.F.R. § 292.207(a) (1997).

reference the Prior Certifications with respect to this notice of Self-Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.<sup>2</sup>

Cabazon Power Partners submits this notice to reflect a change in the upstream ownership of the Facility, as described below.

**1b. Full Address of Applicant**

Cabazon Power Partners LLC  
13000 Jameson Road  
Tehachapi, California 93561  
(805) 822-6835

**1c. Ownership**

Cabazon Power Partners, a Delaware limited liability company, owns the Facility.

As of December 29, 2000, Cabazon Holdings LLC owns a 100 percent interest in Cabazon Power Partners. Enron Wind Cabazon LLC ("Enron Wind Cabazon") owns a 1 percent interest and Enron Wind Cabazon Funding LLC ("EWCF") owns a 99 percent interest in Cabazon Holdings LLC. Each of Enron Wind Cabazon and EWCF is a wholly-owned subsidiary of Enron Wind Development Corp., which is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp. ("EWDHC"). EWDHC is a wholly-owned subsidiary of Enron Wind Corp., which is wholly owned by Enron Renewable Energy Corp. ("EREC"). EREC is a wholly-owned subsidiary of Smith Street Land Company, which is a wholly-owned subsidiary of Enron Corp. ("Enron"). Enron is an Oregon corporation with its principal place of business in Houston, Texas. There are no owners holding 10 percent or more of the common stock of

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<sup>2</sup> 18 C.F.R. § 292.207 (1997).

Enron. No electric utility, electric utility holding company, or person owned by either has any ownership interest in the Facility.

On April 14, 2000, Enron filed an application with the Securities and Exchange Commission for an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79c(a)(1) (1994). Under the Commission regulations, "... a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof."<sup>3</sup> The Commission's regulations further provide that "electric utility holding company" "does not include any holding company which is exempt by rule or order adopted or issued pursuant to sections 3(a)(3) or 3(a)(5) of [PUHCA]."<sup>4</sup> The Commission has determined that, upon the filing of a "good faith" application for exemption under Section 3(a)(3) or Section 3(a)(5) of PUHCA, an applicant is not considered an "electric utility holding company" under the QF ownership test of the Commission's Regulations for purposes of the utility ownership limitations under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Doswell Limited Partnership and Diamond Energy, Inc., 56 FERC ¶ 61,170, at p. 61,590 (1991). Accordingly, as of April 14, 2000, Enron is deemed not to be an "electric utility holding company" for purposes of the ownership limitation under the Commission's regulations.

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<sup>3</sup> 18 C.F.R. § 292.206(b) (2000).

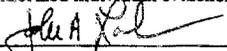
<sup>4</sup> 18 C.F.R. § 292.202(n) (2000).

On November 24, 2000, the Commission approved Sierra Pacific Resources' acquisition and Enron's divestment of Portland General Electric Company, a public utility in the State of Oregon.<sup>5</sup>

As a result, no owner of Cabazon Power Partners is an electric utility, an electric utility holding company, or a subsidiary thereof. None of Enron or any upstream owner of Cabazon Power Partners is an electric utility or an electric utility holding company, or a person owned by either, and none of these entities is engaged in the generation or sale of electric power; or has any ownership or operating interest, within the meaning of Section 292.206 and Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(1). Consequently, the Facility satisfies the requirements of Section 292.206(b) of the Commission's regulations.

Zond Maintenance Corporation is the operator of the Facility. Zond Maintenance Corporation is an indirect, wholly owned subsidiary of Enron Wind Corp.

1d. **Authorized individual evidencing accuracy of information:**



John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.

<sup>5</sup> *Sierra Pacific Power Co., Nevada Power Co., and Portland General Elec. Co.*, 93 FERC ¶ 61,217 (2000), *reh'g pending*.

**2. Communications:**

Correspondence concerning this Notice of Self-Recertification should be addressed to the following persons:

John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 452-4884

Adam Wenner  
Donna J. Bobbish  
Vinson & Elkins, L.L.P.  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6500

**3a. Location of Facility:**

State: California  
County: Riverside  
City or Town: Cabazon  
Street Address: None  
Mailing Address: None

**3b. Utility:**

Southern California Edison Company

**4a. Facility Components:**

See Prior Certifications.

**4b. Power Production Capacity:**

See Prior Certifications.

**4c. Initial Operations:**

The Facility was placed in service in 1985 and removed from service in 1997. Cabazon Power Partners installed new equipment at the Facility site, and commercial operation commenced in December 1998.

**4d. Primary Energy Input:**

See Prior Certifications.

**5. Average Annual Hourly Energy Inputs:**

Not applicable.

**6. Additional Characteristics:**

None.

**PART B -- DESCRIPTION OF THE SMALL POWER PRODUCTION FACILITY**

**7. Fossil Fuel Use:**

Not applicable.

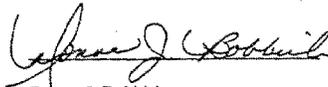
**8. Eligible Facility:**

See Prior Certifications.

**CERTIFICATE OF SERVICE**

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (2000), I hereby certify that I have served a copy of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding. Pursuant to section 292.207(a)(ii) of the Commission's Regulations, 18 C.F.R. §292.207 (2000), I also have served the foregoing document on Southern California Edison Company and the California Public Utilities Commission.

Dated at Washington, D.C. this 24th day of January, 2001.



Donna J. Bobbish  
Vinson & Elkins L.L.P.  
1455 Pennsylvania Ave., N.W.  
Washington, D.C. 20004-1008  
(202) 639-6618

Attorney for Cabazon Power Partners LLC

FILED  
OFFICE OF THE SECRETARY  
01 JAN 24 PM 4: 52  
FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, D.C. 20426  
Writing Office: 202-439-6448  
Washington: 202-439-6604

**Vinson & Elkins**  
ATTORNEYS AT LAW  
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FAX (202) 439-6504

**ORIGINAL**  
Committee on Governmental Affairs  
**EXHIBIT #A-15**

E-mail: dbobbish@vetlaw.com  
Web: www.vetlaw.com

January 24, 2001

David P. Boergers, Secretary  
Federal Energy Regulatory Commission  
Docket Room 1A  
888 First Street, N.E.  
Washington, D.C. 20426

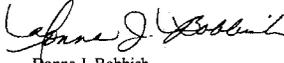
Re: Victory Garden Power Partners I LLC  
Docket No. QF99-92-001 ✓

Dear Mr. Boergers:

Enclosed for filing are an original and 14 copies of the "Notice of Self-Recertification of Qualifying Facility Status for Small Power Production Facility" of Victory Garden Power Partners I LLC ("Victory Garden I").

Please contact me if you have any questions about this Notice.

Sincerely,



Donna J. Bobbish  
Attorney for Victory Garden Power Partners I, LLC

cc: Southern California Edison Company  
California Public Utilities Commission

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WASHINGTON, D.C. AUSTIN BEIJING DALLAS HOUSTON LONDON MOSCOW NEW YORK SINGAPORE



incorporates by reference the Prior Certification with respect to this notice of Self-Recertification as a Qualifying Facility under section 292.207 of the Commission's regulations.<sup>2</sup>

Victory Garden I submits this notice to reflect a change in the upstream ownership of the Facility, as described below.

**1b. Full Address of Applicant**

Victory Garden Power Partners I LLC  
13000 Jameson Road  
Tehachapi, California 93561  
(805) 823-6733

**1c. Ownership**

Victory Garden I, a Delaware limited liability company, owns the Facility.

As of December 29, 2000, Enron Wind Development Corp. ("Enron Wind Dev. Corp.") owns a 100 percent interest in Victory Garden I. Enron Wind Dev. Corp., a California corporation, is a wholly-owned subsidiary of Enron Wind Domestic Holding Corp. ("EWDHC"). EWDHC is a wholly-owned subsidiary of Enron Wind Corp., which is wholly owned by Enron Renewable Energy Corp. ("EREC"). EREC is a wholly-owned subsidiary of Smith Street Land Company, which is a wholly-owned subsidiary of Enron Corp. ("Enron") Enron is an Oregon corporation with its principal place of business in Houston, Texas. There are no owners holding 10 percent or more of the common stock of Enron. No electric utility, electric utility holding company, or person owned by either has any ownership interest in the Facility.

On April 14, 2000, Enron filed an application with the Securities and Exchange Commission for an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the

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<sup>2</sup> 18 C.F.R. § 292.207 (1997).

Public Utility Holding Company Act of 1935 (“PUHCA”), 15 U.S.C. § 79c(a)(1) (1994). Under the Commission regulations, “... a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof.”<sup>3</sup> The Commission’s regulations further provide that “electric utility holding company” “does not include any holding company which is exempt by rule or order adopted or issued pursuant to sections 3(a)(3) or 3(a)(5) of [PUHCA].”<sup>4</sup> The Commission has determined that, upon the filing of a “good faith” application for exemption under Section 3(a)(3) or Section 3(a)(5) of PUHCA, an applicant is not considered an “electric utility holding company” under the QF ownership test of the Commission’s Regulations for purposes of the utility ownership limitations under the Public Utility Regulatory Policies Act of 1978 (“PURPA”). Doswell Limited Partnership and Diamond Energy, Inc., 56 FERC ¶ 61,170, at p. 61,590 (1991). Accordingly, as of April 14, 2000, Enron is deemed not to be an “electric utility holding company” for purposes of the ownership limitation under the Commission’s regulations.

On November 24, 2000, the Commission approved Sierra Pacific Resources' acquisition and Enron's divestment of Portland General Electric Company, a public utility in the State of Oregon.<sup>5</sup>

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<sup>3</sup> 18 C.F.R. § 292.206(b) (2000).

<sup>4</sup> 18 C.F.R. § 292.202(n) (2000).

<sup>5</sup> Sierra Pacific Power Co., Nevada Power Co., and Portland General Elec. Co., 93 FERC ¶ 61,217 (2000), *reh'g pending*.

As a result, no owner of Victory Garden I is an electric utility, an electric utility holding company, or a subsidiary thereof. None of Enron or any upstream owner of Victory Garden I is an electric utility or an electric utility holding company, or a person owned by either, and none of these entities is engaged in the generation or sale of electric power, or has any ownership or operating interest, within the meaning of Section 292.206 and Form 556, in any electric facilities other than qualifying cogeneration or small power production facilities, "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA, or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, 15 U.S.C. § 79z-5b(1). Consequently, the Facility satisfies the requirements of Section 292.206(b) of the Commission's regulations.

Zond Maintenance Corporation is the operator of the Facility. Zond Maintenance Corporation is an indirect, wholly owned subsidiary of Enron Wind Corp.

**1d. Authorized individual evidencing accuracy of information:**



John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.

**2. Communications:**

Correspondence concerning this Notice of Self-Recertification should be addressed to the following persons:

John A. Lamb  
Assistant General Counsel  
Enron Wind Corp.  
444 S. Flower Street  
Los Angeles, CA 90071-2946  
(213) 452-4884

Adam Wenner  
Donna J. Bobbish  
Vinson & Elkins, L.L.P.  
1455 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004-1008  
(202) 639-6500

**3a. Location of Facility:**

State: California  
County: Kern  
City or Town: Tehachapi  
Street Address: None  
Mailing Address: None

**3b. Utility:**

Southern California Edison Company.

**4a. Facility Components:**

See Prior Certification.

**4b. Power Production Capacity:**

See Prior Certification.

**4c. Initial Operations:**

The Facility was placed in service in June 1999.

**4d. Primary Energy Input:**

See Prior Certification.

**5. Average Annual Hourly Energy Inputs:**

Not applicable.

**6. Additional Characteristics:**

None.

**PART B -- DESCRIPTION OF THE SMALL POWER PRODUCTION FACILITY**

**7. Fossil Fuel Use:**

Not applicable.

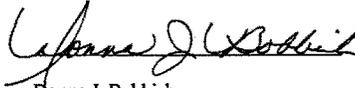
**8. Eligible Facility:**

See Prior Certification.

**CERTIFICATE OF SERVICE**

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (2000), I hereby certify that I have served a copy of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding. Pursuant to section 292.207(a)(ii) of the Commission's regulations, 18 C.F.R. §292.207 (2000), I also have served the foregoing document on Southern California Edison Company and the California Public Utilities Commission.

Dated at Washington, D.C. this 24th day of January, 2001.



Donna J. Bobbish  
Vinson & Elkins L.L.P.  
1455 Pennsylvania Ave., N.W.  
Washington, D.C. 20004-1008  
(202) 639-6618

Attorney for Victory Garden Power Partners I LLC

Committee on Governmental Affairs  
**EXHIBIT #A-16**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form U-1

Application Under  
The Public Utility Holding Company Act of 1935

Enron Corp.  
1400 Smith Street  
Houston, Texas 77002-7361

(Name of company filing this statement and address of principal executive offices)

None

(Name of top registered holding company parent of each applicant or declarant)

Kate B. Cole  
Assistant Secretary  
Enron Corp.  
1400 Smith Street  
Houston, Texas 77002-7361

(Names and addresses of agents for service)

The Commission is also requested to send copies of any communications in connection with this matter to:

Robert D. Eickenroht  
Assistant General Counsel  
Enron Corp.  
1400 Smith Street, E.B. 4859  
Houston, Texas 77002-7361

Joanne Rutkowski  
LeBoeuf, Lamb, Greene & MacRae,  
L.L.P.  
1875 Connecticut Avenue, N.W.  
Washington, D.C. 20009-5728

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Item 3.	Applicable Statutory Provisions
Item 4.	Regulatory Approval
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Item 6.	Exhibits and Financial Statements
Item 7.	Information as to Environmental Effects

## ITEM 1. DESCRIPTION OF PROPOSED TRANSACTION

(a) Furnish a reasonably detailed and precise description of the proposed transaction, including a statement of the reasons why it is desired to consummate the transaction and the anticipated effect thereof. If the transaction is part of a general program, describe the program and its relation to the proposed transaction.

Enron Corp. ("Enron"), a public-utility holding company that is exempt from registration pursuant to Rule 2 under Section 3(a)(1) of the Public Utility Holding Company Act of 1935 (the "1935 Act" or "Act"), is seeking an order of the United States Securities and Exchange Commission ("Commission") finding that Enron is exempt from all provisions of the Act, other than Section 9(a)(2), pursuant to Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Act.<sup>1</sup>

## A. Background

## 1. Enron Corp.

Enron is one of the world's leading electricity, natural gas and communications companies. The company, which owns approximately \$34 billion in energy and communications assets, produces electricity, develops, constructs and operates energy facilities worldwide, delivers physical commodities and financial and risk management services to customers around the world and is developing an intelligent network platform to facilitate online business. Enron operates through three principal business units: (1) Transportation and Distribution; (2) Wholesale Energy Operations (including broadband services); and (3) Retail Energy Services.

Transportation and Distribution - This group includes Portland General Electric Company ("Portland General") and Enron's Gas Pipeline Group. The Gas Pipeline Group operates a 32,000-mile interstate natural gas pipeline network, with access to every major gas supply basin in North America. The network directly serves customers in 21 states.

Wholesale Energy Operations - Enron's wholesale group consists of two primary lines of business: Commodity Sales and Services (marketing energy commodities and services and managing the associated contract portfolios) and Energy Assets and Investments (investing in, developing, constructing and operating energy and other assets). Enron is the largest supplier of electricity and natural gas in North America. Enron also operates extensively in the wholesale electricity markets in Northern Europe and the United Kingdom. In Central America, South America, India, China and other parts of Asia, Enron develops and operates energy infrastructure, including gas pipelines and power plants. Enron's wholesale energy operations and services business is conducted principally through Enron North America.

<sup>1</sup> Enron, which is currently exempt pursuant to Rule 2 under Section 3(a)(1) of the Act, will undertake to continue to file a Form U-3A-2 during the pendency of this application or until Portland General is divested.

Retail Energy Services - Enron offers comprehensive products to reduce energy costs for business customers throughout the United States and Europe. Enron provides energy outsourcing services to industrial and commercial customers. Enron has built strong sales and implementation teams for the energy outsource market and now manages over 16,500 facilities worldwide. Enron's retail energy services are provided principally through Enron Energy Services.

Enron also participates in the water and telecommunications industries. Through Azurix, Enron owns and operates water companies in the United Kingdom, Argentina and Mexico. Enron Broadband Services is developing an intelligent fiber optic network platform to facilitate online business in the United States.

The table below provides selected financial data for Enron.<sup>2</sup>

	For the Years Ended December 31,				
	1999	1998	1997	1996	1995
	(\$ in millions)				
Operating Revenues	40,112	31,260	20,273	13,289	9,189
Net Operating Income	802	1,378	15	690	618
Net Income	893	703	105	584	520
Total Assets	33,381	29,350	22,552	16,137	13,239

Enron is a public utility holding company within the meaning of the 1935 Act, by reason of its ownership of all of the outstanding voting securities of Portland General. As noted above, Enron currently claims exemption from registration pursuant to Rule 2 under Section 3(a)(1) of the Act. Enron's stock is listed on the New York, London, Pacific and Chicago Stock Exchanges, and it is a reporting company under the Securities Exchange Act of 1934, as amended.

## 2. Portland General Electric Company

Portland General is Enron's only public-utility subsidiary company. Portland General is engaged in the generation, purchase, transmission, distribution and sale of electric energy in Oregon. Portland General's electric distribution system is located within its service territory in Oregon. Portland General serves an area of 3,170 square miles, including 54 incorporated cities, of which Portland and Salem are the largest.

Portland General sells electric energy at wholesale in interstate commerce to electric utilities located in other states, primarily California. Portland General purchases electric energy from public utility districts located in Washington and from nonassociated utilities in Oregon, Washington, Montana, Idaho, Arizona, New Mexico, California and Canada. Portland General purchases surplus electric energy from the Bonneville Power Administration ("BPA"), a

<sup>2</sup> From Enron's Form 10-K filings.

federal agency that markets electric energy generated by federal hydroelectric dams located on the Columbia River in Oregon and Washington.

Portland General owns wholly or jointly the following generating facilities:

Name	Location	Net Capability (MW)	Percent of Company's Interest	Fuel
Sullivan	West Linn, OR	16	100.0	Hydro
Faraday	Estacada, OR	44	100.0	Hydro
River Mill	Estacada, OR	25	100.0	Hydro
Bull Run	Bull Run, OR	22	100.0	Hydro
Oak Grove	Three Lynx, OR	44	100.0	Hydro
Pelton	Madras, OR	108	100.0	Hydro
North Fork	Estacada, OR	54	100.0	Hydro
Round Butte	Madras, OR	300	100.0	Hydro
Beaver	Clatskanie, OR	500	100.0	Gas or Oil
Boardman	Boardman, OR	529	65.0	Coal
Colstrip 3&4	Colstrip, MT	1,480	20.0	Coal
Coyote Springs	Boardman, OR	241	100.0	Gas or Oil

Portland General has transmission lines for the delivery of electricity from its plants located in Oregon to its service territory or to the Northwest grid. Electric energy from the plants located in other states is delivered to Portland General over the Northwest grid. Portland General owns 20% of the Pacific Northwest Intertie, a 4,800 MW transmission facility between John Day, in Northern Oregon, and Malin, in Southern Oregon near the California border. This line is used primarily for interstate sales and purchases of electric energy among BPA, utilities in the Pacific Northwest, including Portland General, and California utilities.

Portland General also has a 90% ownership interest in a 20 inch diameter natural gas pipeline that runs approximately 18 miles from its Beaver generating plant, located in Clatskanie, Oregon, to Cowlitz County Washington where it interconnects with the interstate gas distribution system of Northwest Pipeline Company.

Portland General is subject to regulation of its retail rates and conditions of service by the Oregon Public Utility Commission ("OPUC"). In addition, the OPUC regulates the issuance of securities and prescribes the system of accounts to be kept by Oregon utilities. Portland General is also subject to the jurisdiction of the FERC with regard to the transmission and sale of wholesale electric energy, licensing of hydroelectric projects and certain other matters. Portland General is decommissioning its Trojan nuclear generating facility, and related activities are subject to regulation by the Nuclear Regulatory Commission and the Oregon Department of Energy.

The table below provides selected financial data for Portland General:<sup>3</sup>

	For the Years Ended December 31,				
	1999	1998	1997	1996	1995
	<i>(\$ in millions)</i>				
Operating Revenues	1,378	1,176	1,416	1,110	982
Net Operating Income	190	200	208	230	201
Net Income	128	137	126	156	93 <sup>4</sup>
Total Assets	3,167	3,162	3,256	3,398	3,246

Enron acquired Portland General on July 1, 1997 by merger with its former parent Portland General Corporation. The acquisition implemented Enron's strategy of participating in the deregulating electric utility industry. Enron's affiliation with Portland General has given it insight and access to new business opportunities in the broader energy industry. For example, Portland General has leveraged its technical competencies into Enron's worldwide operations through projects such as generation, consulting, distribution engineering and due diligence for privatization. As Enron has built a platform for its integrated gas and electricity business in South America, Portland General has provided valuable expertise in evaluating regional electric distribution assets that complement Enron's strategy.

On November 8, 1999, Enron and Sierra Pacific Resources ("Sierra Pacific") announced that they had entered into a purchase and sale agreement for Portland General. In a press release issued that day, Kenneth L. Lay, the Chairman and CEO of Enron, explained: "We have been very pleased with the performance of Portland General. However, the rapidly evolving competitive electricity market allows us to deliver commodity services and risk management products to our customers without requiring the ownership of a regulated electric utility." The pending sale of Portland General is the subject of a separate application before the Commission, discussed below.

### 3. Sale of Portland General to Sierra Pacific

Enron has entered into a definitive agreement to sell Portland General to Sierra Pacific for \$2.1 billion, comprised of \$2.02 billion in cash and the assumption of Enron's approximately \$80 million merger payment obligation. Sierra Pacific will also assume \$1 billion in Portland General debt and preferred stock. The proposed transaction, which is subject to customary regulatory approvals, is expected to close in the second half of 2000.

Sierra Pacific is currently an exempt holding company under Section 3(a)(1) of the Act whose principal subsidiaries are Sierra Pacific Power Company and Nevada Power Company. Combined, the two public-utility companies serve 843,000 electric customers in Nevada and the Lake Tahoe area of California, along with 105,000 natural gas and 67,000 water

<sup>3</sup> From Portland General's Form 10-K filings

<sup>4</sup> Includes a loss of \$50 million from regulatory disallowances.

customers in Reno and Sparks, Nevada. Upon the acquisition of Portland General, Sierra Pacific intends to register under the Act.

Additional information regarding Enron and its subsidiaries, including Portland General, is set forth in the following documents, each of which is incorporated herein by reference:

- (a) Enron Form U-3A-2, filed with the Commission on February 29, 2000;
- (b) Enron Form U-3A-2\A, filed with the Commission on March 31, 2000;
- (c) Enron Annual Report on Form 10-K for year ended December 31, 1999, filed with the Commission on March 30, 2000;
- (d) Enron Proxy Statement, dated March 28, 2000, filed with the Commission on March 21, 2000;
- (e) Enron Annual Report to Stockholders for the year ended December 31, 1999; and
- (f) Portland General Annual Report on Form 10-K for year ended December 31, 1999, filed with the Commission on March 3, 2000.

Additional information regarding the sale of Portland General to Sierra Pacific is set forth in the following documents, each of which is incorporated herein by reference:

- (a) Form U-1 Application or Declaration of Sierra Pacific Resources and Portland General Electric Company (Commission File No. 70-9619), filed February 3, 2000 (the "Merger Application");
- (b) Form U-1 Application or Declaration of Sierra Pacific Resources and Portland General Electric Company (Commission File No. 70-9621), filed February 3, 2000 (the Service Company Application);
- (c) Joint Application of Sierra Pacific Power Company, Nevada Power Company and Portland General Electric Company for Authorization and Approval of Acquisition and Indirect Merger, filed March 3, 2000 (the FERC Application).

#### B. Reasons Enron Is Seeking An Alternative Exemption.

As noted above, Enron is currently exempt by rule pursuant to Section 3(a)(1). It is seeking alternative relief under Section 3(a)(3) or 3(a)(5) as a means of obtaining relief from the "qualifying facility" or "QF" ownership restrictions under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Briefly stated, the regulations under PURPA generally limit

an electric-utility holding company to no more than 50% equity interest in a QF.<sup>5</sup> To date, the PURPA ownership restrictions have significantly impaired the ability of Enron to participate in competitive auctions of U.S. generating assets. There is, however, an exception (relied upon by AES Corporation) for holding companies that are exempt "by rule or order" under Section 3(a)(3) or 3(a)(5) of the 1935 Act.<sup>6</sup> For the reasons set forth below, Enron believes it is entitled to an order of exemption under either or both sections.

It may help to put Enron's concerns in context. Since 1997, entities controlling more than 5,000 MW of QF capacity -- or almost 10% of the nation's entire QF infrastructure -- have undergone changes of control, largely by means of competitive auctions. Enron has been disadvantaged in the great majority of these auctions, either because more than a 50% interest in a QF was being sold, or because the QF was already partially owned by electric utility affiliates. Most auctions to date have involved groups of QFs; although the ownership restrictions may present problems with only a small portion of the assets in a group, sellers typically prefer to transfer ownership in a single transaction, often as a stock sale rather than an asset sale. Thus, Enron has effectively been precluded from participating in auctions even though the QF ownership restrictions would present a problem only with respect to a small part of the assets being sold.

The nation's supply of QF generating assets is not expanding. PURPA-related new project development declined with the passage of the Energy Policy Act of 1992, and now has virtually ceased. While there is currently more than 75,000 MW of new capacity under development or construction, all of it will be owned by exempt wholesale generators or regulated utilities. Nonetheless, there is in place today more than 50,000 MW of installed QF capacity, most placed in service between 1982 and 1992, and most financed by long-term, often fixed-price power supply contracts with regulated utilities. As the electricity industry has evolved competitively, these assets have tended to move -- as assets do in deregulation -- to lower-cost, more efficient managers. This process has often involved the restructuring or termination of fixed-price contracts, allowing the assets to be operated in an economical, market-responsive manner. Increasingly, smaller QF operators are selling their projects through auctions to larger companies (including, potentially, Enron) that have the financial capability to accomplish the contract restructurings and to operate the QFs as merchant plants. Enron's goal, in seeking to participate more fully in the auction of QF assets, is to restructure the contracts, thereby reducing the total number of above-market QF contracts and the total stranded costs to be borne by the public as a result of competition.

<sup>5</sup> A QF cannot be owned by a person that is primarily engaged in the generation or sale of electric power. 16 U.S.C. §796(18)(B). The PURPA regulations provide that a facility "shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest is held by an electric utility, or utilities, or by an electric utility holding company or companies, or any combination thereof." 18 C.F.R. §292.206(b).

<sup>6</sup> 18 C.F.R. §§ 292.206(c)(1) and (c)(2).

Enron either has not participated in these auctions or else withdrew relatively early in the auction process, due in large part to the company's regulatory disadvantages. In the few cases in which Enron has purchased QF interests -- which, to date, has occurred only through negotiated transactions, rather than the competitive auctions that have become the industry's primary method of asset transfer -- Enron has been required to limit its ultimate ownership interest. While Enron has successfully structured some QF purchases using nonutility financial partners, this approach has materially increased the cost of the transactions and accordingly has reduced the degree of cost mitigation that Enron can offer to the utilities and to the public.

(b) Describe briefly, and where practicable state the approximate amount of, any material interest in the proposed transaction, direct or indirect, of any associate or affiliate of the applicant or declarant company or any affiliate of any such associate company.

See Item 1.

(c) If the proposed transaction involves the acquisition of securities not issued by a registered holding company or subsidiary thereof, describe briefly the business and property, present or proposed, of the issuer of such securities.

Not applicable.

(d) If the proposed transaction involves the acquisition or disposition of assets, describe briefly such assets, setting forth original cost, vendor's book cost (including the basis of determination) and applicable valuation and qualifying reserves.

Not applicable.

#### ITEM 2. FEES, COMMISSIONS AND EXPENSES

(a) State (1) the fees, commissions and expenses paid or incurred, or to be paid or incurred, directly or indirectly, in connection with the proposed transaction by the applicant or declarant or any associate company thereof, and (2) if the proposed transaction involves the sale of securities at competitive bidding, the fees and expenses to be paid to counsel selected by applicant or declarant to act for the successful bidder.

Legal fees in connection with the preparation of the Application (to be filed by amendment)

(b) If any person to whom fees or commissions have been or are to be paid in connection with the proposed transaction is an associate company or an affiliate of the applicant or declarant, or is an affiliate of an associate company, set forth the facts with respect thereto.

Not applicable.

## ITEM 3. APPLICABLE STATUTORY PROVISIONS

(a) State the section of the Act and the rules thereunder believed to be applicable to the proposed transaction. If any section or rule would be applicable in the absence of a specific exemption, state the basis of exemption.

Section 3 of the Act provides that the Commission upon application shall by order exempt any person from the provisions of the Act if such person meets the requirements for any exemption contained in Sections 3(a)(1) through 3(a)(5) and if the exemption is not detrimental to the public interest or the interest of investors or consumers. Section 3(a)(3) of the Act is applicable to Enron because Enron is "only incidentally" a holding company, as it currently is, and will remain, primarily engaged and interested in non-utility businesses, and will not derive a material part of its income from a public-utility company. Accordingly, Enron is entitled to an exemption from all the provisions of the Act, except Section 9(a)(2), pursuant to Section 3(a)(3). In the alternative, Enron is also entitled to an exemption under Section 3(a)(5) of the Act.

During the pendency of this application, Enron is entitled to an exemption pursuant to Section 3(c) of the Act. That section, in pertinent part, provides that: "The filing of an application in good faith under [Section 3(a)] by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon the application."

## A. Section 3(a)(3)

Enron satisfies the requirements for an exemption under Section 3(a)(3) of the Act. That section directs the Commission:

[to] exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of [the Act], unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors and consumers, if such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public-utility company and (A) not deriving, directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public-utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all the outstanding securities of such companies are owned, directly or indirectly, by such holding company.

Of interest here, Section 3(a)(3)(A) provides an exemption for a holding company that is "only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public-utility company," where the holding company does not derive, "directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public-utility company."

Enron's interest in Portland General fits comfortably within the exemption provided by Section 3(a)(3)(A). Enron is primarily engaged and interested in its nonutility energy, water and communications businesses. Enron's acquisition of Portland General was designed to provide a strategic foothold in the deregulating utility industry. Its experience with Portland General has contributed positively to Enron's other nonutility businesses. Portland General is not a material subsidiary of Enron within the meaning of the Act and, finally, the proposed exemption will not be detrimental to investors or consumers.

1. Enron is Only Incidentally a Holding Company.

Section 3(a)(3) was added to the text of the 1935 Act to accommodate companies such as Alcoa, which were "essentially industrial, generating power for their own use and selling the excess to the local community."<sup>7</sup> In this regard, the Commission has interpreted Section 3(a)(3) to require the showing of a nexus between the utility operations and the holding company's primary nonutility business. Over the years, the Commission's interpretation of "incidental" in the context of Section 3(a)(3) has tracked its then-current interpretation of similar language in Section 11(b)(1). Under that section, a registered holding company is generally limited to "such other businesses as are reasonably incidental, or economically necessary or appropriate" to the system's core utility operations. The Commission has read this provision to require an operating or "functional relationship" between the utility operations and the holding company's primary nonutility business.

Over the years, the test of "functional relationship" for registered holding companies has evolved from a requirement that the nonutility activity directly serve the needs of the operating utility to a more general concern that the proposed activity be in some way related, or not unrelated, to the larger energy business. To that end, the Commission has found that "certain activities are an integral part of the contemporary utility business."<sup>8</sup> These activities include the rendering of energy management services and demand-side management service; the brokering and marketing of energy commodities; the production, sale and distribution of thermal energy products; the sale of technical, operational, management and other similar kinds of services and expertise; the development, ownership and operation of "qualifying facilities" under PURPA; and, for gas registered companies, any activities involving the transportation or storage of natural gas and activities such as exploration, development, production, marketing and manufacture related to the supply of natural or manufactured gas.<sup>9</sup>

<sup>7</sup> Statement of Sen. Wheeler, 79 Cong. Rec. 8843 (1935); see also Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, on H.R. 5423, 74th Cong., 1st Sess. 2226 (citing the case of an industrial establishment that has a power plant of its own and distributes the power as a by-product).

<sup>8</sup> Exemption of Acquisition by Registered Holding Companies of Securities of Nonutility Companies Engaged in Certain Energy-Related and Gas-Related Activities, Holding Co. Act Release No. 26667 (Feb. 14, 1997).

<sup>9</sup> See Rule 58 under the Act.

Most recently, the Commission has authorized a registered coal-fired electric utility holding company to invest up to \$800 million in natural gas production, gathering, processing, storage and transportation facilities and equipment, liquid oil reserves and storage facilities, and associated facilities, on the theory that such assets are related to the parent's energy marketing activities, and registered gas utility holding companies are permitted to acquire a long list of "energy-related companies" -- regardless of whether the acquired nonutility business directly serves the system's core utility operations.<sup>10</sup>

As noted above, Enron's affiliation with Portland General has given it insight and access to new business opportunities in the broader energy industry. For example, Portland General has leveraged its technical competencies into Enron's worldwide operations through projects such as generation, consulting, distribution engineering and due diligence for privatization. As Enron has built a platform for its integrated gas and electricity business in South America, Portland General has provided valuable expertise in evaluating regional electric distribution assets that complement Enron's strategy. The fact that Enron is now seeking to sell Portland General in response to changes in "the rapidly evolving competitive electricity market" does not affect the validity of the underlying functional relationship. Against this background, Enron is "only incidentally" a holding company, within the meaning of Commission precedent.

2. Enron will Not Derive a Material Part of its Income from Portland General

The further question, which is common to both Section 3(a)(3) and 3(a)(5), is the requirement that the holding company not derive "directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public utility company." Historically, the Commission has required that the utility operations be both small in a relative sense (i.e., not material), and small in an "absolute" sense.<sup>11</sup>

Concerning materiality, the Commission can consider a variety of measures in determining what is a material part of income. In practice, however, the Commission has generally relied on a comparison of gross revenues (the "gross-to-gross" test). AES Corporation, Holding Co. Act Release No. 27063 (Aug. 20 1999). Although AES involved an exemption under Section 3(a)(5), the Commission explained, "Since the same language ('material part of its income') appears in all three exemptions involving relative size criteria of an applicant's public-utility subsidiaries, i.e., sections 3(a)(1), 3(a)(3) and 3(a)(5), it obviously makes sense to take a consistent approach to the interpretation of this language."

<sup>10</sup> American Electric Power Co., Holding Co. Act Release No. 26933 (Nov. 2, 1998).

<sup>11</sup> AES Corporation, Holding Co. Act Release No. 27063 (Aug. 20, 1999).

The Commission in AES compared the relative size of the utility and the holding company post-merger, based on gross revenues, operating income and net assets (in \$millions):

		AES & CILCO	CILCO	Percent
Gross Revenues	1996	1,676	524	31%
	1997	2,603	553	21%
	1998	4,199	538	13%
Operating Income	1996	456	96	21%
	1997	706	103	15%
	1998	1,089	93	9%
Net Assets	1996	5,162	1,036	20%
	1997	11,218	1,023	9%
	1998	13,164	1,024	8%

In AES, the Commission found a subsidiary that contributed 10.35% of the holding company's adjusted revenues was not material for purposes of exemption under Section 3(a)(5).

In comparison, Portland General has contributed less than 4% of Enron's gross revenues for each of the two past years:

	1998			1999		
	Enron	Portland General	%	Enron	Portland General	%
	<i>(\$ in millions)</i>			<i>(\$ in millions)</i>		
Gross Revenues	31,260	1,176	3.8%	40,112	1,378	3.4%
Operating Income	1,378	200	14.5%	802 <sup>12</sup>	190	23.7%
Assets	29,350	3,162	10.8%	33,381	3,167	9.5%

<sup>12</sup> The operating income for Enron decreased for the fiscal year ended December 31, 1999 compared to the fiscal year ended December 31, 1998 for two principal reasons: (a) in 1999, Enron recognized a one-time charge of \$441 million related to the impairment of its methyl tertiary butyl ether (or MTBE) facilities, in response to changes in market conditions and demand for MTBE and (b) in 1999, more of Enron's earnings were recorded in "equity in earnings of unconsolidated equity affiliates" than in 1998 (\$309 million compared to \$97 million). These earnings represent similar kinds of activities to those included in operating income, but they are recorded by entities in which Enron owns directly or indirectly less than 50%, so Enron records only one line item for its share of their net income. In AES, the Commission found that a pro rata consolidation of financial data provided a more appropriate representation of the size of the system's utility business than the equity accounting required by generally accepted accounting principles. In this matter, if the \$309 million recorded in "equity in earnings of unconsolidated equity affiliates" were included in operating income, Portland General's contribution to operating income would be reduced to 17.1%. Further, but for the MTBE write-off, which is a one-time event, Portland General would represent only 12.2% of Enron's 1999 operating income.

Accordingly, Portland General is not a material utility subsidiary within the meaning of Commission precedent.

3. The Proposed Exemption will Not be Detrimental to the Protected Interests.

Notwithstanding an applicant's compliance with the language of the statute, the Commission has discretion to deny an exemption if it finds the exemption "detrimental to the public interest or the interest of investors or consumers," the so-called "protected interests" under the Act. In this regard, the Commission in the past has imposed an additional condition that the utility operations of Section 3(a)(3)-exempt holding companies be "small in an absolute as well as a relative sense."<sup>13</sup> The limitation was imposed in early cases to address the situation in which "any public utility holding company could insulate itself from the Act by acquiring and holding the stocks of companies doing some business other than that of a retail utility business."<sup>14</sup> The Commission in AES stated that: "This approach is intended to ensure that the exemption is not available to a company with a large utility business and a total business that is predominantly nonutility in nature just because the nonutility holdings dwarf the utility operations."

It bears repeating that the Commission developed the absolute size standards in matters involving ownership of multiple public-utility companies formed prior to the Act which were sprawled across multiple states, some not subject to even minimal state regulation, and others which, by their nature, could not be the subject of effective regulation. In contrast, in the instant matter, the utility operations are confined to a single state.<sup>15</sup> Further, Enron currently qualifies for exemption as an intrastate holding company, an exemption that is premised on the state's ability to effectively regulate the utility operations within its borders. Accordingly, the considerations that led the Commission to apply a restrictive gloss to Sections 3(a)(3) and 3(a)(5) do not apply to this Application. Indeed, the intrastate size and scope of Portland General's utility operations reflect decades of effective regulation, not an absence of regulation.

<sup>13</sup> Electric Bond and Share Co., 33 S.E.C. 21 (1952), quoting Standard Oil Co., 10 S.E.C. 1122, 1129 (1942).

<sup>14</sup> Id.

<sup>15</sup> Cf. AES and Gaz Metropolitan, Inc., Holding Co. Act Release No. 26170 (Nov. 23, 1994) (granting exemptions under Section 3(a)(5) to holding companies with essentially intrastate operations).

Finally, the Commission in AES noted that the utility was "significantly larger" than the utility considered in the only other modern decision under Section 3(a)(5) (or 3(a)(3)).<sup>16</sup> The Commission nonetheless concluded that the utility in AES nonetheless met the "absolute size" standard because it was "significantly smaller," *in terms of its impact (rather than its absolute size)*, than the utilities found to be impermissibly large in early decisions. In this matter, although Portland General is the largest investor-owned utility in Oregon, this analysis excludes BPA and other public power agencies and cooperatives. BPA is larger in all relevant respects than any of the investor-owned utilities in the Portland General region.<sup>17</sup> Further, Portland General is comparable to the utility at issue in AES in terms of the relative significance of the utility's revenues, assets and customers.<sup>18</sup>

B. Section 3(a)(5)

Briefly stated, Section 3(a)(5) of the Act provides an exemption where a holding company "is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public utility company."

There are only two modern decisions addressing the application of Section 3(a)(5). In its 1994 Gaz Metropolitan decision, the Commission granted an exemption to a Quebec corporation that acquired a Vermont gas utility company. More recently, in last summer's AES decision, the Commission granted the exemption to a U.S. independent power producer that acquired an Illinois electric and gas utility company. In that matter, the Commission stated that a request for exemption under Section 3(a)(5) raised three issues:

<sup>16</sup> See AES, citing Gaz Metropolitan, Inc. (revenues of \$38 million). Portland General is smaller in absolute terms than the utility at issue in the pending filing by Chevron Corporation for an order under Section 3(a)(3) of the Act. See Chevron Corporation, Post-Effective Amendment No.1 to SEC File No. 70-9553. Illinois Power Company, a combination gas and electric utility company, reported operating revenues of \$1,903.2 million and net operating revenues of \$1,125.8 million, for the year ended December 31, 1999. In comparison, Portland General had operating revenues of \$1,378 million and net operating revenues of \$740 million for the same period. While we recognize that the Commission has not yet acted on the Chevron request for exemption, we believe that this information is germane to our filing.

<sup>17</sup> BPA, which generates 46% of the electric power consumed in the region, owns one of the world's largest high-voltage transmission systems. BPA had operating revenues of \$2,313 million in 1998.

<sup>18</sup> In 1997, for example, Portland General accounted for only 0.6% of total utility revenues of all utility companies, 0.5% of total assets for the same group, and 0.5% of total national utility customers. These rankings are slightly higher than those of CILCO, the utility at issue in AES, which represented 0.2%, 0.2% and 0.3% of national revenues, assets and customers respectively, but lower than those of Illinois Power Company, the utility at issue in the Chevron application, which represented 0.7%, 1.1% and 0.7% of the national totals.

First, it is necessary to examine the significance of the utility operations that AES will acquire to determine if they are small in a relative sense (i.e., not material). Second, we must consider whether they are small in an absolute sense. Finally, we must consider whether a company such as AES, that is not an essentially foreign public-utility holding company, can qualify for the exemption. We examine these issues in the context of the abuses that the Act was intended to address.

The first and second issues, concerning the relative and absolute size of the utility operations, have been discussed above. What remains is the application of Section 3(a)(5) to an entity such as Enron that is not “essentially foreign.”

In AES, the Commission departed from earlier cases that had held that, in order to qualify for an exemption under Section 3(a)(5), an applicant must be a U.S. holding company with “essentially foreign utility operations.”<sup>19</sup> The Commission explained:

“... we do not, however, believe that it is necessary to limit the section 3(a)(5) exemption to a U.S. holding company whose operations are essentially foreign to achieve the policy objectives of the Act. On the facts of this matter, a grant of exemption is consistent with the underlying rationale of the exemption and the Act’s legislative history (including subsequent amendments to the Act). Following the acquisition of CILCO, AES will be a U.S. holding company that is essentially engaged in utility businesses that Congress has determined should not be subject to regulation under the Act. Just as Congress determined that the public interest does not require regulation of public-utility holding companies whose utility operations are essentially foreign, except for a small domestic utility, the public interest does not require regulation of a U.S. holding company whose utility operations are exclusively exempt, except for a small domestic utility.

As in the case of AES, Enron is “a U.S. holding company that is essentially engaged in utility businesses that Congress has determined should not be subject to regulation under the Act.” Although Enron is one of the world’s largest energy providers, the vast majority of its activities, including energy trading (which does not fall within the definition of an electric or gas utility company), gas transportation (which is not included in the definition of a gas utility company) and the development of independent power projects (which are exempt as “QFs” under PURPA or as “exempt wholesale generators” or “foreign utility companies” under the Energy Policy Act of 1992), are utility businesses that Congress has determined should not be subject to regulation under the Act. It is appropriate, therefore, and consistent with the precedent for the Commission to grant Enron an exemption under Section 3(a)(5) of the Act.

<sup>19</sup> AES, citing Cities Service Co., 8 S.E.C. 318 (1940) and Electric Bond and Share.

(b) If an applicant is not a registered holding company or a subsidiary thereof, state the name of each public utility company of which it is an affiliate, or of which it will become an affiliate as a result of the proposed transaction, and the reasons why it is or will become such an affiliate.

Enron is an affiliate of Portland General.

ITEM 4. REGULATORY APPROVAL

(a) State the nature and extent of the jurisdiction of any State commission or any Federal commission (other than the U. S. Securities and Exchange Commission) over the proposed transaction.

Not applicable.

(b) Describe the action taken or proposed to be taken before any commission named in answer to paragraph (a) of this item in connection with the proposed transaction.

Not applicable.

ITEM 5. PROCEDURE

(a) State the date when Commission action is requested. If the date is less than 40 days from the date of the original filing, set forth the reasons for acceleration.

It is requested that the Commission act on this matter in a timely manner, provided it is Enron's intention that this filing not delay the Commission's review of the Merger Application.

(b) State (i) whether there should be a recommended decision by a hearing officer, (ii) whether there should be a recommended decision by any other responsible officer of the Commission, (iii) whether the Division of Investment Management may assist in the preparation of the Commission's decision, and (iv) whether there should be a 30-day waiting period between the issuance of the Commission's order and the date on which it is to become effective.

The Applicant states that (i) there should be a recommended decision by a hearing officer, (ii) there should be a recommended decision by any other responsible officer of the Commission, (iii) the Division of Investment Management may assist in the preparation of the Commission's decision, and (iv) there should be a 30-day waiting period between the issuance of the Commission's order and the date on which it is to become effective.

ITEM 6. EXHIBITS AND FINANCIAL STATEMENTS

(a) Exhibits

A Opinion of Counsel (to be filed by amendment)

B Proposed Notice

ITEM 7. INFORMATION AS TO ENVIRONMENTAL EFFECTS

(a) Describe briefly the environmental effects of the proposed transaction in terms of the standards set forth in Section 102(2)(C) of the National Environmental Policy Act [42 U.S.C. 4232(2)(C)]. If the response to this term is a negative statement as to the applicability of Section 102(2)(C) in connection with the proposed transaction, also briefly state the reasons for that response.

The proposed transactions subject to the jurisdiction of this Commission have no environmental impact in and of themselves.

(b) State whether any other federal agency has prepared or is preparing an environmental impact statement ("EIS") with respect to the proposed transaction. If any other federal agency has prepared or is preparing an EIS, state which agency or agencies and indicate the status of that EIS preparation.

No federal agency has prepared or, to Enron's knowledge, is preparing an EIS with respect to the proposed transaction.

SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, the undersigned company has duly caused this Application-Declaration to be signed on its behalf by the undersigned thereunto duly authorized. The signature of the applicant and of the person signing on its behalf is restricted to the information contained in this application which is pertinent to the application of the respective company.

ENRON CORP.

By:   
James V. Derrick, Jr.  
Executive Vice President &  
General Counsel

Date: April 12, 2000

Before the  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935  
Release No. / , 2000

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In the Matter of:

Enron Corp.  
1400 Smith Street  
Houston, Texas 77002-7361

(70- )

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Enron Corp. ("Enron"), a public-utility holding company that is exempt from registration pursuant to Rule 2 under Section 3(a)(1) of the Public Utility Holding Company Act of 1935 (the "Act"), is seeking an order of the United States Securities and Exchange Commission ("Commission") finding that Enron is exempt from all provisions of the Act, other than Section 9(a)(2), pursuant to Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Act.

Enron currently owns all of the common stock of Portland General Electric Company ("Portland General"). Enron has entered into a definitive agreement to sell Portland General to Sierra Pacific Resources ("Sierra Pacific") for \$2.1 billion, comprised of \$2.02 billion in cash and the assumption of Enron's approximately \$80 million merger payment obligation. Sierra Pacific will also assume \$1 billion in Portland General debt and preferred stock. The proposed transaction, which is subject to customary regulatory approvals, is expected to close in the second half of 2000.

Enron is seeking an exemption under Section 3(a)(3) or, in the alternative, Section 3(a)(5), as a means of obtaining relief from the "qualifying facility" or "QF" ownership restrictions under the Public Utility Regulatory Policies Act of 1978.

The Application and any amendments thereto are available for public inspection through the Commission's Office of Public Reference. Interested persons wishing to comment or request a hearing should submit their views in writing by \_\_\_\_\_, 2000 to the Secretary, Securities and Exchange Commission, 450 Fifth St., N.W., Washington, D.C. 20549.

Committee on Governmental Affairs  
EXHIBIT #A-17

LEBOEUF, LAMB, GREENE & MACRAE  
L.L.P.

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

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April 13, 2000

LONDON  
(A LONDON-BASED  
MULTINATIONAL PARTNERSHIP)

PARIS

BRUSSELS

MOSCOW

RIYADH  
(AFFILIATED OFFICE)

TASHKENT

BISHKEK

ALMATY

BEIJING

**CONFIDENTIAL TREATMENT REQUESTED  
PURSUANT TO RULE 104 UNDER THE  
PUBLIC UTILITY HOLDING COMPANY  
ACT OF 1935**

Catherine A. Fisher  
Assistant Director  
Office of Public Utility Regulation  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth St., N.W.  
Washington, D.C. 20549

Re: Enron Corp. Application under Sections 3(a)(3)/3(a)(5)

Dear Cathie:

I am writing to provide some background information with respect to an application ("Application") that Enron Corp. ("Enron") is filing under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 (the "1935 Act" or "Act"). Briefly stated, Enron is seeking relief, similar to that granted AES Corporation, to enable it to compete effectively in the developing QF market, pending completion of the sale of Portland General Electric Company ("Portland General") to Sierra Pacific Resources, Inc. ("Sierra Pacific").

Enron is currently a holding company that claims exemption pursuant to Rule 2 under Section 3(a)(1) of the Act, by reason of its ownership of all of the outstanding voting securities of Portland General. As you know, Enron has entered into a definitive agreement to sell Portland General to Sierra Pacific Resources, Inc., and applications for approval of that transaction were filed with this Commission on February 3, 2000 (SEC File No. 70-9619) and with the FERC on March 3, 2000. The Sierra Pacific/Portland General transaction, which is

Catherine A. Fisher  
April 13, 2000  
Page 2

subject to customary regulatory approvals, is expected to close in the second half of 2000. Upon completion of the sale, Enron will cease to be a holding company within the meaning of the Act.

Pending Commission action on the Sierra/Portland General transaction or issuance of a final order on the instant Application, Enron will rely on the good-faith exemption granted by Section 3(c) of the 1935 Act as a means of obtaining relief from the QF ownership restrictions under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Briefly stated, the regulations under PURPA generally limit an electric-utility holding company to no more than 50% equity interest in a QF.<sup>1</sup> There is, however, an exception (relied upon by AES) for holding companies that are exempt "by rule or order" under Section 3(a)(3) or 3(a)(5) of the 1935 Act.<sup>2</sup> The Federal Energy Regulatory Commission ("FERC") has interpreted this language to apply as well to entities that have filed a good-faith application for exemption under Section 3(a)(5) and, by extension, Section 3(a)(3) of the 1935 Act. *Doswell Limited Partnership and Diamond Energy, Inc.*, 56 F.E.R.C. ¶61,170 (July 31, 1991) (a copy of the order is attached).<sup>3</sup>

As explained more fully in the Application, Enron believes that it is entitled to an exemption under either Section 3(a)(3) or 3(a)(5), based on the precedent, the nature of its primary nonutility business and the relative and absolute size of its utility operations. Indeed, if the Sierra Pacific/Portland General transaction were to fall through, Enron would ask the Commission to rule on the merits of the Application. We do not anticipate any problems, however, with the Sierra Pacific/Portland General transaction and so, would simply rely on the good-faith exemption provided by the instant filing (as it affects Enron's QF ownership rights), pending the outcome of the Commission's review in File No. 70-9619.

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<sup>1</sup> A QF cannot be owned by a person primarily engaged in the generation or sale of electric power. 16 U.S.C. §796(18)(B) (1996). The PURPA regulations provide that a facility "shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest is held by an electric utility, or utilities, or by an electric utility holding company or companies, or any combination thereof." 18 C.F.R. §292.206(b) (1999).

<sup>2</sup> 18 C.F.R. §§ 292.206(c)(1) and (c)(2) (1999).

<sup>3</sup> The FERC explained: "Although section 292.202(n) specifically utilizes the phrase "rule or order," reliance on the statutory PUHCA section 3(c) "safe harbor" is not inconsistent with our regulations. In our view, treating a pending good faith SEC application differently than the SEC "rule or order" language in the regulations concerning granting an exemption would be inconsistent with the intent of section 292.202(n)." The FERC noted that it had made a similar finding with respect to a company's filing of an application under Section 2(a)(3) of the 1935 Act, and the pendency of the exemption from the definition of "electric utility company" during the pendency of a good faith application. See *Long Lake Energy Corporation*, 51 F.E.R.C. ¶61,262 (1990).

Catherine A. Fisher  
April 13, 2000  
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To address any concerns during the pendency of this Application, we would offer the following additional safeguards for the public interest and the interest of investors and consumers so long as Enron continues to own Portland General:

- Enron, which is currently exempt pursuant to Rule 2 under Section 3(a)(2) of the Act, will undertake to continue to file Form U-3A-2 during the pendency of the exemptive Application or until Portland General is divested.
- Enron will not rely on the temporary good faith exemption to facilitate the growth and extension of a holding company system. Once the sale of Portland General is complete, Enron will cease to be a 1935 Act-jurisdictional entity and so, will withdraw the instant Application.
- Finally, in the event that the sale of Portland General is not completed in a timely manner and if it appeared that it would ultimately be determined that Enron was not entitled to an order of exemption under either Section 3(a)(3) or 3(a)(5), Enron would undertake to restructure its QF interests within a reasonable time and thereafter withdraw the request for exemption.

\* \* \* \* \*

We would be happy to meet with you and to provide any additional information. If you have any questions, please call me at (202) 986-8281.

Sincerely



Joanne C. Rutkowski

Enclosures

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**Enron Corp.**  
**Alternative PUHCA Exemption for  
QF Relief**

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**SEC Staff Presentation**

**July 27, 2001**

Committee on Governmental Affairs  
**EXHIBIT #A-18**



# Overview

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- **Summary Points**
- **QF Restructuring Opportunity**
- **Enron's Core Competencies**
- **Missed Opportunities**
- **Impediments of the "Good Faith" Exemption**
- **Relative Comparisons**
- **Absolute Comparisons**
- **Conclusion**



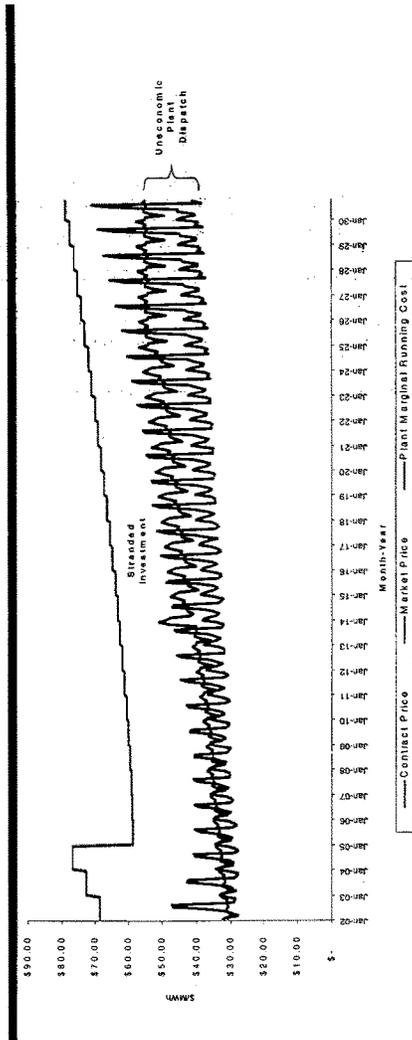
## Summary Points

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- Enron currently has a Section 3(a)(1) exemption under PUHCA, which restricts Enron from acquiring more than 50% of a QF (or joining with utilities to jointly acquire or own more than 50% of a QF)
- On April 14, 2000, Enron filed a Form U-1 Application entitling Enron to a “good faith” exemption under Section 3(a)(3) or, alternatively, Section 3(a)(5), alleviating Enron from the QF ownership restrictions; the SEC and Enron agreed to delay pursuing a formal order on the Application pending the PGE sale
- The objective in Enron seeking an alternative exemption, under Section 3(a)(3) or 3(a)(5), is to gain relief from the QF ownership limitations
- An exemption under either Section 3(a)(3) or 3(a)(5) would provide the necessary relief, and Enron is willing to discuss either exemption with the SEC



## QF Restructuring Opportunity



PURPA marked the nation's first step toward competitive electricity markets. Since its implementation in 1978:

- Wholesale competition has advanced through the passage of the EPAct and FERC Order 888
- Electricity prices have become increasingly transparent and markets increasingly more liquid
- Electric technologies have advanced in terms of efficiency, thus lowering electricity prices on average
- Retail markets have moved toward full deregulation, creating opportunities for public utilities to deal with uneconomic costs (or "stranded investment") stemming from long-term power supply arrangements (e.g., "securitization")

Opportunities will exist during the transition to fully competitive retail markets to restructure QF contracts in a manner that:

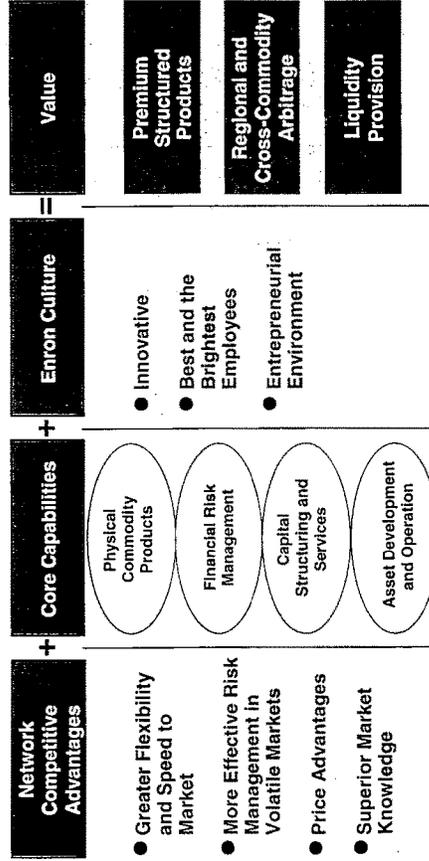
- Encourages economic plant dispatch
- Provides ratepayer relief
- Enhances shareholder value



# Enron's Core Competencies

- Enron is well situated to participate in the business of QF contract restructuring

## Value Formula



## Missed Opportunities

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- Prior to the PGE acquisition in July 1997, Enron held more than 50% interests in several QF's which it subsequently sold as a result of the PGE acquisition
- From July 1997 to April 14, 2000 (the date of filing of the Application), Enron had to (1) limit its ownership in QF's or (2) utilize highly structured vehicles to acquire interests in QF's; In many instances, Enron has been precluded from participating in competitive auctions because of its regulatory disadvantage
- Enron has structured some QF purchases using non-utility financial partners, which has (1) markedly increased the cost of the transactions, (2) introduced a degree of regulatory risk, and (3) reduced the benefits that Enron can offer to all parties, including utilities and the public

## Missed Opportunities: cont.

### Examples

#### Project

#### Description / Impediment

##### CalEnergy

In preparation for its merger with Mid-American Energy Corp., CalEnergy Corporation was required in May 1999 to divest varying percentages -- but generally 50% -- of its interests in 14 QFs, with a total of 896 gross MW (440 net MW). Enron, as a utility affiliate, was prevented from participating in the transaction. The sale was completed to El Paso Energy Corp.

##### Dynegy

In preparation for its pending merger with Illinova Corp., Dynegy was required by FERC regulations to divest varying percentages of eight QFs, with a total of 326 gross MW (157 net MW), all located in California. Dynegy determined to sell all of its interests in ten QFs in the state, with a total of 614 gross MW (345 net MW). Enron, as a utility affiliate, was prevented from participating in eight of the ten projects, and was thus effectively unable to compete in the auction. The sale was completed to El Paso Energy Corp.

##### Brooklyn Union

In preparation for its merger with Long Island Lighting Company, KeySpan Energy, the parent of Brooklyn Union Gas, was required in December 1997 to divest its ownership in four QFs, with a total of 388 gross MW (120 net MW). Enron, as a utility affiliate, was prevented from participating in the auction. The sale was completed to Calpine Corporation.

##### U.S. Generating

In March 1998, as part of a restructuring of domestic and international project interests between US Generating (a subsidiary of PG&E Corp.) and Bechtel Enterprises, Bechtel sold its approximately 50% interests in 10 QF projects, with a total of 636 MW gross (335 MW net). The sale was completed to Cogentrix Energy.

## Missed Opportunities: cont.

### ▶ Examples

<u>Project</u>	<u>Description / Impediment</u>
<u>United Utilities PLC</u>	In June 1997, United Utilities sold its interests in two QFs with a total of 390 gross MW (195 net MW). The other 50% owner of both projects was a utility affiliate, and Enron could not participate in the auction. The sale was completed to Calpine Corporation.
<u>ENPEX</u>	In April 1999, ENPEX sold its 50% interest in the 137 MW Newark Bay QF project. The other 50% owner of the plant was a utility affiliate, and Enron could not participate in the auction. The sale was completed to El Paso Energy Corp.
<u>LG&amp;E</u>	In March 1999, LG&E Corp. and Westmoreland Energy sold their combined 100% interest in the 80 MW Rensselaer QF project in an auction process. The sale was completed to Coastal Corp.
<u>Energy Management</u>	In June 1999, Energy Management, Inc. and General Electric Capital Corporation announced the sale of their combined 100% ownership in two QFs with a total of 136 MW. Enron was unable to participate in the auction without partners, a competitive disadvantage. The sale was completed to El Paso Energy Corporation.
<u>LS Power</u>	In March 1998, LS Power Corp. sold in an auction process its 74% ownership in two QF projects totaling 500 MW gross (370 MW net). The sale was completed to Cogentrix Energy.

## Missed Opportunities: cont.

### ➤ Examples

<u>Project</u>	<u>Description / Impediment</u>
<u>Midland Cogeneration Venture</u>	In 1997, PanEnergy Corp., as part of its acquisition by Duke Energy, was required to sell its 18.1% interest in the 1,240 MW MCV project. The sale was completed to a subsidiary of MCN Corporation. As part of its merger with DTE Energy Corp., in December 1999 MCN undertook an auction of its 23.1% interest in the project. The sale was completed to Coastal Corporation.
<u>Cogeneration Corporation of America</u>	In August 1999, Calpine Corp. acquired 80% of the stock of Cogen Corporation of America for \$225 million. The acquired company had ownership interests in six QFs totaling 580 MW of capacity.
<u>Bonneville Pacific Corporation</u>	In September 1999, El Paso Energy Corp. acquired 100% of the stock of Bonneville Pacific for \$63 million. The acquired company had a 50% ownership interest in an 85 MW QF.
<u>Sithe Energies</u>	In 2000, the corporate majority shareholder of Sithe announced it would sell its stock in an auction process. Sithe Energies owned interests in 13 QF projects totaling 1,480 MW. Sithe additionally owned more than 8,000 MW of non-QF generating assets, both in the U.S. and internationally. The sale of the non-QF assets was completed to an affiliate of GPU, Inc.
<u>Oxbow Power</u>	The individual shareholders of Oxbow Power announced they would sell their stock in an auction process. Oxbow owns interests in four QF projects, totaling 340 MW.
<u>Foster-Wheeler</u>	The company announced it would sell the stock of its Power Systems subsidiary in an auction process. Foster Wheeler owns interests in seven QFs, totaling 254 MW.

## Impediments of the Good Faith Exemption

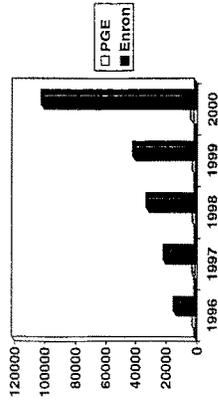
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- Enron's current "Good Faith" exemption has the following pitfalls and anti-competitive consequences:
  - Requires education of the Counterparty
  - Becomes an excuse to prevent Enron's participation in Competitive Auctions
  - Requires Enron to represent and guarantee its PUHCA and QF status
  - Requires Enron to obtain legal opinions to support the "Good Faith" nature of the Application and status under PUHCA and PURPA
  - Results in uncertainty as to whether the SEC will grant a Final Order, and requires "escape-hatch" planning
  - Raises accounting and tax issues associated with a later potential restructuring
  - Impedes the operation of QFs (cap-x, exit strategies, e.i.c.)

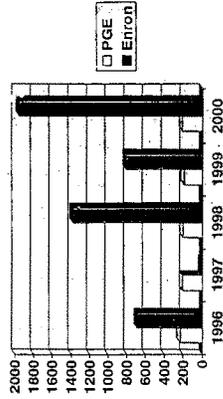
# Relative Comparisons Show PGE as a Small Utility

(\$ in Millions, From Enron and PGE Form 10-Ks)

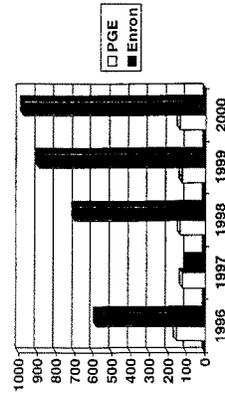
Operating Revenues



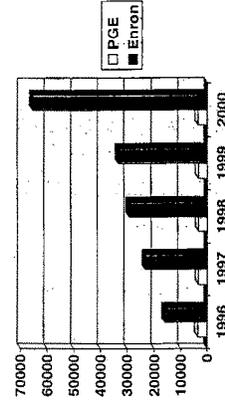
[Net] Operating Income



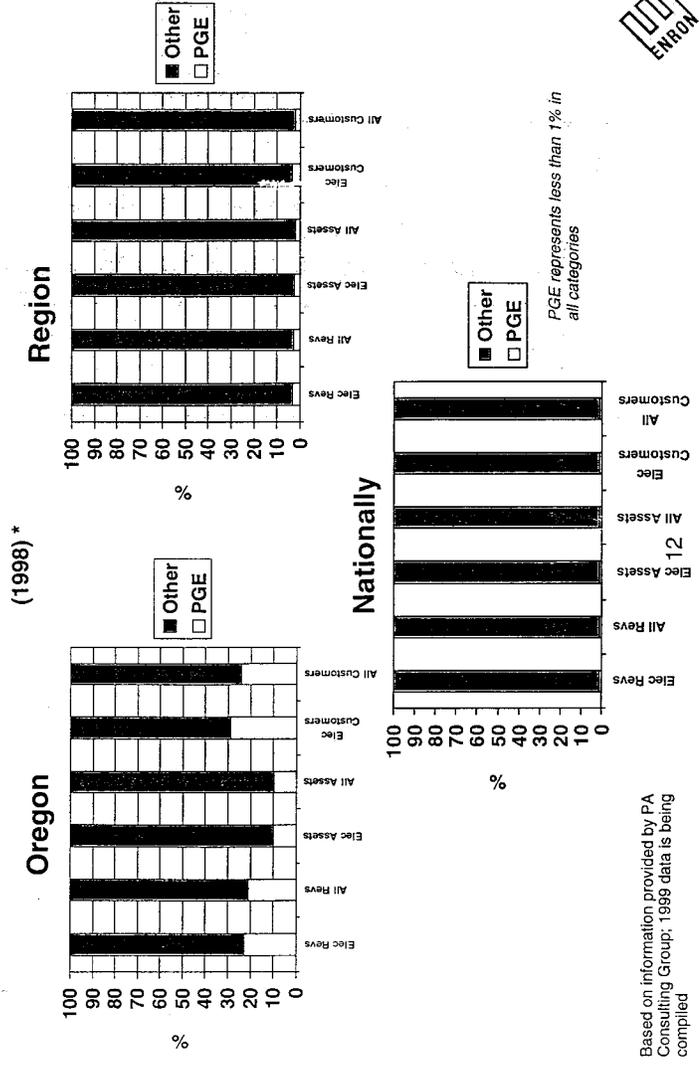
Net Income



Total Assets



# Absolute Comparisons Show PGE as a Small Utility



Based on information provided by PA Consulting Group. 1998 data is being compiled

## Conclusion

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- Enron's current PUHCA status, even with the "Good Faith" exemption, results in:
  - Inherent Delay in Deal Execution
  - Increased Structuring Complexity
  - Increased Costs (both in deal complexity and risk premium)
  - Loss of Benefits to Enron, its Customers and the Public
  - Missed Opportunities

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U.S. Securities and Exchange Commission

Committee on Governmental Affairs  
EXHIBIT #A-19

**UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION**

**Public Utility Holding Company Act of 1935  
Release No. 27574 / October 7, 2002**

**ADMINISTRATIVE PROCEEDING  
File No. 3-10909**

In the Matter of	:	
	:	
Applications of Enron Corp. for Exemptions Under the Public Utility Holding Company Act of 1935, (Nos. 70-9661 and 70-10056)	:	ORDER SCHEDULING HEARING PURSUANT TO SECTION 19 OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
	:	
	:	

Enron Corp. ("Enron"), an Oregon corporation with headquarters at 1400 Smith Street, Houston, Texas 77002-7361, has filed two applications with the Securities and Exchange Commission ("Commission") seeking orders exempting Enron from all provisions of the Public Utility Holding Company Act of 1935 (the "Act") except section 9(a)(2). Enron represents that it is a public utility holding company by reason of its ownership of all of the outstanding voting securities of Portland General Electric Company ("Portland General"). In one application, Enron requests exemption under section 3(a)(1) of the Act.<sup>1</sup> In the other application, Enron requests exemption under sections 3(a)(3) and 3(a)(5) of the Act.<sup>2</sup>

We have reviewed the applications. For the reasons described below, we conclude that it is appropriate to hold a hearing on Enron's applications before ruling on them.

An exemption under section 3(a)(1) is available to a public-utility holding company if

such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single state in which such holding company and every such subsidiary company thereof

are organized.<sup>3</sup>

We cannot, from the face of Enron's application for an exemption under section 3(a)(1), determine facts sufficient to conclude that Enron meets the statutory criteria. Among other things, we must determine whether Portland General is predominantly intrastate in character and carries on its business substantially in a single state.<sup>4</sup> That issue is clouded by representations in the application that raise questions concerning (1) Portland General's 20% ownership stake in the Pacific Northwest Intertie,<sup>5</sup> (2) the extent to which Portland General uses its stake in the Pacific Northwest Intertie to facilitate sales of electricity outside of Oregon delivered at the Mid-Columbia trading hub, and (3) the percentage of Portland General's revenue that is generated through its ownership of a station in Colstrip, Montana.

An exemption under section 3(a)(3) is available to a public-utility holding company if

such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public utility company and (A) not deriving, directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all the outstanding securities of such companies are owned, directly or indirectly, by such holding company.<sup>6</sup>

We cannot, from the face of Enron's application for an exemption under section 3(a)(3), determine facts sufficient to conclude that Enron meets the statutory criteria. To find that these criteria are satisfied, we must determine, among other things, that Enron's ownership of Portland General bears a necessary functional relationship to, and primarily serves the needs of, Enron's nonutility operations.<sup>7</sup> We must also make determinations concerning, among other things, Enron's income derived through Portland General in comparison with Enron's other income.<sup>8</sup> Because Enron is currently being reorganized under the supervision of the United States Bankruptcy Court for the Southern District of New York, and because of related disruptions to its business and financial affairs,<sup>9</sup> the record must be more fully developed before we can determine whether Enron satisfies the 3(a)(3) criteria.

An exemption under section 3(a)(5) is available to a public-utility holding company if

such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company.<sup>10</sup>

We cannot, from the face of Enron's application for an exemption under section 3(a)(5), determine facts sufficient to conclude that Enron meets the

statutory criteria. An application for exemption under section 3(a)(5) requires us to make some of the same determinations as are required for an exemption under section 3(a)(3), including determinations about relationships between Enron's income derived from Portland General and Enron's other income.<sup>11</sup> For the reasons described above, a more fully developed record is required to make that determination. In addition, determining whether to grant an exemption pursuant to section 3(a)(5) requires us to determine whether Enron is the type of holding company to which section 3(a)(5) was intended to apply.

Finally, if a more fully developed record shows that Enron satisfies the more specific statutory criteria for any one of the three exemptions discussed above, we must nevertheless decline to grant the exemption if we find that the exemption would be "detrimental to the public interest or the interest of investors or consumers."<sup>12</sup> In this particular matter, in light of the acknowledged disruptions to Enron's business and financial affairs,<sup>13</sup> we believe that the question of whether an exemption would be detrimental to the public interest or the interest of investors and consumers is itself a question that should be the subject of a hearing before any exemption is granted.

We also recognize, however, that the question of whether an exemption would be detrimental to the public interest or the interest of investors and consumers is a question that we need reach only if it first appears that Enron satisfies any of the specific statutory criteria for an exemption. We therefore conclude that the most efficient way to proceed with a hearing on Enron's applications is in two phases. Phase I will be for the limited purpose of determining whether Enron satisfies any of the particular statutory criteria for an exemption under section 3(a)(1), section 3(a)(3), or section 3(a)(5) of the Act, and evidence and arguments presented shall be limited to those specific questions. Phase II, if the hearing officer determines it to be necessary, will be for the purpose of determining whether granting an exemption to Enron would be detrimental to the public interest or the interest of investors or consumers.

For the foregoing reasons,

IT IS ORDERED that a hearing shall be commenced, pursuant to section 19 of the Act and in accordance with the Commission's Rules of Practice,<sup>14</sup> at a time and place to be fixed by further order, for the purpose of determining whether Enron satisfies the statutory criteria for an exemption under section 3(a)(1), section 3(a)(3), or section 3(a)(5) of the Act and, if so, whether granting such an exemption would be detrimental to the public interest or the interest of investors or consumers;

IT IS FURTHER ORDERED that Commissioner Roel C. Campos shall preside as hearing officer at the hearing, shall exercise the authority described in Commission Rule of Practice 111,<sup>15</sup> and shall, pursuant to Commission Rule of Practice 360,<sup>16</sup> prepare an initial decision;

IT IS FURTHER ORDERED that Enron and the Division of Investment Management shall be parties to the proceeding and that Enron, as the proponent of the exemptive orders it seeks, shall, pursuant to 5 U.S.C. § 556(d), bear the burden of proving that it is entitled to such exemptive

orders;

IT IS FURTHER ORDERED that any person who seeks to intervene as a party pursuant to Rule of Practice 210(b)<sup>17</sup> shall file a motion to intervene with the Secretary of the Commission no later than October 21, 2002, and any person who seeks to participate on a limited basis pursuant to Rule of Practice 210(c)<sup>18</sup> shall file a motion for leave to participate with the Secretary of the Commission no later than 20 days prior to the date fixed for the Phase I hearing. A movant shall serve a copy of any such motion upon Enron at the address noted above in accordance with Rule 150(c) of the Commission's Rules of Practice, and proof of such service shall be filed with the Secretary of the Commission contemporaneously with the motion. Any such motion shall state whether the movant seeks to intervene or participate for purposes of Phase I only, Phase II only, or both Phases, and shall describe the nature and extent of the movant's interest with respect to each such Phase. Such motions as have already been received concerning Enron's applications shall be considered as timely filed in this matter,<sup>19</sup> although movants may supplement those motions in light of this Order if such supplements are received no later than October 21, 2002;

IT IS FURTHER ORDERED that, without prejudice to the ability of the hearing officer to decide that additional factual or legal issues should be considered as part of the hearing in this matter, particular attention should be given at the hearing to the questions described above; and

IT IS FURTHER ORDERED that the Secretary of the Commission shall give notice of the hearing by sending copies of this Order by certified mail to Enron at the address noted above; that the Secretary of the Commission shall mail a copy of this Order to each of the persons that have sought to intervene concerning Enron's applications; and that notice to all other persons shall be given by publication of this Order in the Federal Register.

By the Commission.

Jonathan G. Katz  
Secretary

#### Footnotes

<sup>1</sup> SEC File No. 70-10056 (filed Feb. 28, 2002; Amendment No. 1 filed May 31, 2002). Enron had previously been exempt under section 3(a)(1) by virtue of making certain representations on Form U-3A-2, pursuant to Rule 2 under the Act (17 C.F.R. § 250.2). Enron states that it "is presently unable to collect and produce the information required by Form U-3A-2," and it therefore seeks an order of exemption rather than exemption by operation of Rule 2.

<sup>2</sup> SEC File No. 70-9661 (filed Apr. 12, 2000). At the time that Enron filed this application for exemption under sections 3(a)(3) and 3(a)(5), Enron was already exempt under section 3(a)(1) by operation of Rule 2. Enron nevertheless requested exemption under sections 3(a)(3) and 3(a)(5) because an exemption under those provisions (unlike an exemption under section 3(a)(1)) would have the effect of affording Enron relief from the "qualifying facility" (or "QF") ownership restrictions under the Public Utility

Regulatory Policies Act of 1978 and the rules of the Federal Energy Regulatory Commission thereunder.

<sup>3</sup> 15 U.S.C. § 79c(a)(1).

<sup>4</sup> See *NIPSCO Industries, Inc., Holding Co.* Act Release No. 26975 (Feb. 10, 1999).

<sup>5</sup> According to Enron's application, the Pacific Northwest Intertie is a 4,800 MW transmission facility between the towns of John Day in Northern Oregon, and Malin, in Southern Oregon which is near the California border. Enron represents that this line is primarily used for interstate sales and purchases of electric energy among the Bonneville Power Administration (a federal agency that markets electric energy generated by federal hydroelectric dams located on the Columbia River in Oregon and Washington), utilities in the Pacific Northwest, and certain California utilities.

<sup>6</sup> 15 U.S.C. § 79c(a)(3).

<sup>7</sup> See generally *Electric Bond and Share Company*, 33 S.E.C. 21, 41-43 (1952); *Standard Oil Company*, 10 S.E.C. 1122, 1125-28 (1942); *Manufacturer's Trust Company*, 9 S.E.C. 283, 288 note 5 (1941); *Cities Service Co.*, 8 S.E.C. 318, 329-32 (1940). In its application, Enron asserts that it is "only incidentally" a holding company in that its affiliation with Portland General has given Enron "insight and access to new business opportunities in the broader energy industry," and that Portland General has provided Enron with "valuable expertise in evaluating regional electric distribution assets that complement Enron's strategy."

<sup>8</sup> See, e.g., *Cities Service Co.*, 8 S.E.C. 318 (1940). We must also consider whether Portland General is small other than in relation to Enron, which requires us to consider Portland General's size in relation to the state, regional and national electricity markets in which it operates. *Id.*

<sup>9</sup> In its application for exemption under section 3(a)(1), Enron has acknowledged this disruption, stating that "[a]s a consequence of the bankruptcy, the loss of a substantial portion of its staff, and the dismissal of its auditor Arthur Andersen LLP, Enron is presently unable to collect and produce the information required by Form U-3A-2, including the consolidating financial statements of Enron and its subsidiaries for the year ended December 31, 2001."

<sup>10</sup> 15 U.S.C. § 79c(a)(5).

<sup>11</sup> See, e.g., *AES Corporation, Holding Co.* Act Release No. 27053 (Aug. 20, 1999); *Cities Service Co.*, 8 S.E.C. 318 (1940).

<sup>12</sup> 15 U.S.C. § 79c(a).

<sup>13</sup> See note 9, *supra*.

<sup>14</sup> 17 C.F.R. Part 201.

<sup>15</sup> 17 C.F.R. § 201.111.

<sup>16</sup> 17 C.F.R. § 201.360.

<sup>17</sup> 17 C.F.R. § 201.210(b).

<sup>18</sup> 17 C.F.R. § 201.210(c).

<sup>19</sup> Motions to intervene have been received from Southern California Edison Company (received March 27, 2002), Sithe/Independence Power Partners, L.P. (received April 16, 2002), and the Electric Power Supply Association (received April 16, 2002).

<http://www.sec.gov/rules/other/35-27574.htm>

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

Enron Corp., Application for Exemption	)	
From the Provisions of the Public Utility	)	File No. 070-09961
Holding Company Act of 1935	)	
Pursuant to Sections 3(a)(3) and 3(a)(5)	)	

**MOTION TO INTERVENE OF  
THE ELECTRIC POWER SUPPLY ASSOCIATION AND  
RESPONSE TO OPPOSITION MOTION FILED BY  
SOUTHERN CALIFORNIA EDISON COMPANY**

Pursuant to Securities and Exchange Commission ("SEC") Rules 154(b) and 210(b), 17 C.F.R. §§ 201.154(b) and 201.210(b), the Electric Power Supply Association ("EPSA") hereby requests that it be given leave to intervene in the above-captioned proceeding, and responds in opposition to the Motion to Intervene and Opposition filed by Southern California Edison Company ("Edison") on March 27, 2002.

**I. BACKGROUND AND STATEMENT OF INTEREST**

On April 17, 2000, Enron Corp. ("Enron") filed an application seeking an SEC order finding that Enron is exempt from the provisions of the Public Utility Holding Company Act of 1935, as amended ("PUHCA")<sup>1</sup> (other than Section 9(a)(2)), pursuant to PUHCA Sections 3(a)(3) and/or (3)(a)(5) ("Enron Application" or "Application").<sup>2</sup> As Enron explained, it is currently an electric utility holding company exempt from PUHCA requirements pursuant to Section 3(a)(1). It filed the Application seeking a further determination as to its exempt status under Sections 3(a)(3) and 3(a)(5) in order to obtain relief from certain Qualifying Facility ("QF") ownership restrictions under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Under current PURPA requirements, electric utility holding companies and electric

<sup>1</sup> 15 U.S.C. §§ 79c-79z.

<sup>2</sup> 15 U.S.C. §§ 79c(a)(3), 79c(a)(5).

utilities, as defined under PUHCA, are limited to owning no more than a 50% equity share in a QF.<sup>3</sup> This restriction does not apply, however, to a holding company that has been deemed exempt by rule or order of the SEC under PUHCA Sections 3(a)(3) or 3(a)(5).<sup>4</sup>

In support of its Application for an exemption under 3(a)(3) and 3(a)(5), Enron presented data to support a showing that it was only incidentally a holding company, and that it would not derive a material part of its income from its one public utility subsidiary, Portland General Electric Company ("Portland General"). Enron presented evidence comparing Enron's gross revenues, operating income, and net assets with that of Portland General, demonstrating that Portland General contributed less than 4% to Enron's gross revenues for each of the two years prior to filing the Application.<sup>5</sup>

On March 27, 2002, Edison filed a Motion to Intervene and Opposition to the Enron Application ("Edison Motion" or "Motion"). In its Motion, Edison asks the SEC to deny Enron's Application based on the change in circumstances since the time of Enron's filing (*i.e.*, Enron's recent bankruptcy proceedings and the divestiture of its wholesale trading operations). Edison also includes in its filing the unusual request that the SEC deny the application summarily, and that it *retroactively revoke* the standard temporary exemption granted to parties who seek an SEC ruling on an exemption.<sup>6</sup> Edison argues that Enron's Application was not filed in good faith, and that subsequent modifications to Enron's reported earnings for the years 1997

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<sup>3</sup> 16 U.S.C. §§ 796(17)(C), (18)(B); 18 C.F.R. § 292.206(b).

<sup>4</sup> 18 C.F.R. §§ 292.206(c)(1) and (c)(2).

<sup>5</sup> *Cf. AES Corp., Holding Co.* Act Release Nos. 35-27063, 70-9465, 1999 SEC LEXIS 1676 (Aug. 20, 1999) ("*AES I*") (a contribution of 10.35% to the holding company's adjusted revenues by a public utility subsidiary was not material for purposes of a 3(a)(5) exemption). In *AES I*, the SEC also explained that while it may look to a number of inputs to determine what is material under PUHCA Sections 3(a)(1), 3(a)(3), and 3(a)(5), in practice it has relied primarily on gross revenue or adjusted gross revenue for its analysis of the public utility's comparative contribution).

<sup>6</sup> *See* 15 U.S.C. §79c(c).

to 2000 reveal this lack of good faith for the Enron Application when it was originally filed. Edison further argues that Enron should not be permitted to rely on the temporary exemption provided to good faith applicants under PUHCA Section 3(c).

Edison states that its purpose in filing the Motion is to resolve questions concerning the status of QF projects owned by Enron that currently sell power to Edison pursuant to PURPA. In particular, Edison apparently is seeking to use an adverse ruling by the SEC, coupled with an adverse determination by the FERC as to the continued QF status of these Enron projects, to “establish a breach of the warranties in the Enron Agreements [with Edison] requiring that the Enron Projects maintain QF status throughout the terms of the agreements, thereby establishing a potential payment refund obligation on the part of the projects.”<sup>7</sup> However, the relief Edison is requesting would have much broader impacts on (and do much greater damage to) the energy industry than Edison reveals. As discussed below, Edison’s requested action not only is adverse to Enron, it could also directly affect any QF project in which Enron is a partial owner, and indirectly affect the co-owner’s affiliates. Moreover, as explained below, an adverse ruling without time to respond to the change in Enron’s status could have a cascading adverse effect on companies who are wholly unaffiliated with Enron and have no interest in any Enron-owned projects.

EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, who account for more than a third of the nation’s installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers.

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<sup>7</sup> Edison Motion at 9-10.

Many of EPSA's members are direct or indirect owners of QF projects and other electric generating facilities that are currently exempt from many of the restrictions and regulatory obligations of PUHCA and the Federal Power Act ("FPA"). Because some of these members own QF projects jointly with Enron and/or own QF projects jointly with partners that, in turn, jointly own QF projects with Enron, they may be faced with the loss of their QF status as a result of an adverse ruling by the SEC in this case. Moreover, because the Edison Motion seeks summary action (or even worse, retroactive revocation of a temporary exemption), affected projects and co-owners will have no opportunity to address any concerns the SEC might have concerning Enron's 3(a)(3) or 3(a)(5) exempt status. Indeed, Edison's call for summary action may have a cascading effect that could impact numerous other projects and companies.

Accordingly, EPSA has an interest in participating in this proceeding on behalf of independent generators whose exempt, unregulated status could be threatened by Edison's call for precipitous action by the SEC. To be clear, this intervention does not specifically address the PURPA issues with which Edison is primarily concerned or the merits of Enron's Application with the SEC. Rather, EPSA seeks to leave to intervene in order to protect the interests of EPSA's members. EPSA requests that the SEC reject Edison's call for summary or retroactive relief of any kind, and that the SEC provide an adequate amount of time for: (1) all affected parties to effect changes in their ownership structures or regulatory status to maintain their compliance with PUHCA, PURPA and the FPA and to comply with any other applicable requirements under state and federal law that would result from the SEC's denial of the Enron Application; and/or (2) Enron to address concerns as to its 3(a)(3) or 3(a)(5) exempt status, *e.g.*, through consummation of the contemplated sale of Portland General. As explained below, this

request for adequate time is consistent with PUHCA's due process and notice requirements, the SEC's regulations implementing PUHCA, and the SEC's historic practice and precedent.<sup>3</sup>

**II. RESPONSE TO EDISON'S OPPOSITION AND REQUEST FOR IMMEDIATE AND RETROACTIVE RELIEF**

**A. Edison's Request for Summary Denial of Enron's Application and for Retroactive Revocation of Enron's Temporary Exemption Will Have Broad Adverse Impacts on the Energy Industry and Is Contrary to the Public Interest.**

Edison explains in its Motion that Enron-owned QF projects that sell power to Edison in reliance upon Enron's temporary 3(a)(3) and 3(a)(5) exemption may find themselves in breach of their power sales agreements if the SEC makes a summary determination that the exemption does not apply. EPSA understands that Edison may have intended to focus exclusively on the QF status of certain Enron QF projects that sell power to Edison. However, Edison ignores the many other adverse implications that would result if Edison's requested relief for retroactive and/or immediate relief were granted. Granting Edison's requested relief would have widespread regulatory complications not only for all of Enron's QF project companies, but also for companies that are wholly unaffiliated with Enron. As explained below, these are precisely the kinds of adverse impacts that the SEC should avoid.

The loss of Enron's 3(a)(3) or 3(a)(5) exemption could put at risk the QF status of projects in which Enron has a direct or indirect investment and which are not owned more than 50% by other non-utility upstream owners. For these projects, transforming Enron's upstream interest in the project to an "electric utility" (or "electric utility holding company") interest could increase the total equity share of the aggregated electric utility or electric utility holding

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<sup>3</sup> See 15 U.S.C. §79c(c); 17 C.F.R. §250.6; *see, e.g., AES Corp., Holding Co. Act Release Nos. 35-27363, 70-9779, 2001 SEC LEXIS 540 (March 23, 2001) ("AES II")*.

company interest to more than 50%.<sup>9</sup> At that point, the project may no longer meet the QF ownership requirements.<sup>10</sup> Losing QF status may not only impact the pricing for a QF project's power purchase agreements with utilities; the implications for any such loss in QF status could have much broader negative implications, including the possible loss of the QF's exemption from PUHCA and various FPA rate requirements. Notably, if Edison's request for retroactive or immediate relief is granted, these entities may have no opportunity to preserve their QF status by altering their ownership structure. Moreover, these projects may not have sufficient time (or the ability) to alter their regulatory status at the SEC and FERC by obtaining certification as an Exempt Wholesale Generator ("EWG") and FERC's acceptance of their requested market-based rate authority and existing power purchase agreements.<sup>11</sup>

In addition, the loss of QF status for some of these projects may ultimately lead to subsequent questions regarding the continued exempt status of numerous intermediate and ultimate holding companies. The breadth of the problem may be best understood through real-world examples of the potential impact on non-Enron affiliates if Edison's request were

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<sup>9</sup> Under FERC's implementing regulations, a QF is deemed to be owned by a person primarily engaged in the generation or sale of electric power (and therefore ineligible for QF certification) if more than 50% of the equity interest is held by an electric utility or utilities, by an electric utility holding company or companies, by a subsidiary of an electric utility or electric utility holding company, or any combination thereof. 18 C.F.R. §292.206(b).

<sup>10</sup> These QFs may have to seek declaratory orders from FERC that a temporary shift in ownership would not violate FERC's QF ownership requirements.

<sup>11</sup> In addition, summary action based on changed circumstances and/or retroactive revocation of an exemption could increase the regulatory risk for any QF that is owned or partially owned by a company that relies on a 3(a)(3) or 3(a)(5) exemption to maintain its QF status, as any participant in such a project will have to account for the possibility that the SEC could summarily revoke their exemptions in the future.

granted.<sup>12</sup> EPSA is aware of at least three QF projects which are only partially owned by Enron, and rely on Enron's 3(a)(3) or 3(a)(5) exemption to maintain their QF status:

- (1) Sithe/Independence Power Partners, L.P., a qualifying cogeneration facility in New York, which is owned 60% by Sithe Energies, Inc. (in turn partially owned by Exelon Fossil Holdings, Inc.) and 40% by its limited partner, Oswego Cogen (wholly owned by Enron)<sup>13</sup>;
- (2) Victory Garden Phase IV Partnership, a QF co-owned by subsidiaries of the FPL Group and Enron (each with a 50% share);<sup>14</sup> and
- (2) Sky River Partnership, a second QF co-owned by subsidiaries of the FPL Group and Enron (each with a 50% share).<sup>15</sup>

The immediate loss of QF status upon summary rejection of Enron's application has PUHCA implications for each QF project and each QF project's direct and indirect upstream owners.

Additionally, there are possible compliance issues with FERC filing and rate requirements and for some projects, potential breaches of existing power supply agreements.<sup>16</sup>

In addition, there may be cascading PUHCA implications as a result of summary SEC action if a project jointly owned with Enron loses its QF status:

<sup>12</sup> These projects are provided as examples only, and do not represent the full reach of Enron's interests or partial interests in QF projects. Accordingly, these examples likely represent the tip of the iceberg with respect to the unintended consequences of granting Edison's requested relief.

<sup>13</sup> See Sithe/Independence Funding Corp. and Sithe/Independence Power Partners, L.P., 2001 Form 10-K at 3.

<sup>14</sup> See *Notice of Self-Recertification* filed August 3, 2000 in Docket No. QF90-43-003 (relying on Enron's 3(a)(3) and 3(a)(5) exempt status to meet PURPA ownership requirements).

<sup>15</sup> See *Notice of Self-Recertification* filed August 3, 2000 in Docket No. QF91-59-004 (relying on Enron's 3(a)(3) and 3(a)(5) exempt status to meet PURPA ownership requirements).

<sup>16</sup> EPSA has been informed that Sithe/Independence no longer has an obligation to maintain its QF status under its wholesale power sales agreements. EPSA has not reviewed the specific agreements for the other projects noted, and therefore is unaware of the pricing impacts for those other projects of losing QF status.

1. If Enron's temporary exempt status under 3(a)(3) and 3(a)(5) is summarily revoked, the project's QF status may be in jeopardy until and unless the project can be restructured or one or both owners divest sufficient shares in the project to meet the PURPA requirements.
2. With the loss of its QF status, the project may be considered both an "electric utility" and a "public utility" under PUHCA.
3. If the project company is considered a "public utility", then each direct and indirect upstream owner of 10% or more of the voting equity interests in the project may be considered a public utility holding company for PUHCA purposes. Under PUHCA, public utility holding companies, even intermediate holding companies must register with the SEC under Section 5 of PUHCA or otherwise seek an exemption from PUHCA's registration and other regulatory requirements. Edison's requested relief could therefore subject these companies to retroactive violations of PUHCA's registration and disclosure requirements.
4. Moreover, ultimate parent holding companies that currently rely on 3(a)(1) or 3(a)(2) exemptions may have to address questions about whether the ownership of these projects would threaten their exempt status, depending, in part, upon the materiality of the project's revenues as a contribution to the holding company system revenues.<sup>17</sup>
5. Finally, any other company that co-owns a QF project with another company that has, in turn, become a utility holding company as a result of jointly owning a project with Enron (and has since lost its QF status), may also become a utility holding company, thus continuing the chain reaction to other QF projects and their upstream owners.

The potential damage that the change in PUHCA status could cause to these companies is significant. For example, Section 26 of PUHCA provides that every contract entered into in violation of PUHCA "shall be void."<sup>18</sup> Moreover, these significant harms would be visited upon entities whose good faith reliance on Enron's temporary exemption is not even in question. EPSC assumes that Edison may not have intended to have its requested relief place these non-Enron affiliated companies at risk. However, it is precisely these kinds of risks that causes

<sup>17</sup> See 15 U.S.C. §79c(a)(1) - a(2).

<sup>18</sup> 15 U.S.C. §79z.

EPSA concern, and the SEC should take these illustrative far-reaching adverse consequences into account before acting upon Edison's request for relief.

Ultimately, the summary action requested by Edison will adversely affect numerous innocent entities, and will prove more detrimental to the public interest than leaving Enron's exemption intact until affected parties have an adequate opportunity to respond to Enron's potential change in status. The SEC can easily avoid any such harm, and can do so consistent with PUHCA's requirements, by extending Enron's temporary extension for a reasonable period or by granting the exemption conditioned on the divestiture of Portland General. Additionally, the SEC can grant the QF projects that relied upon Enron's exemption sufficient time to restructure their contracts and regulatory status.

**B. The SEC is Required Under PUHCA to Provide a Minimum Level of Notice and Opportunity to Respond to a Proposed Denial of Enron's Application, and Providing Sufficient Time to Cure Deficiencies or to Otherwise Limit the Harmful Effects of the Loss of its Temporary Exemption is Otherwise Consistent with the SEC's Historic Practice and Regulations.**

Even if the SEC believes it may be appropriate to deny Enron's Application based on Enron's and Portland General's *current* revenue levels, the SEC cannot and should not grant the immediate or retroactive denial of Enron's exemption that Edison seeks. Under PUHCA Section 3(c), the SEC may only deny or otherwise dispose of an application seeking an exemption after providing notice and an opportunity for hearing.<sup>19</sup> Edison tries to avoid this clear directive by claiming that Enron's lack of good faith in filing the Application (discussed further in Section II.C., *infra*) voids the SEC's notice obligation. However, Edison does not cite to a single case in which the SEC has denied an application without providing this minimum form of due process, and after undertaking research on this point, EPSA has been unable to find any cases finding that

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<sup>19</sup> EPSA has reviewed the SEC's public notices, and is not aware of any public notice that the SEC has issued relating to the Enron Application.

the SEC has done so or has the authority to do so (whether based on a lack of good faith or otherwise).

Moreover, the SEC has routinely allowed applicants time to cure deficiencies prior to imposing PUHCA's extensive registration and reporting obligations, particularly where such cures are already in progress and where there has been no showing that allowing such time for cure is detrimental to the public interest. For example, in *AES II*,<sup>20</sup> the SEC granted a Section 3(a)(5) exemption to an electric utility holding company despite its ownership of public utility interests that far exceeded the materiality standard when the application was made (as well as when the exemption was granted). The SEC accepted AES's proposal to grant the exemption conditioned on the divestiture, within two years, of one of its public utility subsidiaries. Only after the divestiture would AES meet the SEC's threshold requirements for showing a lack of materiality under PUHCA Section 3(a)(5).

As the SEC explained in that case, it can "relax[] the strict requirements of the Act and grant[] temporary relief, where 'the overall consequence . . . is to make nearer the ultimate goal of compliance.'"<sup>21</sup> Moreover, in looking at the "overall consequences" in *AES II*, the SEC took into account *the same regulatory consequences* that are at issue here, *i.e.*, the loss of QF status of projects owned or co-owned by the applicant:

It does not appear that the grant of the exemption would be detrimental to the public interest or the interest of investors or consumers. Absent such relief, AES would be exposed to a significant regulatory disadvantage under PURPA.<sup>22</sup>

<sup>20</sup> Holding Co. Act Release Nos. 35-27363, 70-9779, 2001 SEC LEXIS 540 (2001) (*AES II*).

<sup>21</sup> *Id.* at \*34 (citing *Kansas Power and Light Co.*, Holding Co. Act Release No. 25465 (Feb. 5, 1992), quoting *Electric Bond and Share Co.*, 33 S.E.C. 21, 32 (1952), citing *Kansas City Power and Light Co.*, 32 S.E.C. 749 (1951) ("granting temporary exemption under Section 3(a)(2) to permit holding company to eliminate minority interest in newly acquired public-utility subsidiary").

<sup>22</sup> *Id.*

The SEC has been similarly circumspect in revoking existing PUHCA exemptions despite affirmative findings that a change in circumstance raised a substantial question as to the continued propriety of the exemption. In *Colonial Gas Energy System*,<sup>23</sup> the SEC began revocation proceedings after it found that the company's financial statements (filed with the SEC under other federal securities laws) "disclosed complexities in the financial structure of Colonial [a public utility holding company] . . . which impaired Colonial's ability to raise needed capital and adversely affected its operating subsidiaries."<sup>24</sup> Despite this explicit finding, the SEC allowed Colonial's temporary exemption to remain in effect until the company was restructured to eliminate the holding company. See also *Public Service Co. of Colorado*, SEC No-Action Letter, 1981 SEC LEXIS 324 (July 30, 1981) (in which the SEC agreed to defer any enforcement action against an electric utility holding company despite a possible temporary violation of PUHCA, until after the consummation of separate merger transaction and formation of a new registered holding company); *United Utilities*, 1945 SEC LEXIS 732, 20 SEC 496 (1945) (granting a PUHCA exemption subject to the condition that the holding company sell its out-of-state assets). Indeed, we have been unable to find any case in which an existing exemption was revoked without notice and an opportunity to cure or otherwise mitigate the consequences of a change in status.

PUHCA's implementing regulations also demonstrate an aversion to precipitous action in revoking an existing exemption, laying out certain procedural steps that must be followed and substantive standards that must be met before an exemption can be revoked. Under Rule 6 of the SEC's implementing regulations, if the SEC has reason to question the continued propriety of an

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<sup>23</sup> Holding Co. Act Release No. 22144, 1981 SEC LEXIS 996 (1981).

<sup>24</sup> *Id.* at \*4.

existing exemption, it will issue a letter notifying the company that a substantial issue exists as to its claimed exemption and that the exemption will terminate in 30 days.<sup>25</sup> Moreover, the SEC cannot revoke an existing exemption unless there is a change in circumstances which renders the exemption detrimental to the public interest. While Rule 6 appears to primarily apply to instances in which an exemption was granted on a permanent basis, its requirements for notice to companies reinforce the SEC's historic practice of providing due process to companies with respect to exemptions. Given the unique circumstances at hand (namely, the lack of SEC action on an exemption filing for almost two years), the SEC should provide to impacted companies and their QF projects adequate notice prior to any possible revocation of Enron's temporary exemption. At the very least, the SEC should not prejudice companies as a result of its own delay in acting upon Enron's request for an exemption.<sup>26</sup> Enron and other affected parties should not be put in a worse position than they would otherwise have been had the SEC acted upon Enron's application promptly. Instead, companies implicated by Enron's temporary exemption should be allowed the full procedural protection afforded by Section 3(c) of PUHCA and Rule 6.

**C. Edison Has Not Shown that the Exemption Should be Denied, That the Application Was Filed in Bad Faith, or Provided Any Other Reason for a Summary Decision Revoking Enron's Temporary Exemption.**

Edison argues that the change in Enron's position since its Application was filed renders Portland General's contribution to Enron's earnings "material" under the SEC's historical analysis under PUHCA Sections 3(a)(3) and 3(a)(5). However, Edison omits a number of salient points regarding the SEC's approach to granting or denying such exemptions. Most notably, Edison fails to appreciate that the SEC regularly considers the overall consequences surrounding

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<sup>25</sup> 17 C.F.R. §250.6.

<sup>26</sup> Even if the SEC has found reason to deny Enron's Application shortly after its filing, companies would have been able to make informed business decisions based upon the SEC's decision, rather than on Enron's pending temporary exemption.

the denial or revocation of an exemption, and typically provides applicants or other affected parties time to address underlying deficiencies in an application or to take other steps to limit the harm resulting from a change in status. *AES II*, decided just last year, provides one of the best examples of that approach, with the SEC authorizing an otherwise-objectionable acquisition of one public utility company (Indiana Power & Light) by an exempt holding company, conditioned on its planned divestiture of another public utility (Central Illinois Light Co.). Indeed, the argument for granting a conditioned exemption is even more compelling in Enron's case than it was in *AES II*, since Enron plans to divest virtually all of its public utility holdings with the divestiture of Portland General.

Edison tries to distinguish Enron's situation by arguing that Enron should not have the benefit of the Section 3(c) "good faith" exemption, and that summary or retroactive action is therefore required. Edison suggests a number of ways that Enron failed to meet the good faith standard, claiming that: (1) Enron failed to accurately report net income for the years 1997 – 2000, leaving it without a credible basis for its Application when filed in April 2000;<sup>27</sup> (2) Enron failed to apprise the SEC of the impact of these adjustments to reported earnings, or of its bankruptcy proceedings, on the materiality of Portland General's contribution to Enron's earnings;<sup>28</sup> and (3) Enron failed to apprise the SEC when the planned sale of Portland General to Sierra Pacific Resources, as noted in the April 2000 Application, was abandoned.<sup>29</sup> None of these allegations support a decision to deny Enron the benefits of the "good faith" exemption.

As to Edison's first suggestion, any errors or other deficiencies in Enron's reported income for the years 1997-2000 has no bearing on the credibility of the Application that Enron

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<sup>27</sup> Edison Motion at 15.

<sup>28</sup> *Id.* at 1-3, 15.

<sup>29</sup> *Id.* at 15-16.

filed in April 2000. As Edison knows, the SEC looks primarily at gross revenue figures or net operating revenues in examining the materiality of a public utility's contribution to a holding company enterprise, *not* net income.<sup>30</sup> Moreover, as long as Enron had a reasonable basis for contending that it met the materiality standard as of April 2000, it is entitled to a good faith exemption.<sup>31</sup> As to the second allegation, Enron did apprise the SEC of its expected changes to reported earnings as soon as it determined that such changes were appropriate. EPSA is unaware of any explicit obligation to continuously update an application for a PUHCA exemption order while the SEC considers its ruling (beyond making whatever other disclosures to the SEC are required under the federal securities laws). Finally, as to Edison's third allegation, Enron did not rely on the sale of Portland General when it made its Application in April 2000 (presumably because it believed it comfortably met the SEC's requirements for such an exemption at that time, with or without divestiture of Portland General). Moreover, Enron has continued in its effort to divest Portland General, and currently has a binding agreement and FERC approval for the sale of the company to Northwest Natural Gas Company.<sup>32</sup>

In short, Edison has provided no reasonable basis for finding that Enron violated the good faith standard, or that any such violation warrants the summary action and retroactive revocation of an exemption that Edison demands. As noted above, PUHCA *requires* an opportunity for notice and hearing before an application for an exemption can be denied, and there is no

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<sup>30</sup> See, e.g., *AES I* at \*15 - \*18 (explaining that while the SEC may look at a number of inputs to determine what is a comparatively "material" contribution under PUHCA Sections 3(a)(1), 3(a)(3), and 3(a)(5), it has traditionally relied on a comparison of gross revenues and/or gross revenues adjusted to net out fuel costs for that piece of its "materiality" analysis).

<sup>31</sup> See *Kaneb Pipe Line Co.*, 1968 LEXIS 895, 43 SEC 976 (December 24, 1968) (finding that application was filed in good faith as long as applicant had a reasonable basis for contending that it had neither control or a controlling interest in a gas utility, despite a greater than 10% voting interest and the holding company's own efforts to gain control of the gas company to promote a merger).

<sup>32</sup> See *Northwest Natural Gas Co.*, 98 FERC ¶61,134 (2002).

indication that the requirement can be avoided based on an allegation of a lack of good faith. Moreover, even if the SEC had the discretion to retroactively revoke an exemption under Section 3 (which it may not have), it is clear that any retroactive actions under PUHCA require that the SEC "consider the purpose [such relief] would serve."<sup>33</sup> Here, retroactively revoking Enron's exemption does not serve any beneficial purpose whatsoever, but would instead undermine existing QF contracts, jeopardize the QF status of Enron-owned projects, and threaten the exempt status of those projects' co-owners (and all of their affiliates). The equities in this case strongly dictate against providing retroactive relief or otherwise denying Enron the benefits of the temporary exemption through immediate and summary denial of Enron's application. Finally, to the extent that Enron's circumstances have changed since the Application was filed, those changes have occurred quite recently (since December 2001), and clearly do not relate back to the date that the Application was filed.

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<sup>33</sup> *National Propane Corp., Holding Co.* Act Release No. 20684, 1978 SEC LEXIS 859 (1978) (granting a 3(a)(3) exemption but refusing to predate the grant of that exemption to the date of acquisition of the public utility subsidiary).

**IV. CONCLUSION**

Wherefore, for the foregoing reasons, EPSA requests that the SEC: (1) grant EPSA's motion to intervene, (2) reject Edison's request for immediate and retroactive rejection of Enron's application, and (3) grant companies that have relied upon Enron's exemption sufficient opportunity to restructure their QF projects or the regulatory status of the QF project companies, or otherwise extend Enron's temporary exemption for at least one year (or such amount of time as the SEC considers reasonable).

Respectfully submitted,

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Mark Bennett, Senior Manager of Policy  
Electric Power Supply Association  
1401 New York Ave., N.W., Eleventh Floor  
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Dated: April 15, 2002



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James B. Woodruff  
Senior Attorney  
James.Woodruff@sce.com

April 2, 2002

Committee on Governmental Affairs  
**EXHIBIT #A-20b**

VIA OVERNIGHT UPS

Honorable Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

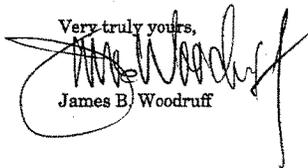
OFFICE OF THE SECRETARY  
FEDERAL ENERGY  
REGULATORY COMMISSION  
02 APR -3 AM 9:43

Re: Victory Garden Power Partners I, LLC	Docket No. QF89-92
ZWHC LLC	Docket No. QF87-365
Victory Garden Phase IV Partnership	Docket No. QF90-43
Sky River Partnership	Docket No. QF91-59
Cabazon Power Partners LLC	Docket No. QF95-186

Dear Ms. Salas:

Pursuant to Rule 214 of the Commission's regulations, 18 C.F.R. § 214 (2001), enclosed please find an original and fourteen copies of Southern California Edison Company's Motion to Intervene in the referenced dockets.

Please conform the enclosed extra copy and return it in the enclosed, self-addressed stamped envelope. Thank you for your attention to this matter.

Very truly yours,  
  
James B. Woodruff

cc: Service Lists

JBW:js

Enclosures

**DOCKETED**  
*h*

ORIGINAL

FILED  
OFFICE OF THE  
SECRETARY

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

7/27/09 - 3 PM 9:43  
FEDERAL ENERGY  
REGULATORY COMMISSION

Victory Garden Power Partners I, LLC	) Docket No. QF99-92
ZWHC LLC	) Docket No. QF87-365
Victory Garden Phase IV Partnership	) Docket No. QF90-43
Sky River Partnership	) Docket No. QF91-59
<u>Cabazon Power Partners LLC</u>	) Docket No. QF95-186

**MOTION TO INTERVENE OF  
SOUTHERN CALIFORNIA EDISON COMPANY**

Pursuant to Rule 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), 18 C.F.R. § 385.214, Southern California Edison Company ("Edison") hereby submits this Motion to Intervene as a party in the above-referenced proceedings.<sup>1</sup> Edison seeks leave to participate as a party because it is the utility-buyer of electricity from the parties providing notice of self-recertification of their qualifying facility ("QF") status in the captioned dockets. The outcome of these proceedings may affect Edison's obligations under long-term power purchase agreements with each of the projects.

<sup>1</sup> Although considerable time has elapsed since these dockets were opened, Edison's motion to intervene is timely. Notice of self-recertification filings is not given in the Federal Register. 18 C.F.R. § 292.207(a)(iv). As a result, there is no prescribed period for seeking leave to intervene. See, 18 C.F.R. §§ 385.210, 385.214(b)(3). Accordingly, Edison need not establish "good cause" although, as set forth herein, there is ample reason to permit Edison to intervene as a party at this time.

On April 14, 2000, Enron Corp. ("Enron"), filed an application at the Securities and Exchange Commission ("SEC") requesting an exemption under Sections 3(a)(3) and 3(a)(5) of the Public Utility Holding Company Act of 1935 ("PUHCA"). As stated by Enron in its application, Enron is seeking exemption under those sections of PUHCA "as a means of obtaining relief from the 'qualifying facility' or 'QF' ownership restrictions under . . . PURPA." *See*, 18 C.F.R. § 292.206(c)(1) and (2) (relieving holding companies that are exempt under Sections 3(a)(3) or (5) from QF ownership restrictions). The SEC has not yet acted on Enron's application.

Enron has an upstream ownership interest in each of the generating facilities at issue in the referenced dockets. Between August 3, 2000 and January 24, 2001, each of the projects filed a notice of self-recertification with the Commission advising the Commission of the pendency of Enron's application at the SEC for exemption and asserting that "as of April 14, 2000, Enron Corp. is deemed not to be an 'electric utility holding company' for purposes of the ownership limitation under the Commission's regulations."

Since April 14, 2000, Enron has purported to benefit from exemption under PUHCA pursuant to Section 3(c), which provides that a holding company which makes a "good faith" application for exemption is deemed to be exempt during the pendency of its application at the SEC. Further, this Commission has determined that it will defer or suspend consideration of QF ownership requirements during the pendency of an application for exemption

under PUHCA at the SEC. *Doswell Limited Partnership*, 56 FERC ¶ 61,170 (1991). This Commission has taken no further action with respect to the notices of self-recertification.

On March 26, 2002, Edison filed a motion to intervene and opposition to Enron's application for exemption under Sections 3(a)(3) and 3(a)(5) at the SEC. A true and correct copy of Edison's motion to intervene and opposition is attached hereto as Exhibit 1. Edison's March 26 motion and opposition at the SEC demonstrate that Enron cannot meet the exemption requirements of Section 3(a)(3) and 3(a)(5). As discussed in Edison's motion, the principal inquiry to be made by the SEC is whether the income of Enron's wholly owned electric public utility, Portland General Electric Company ("PGE"), is material when compared to the income of its holding company, Enron. Because of the dramatic changes in Enron's financial condition in recent months, PGE's income has become an increasingly material part of Enron's overall income, calling into doubt whether Enron is entitled to an exemption under PUHCA.

Furthermore, Edison's motion to intervene and opposition at the SEC demonstrate that Enron should not be entitled to benefit from the interim exemption pursuant to Section 3(c) of PUHCA, which is triggered by the filing of an application in "good faith." Specifically, the massive accounting irregularities disclosed at Enron in recent months and the revelation that Enron must restate its income for the years 1997 through 2000, raise serious

questions concerning whether Enron's initial application was or can now be deemed to have been made in "good faith," as required by Section 3(c) of PUHCA. Based on these developments, Edison has requested not only that Enron's application be summarily denied, but that it be dismissed *nunc pro tunc*.

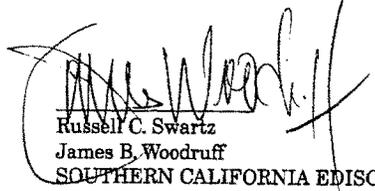
Edison seeks leave to intervene and to participate fully as a party in each of the referenced dockets in order to protect the interests of its ratepaying customers, who ultimately bear the cost of electricity purchased by Edison from legitimate QF projects. Failure by a project to maintain QF status pursuant to this Commission's ownership criteria may relieve Edison of the obligation to purchase power from the project or affect the price paid by Edison for energy and capacity delivered by the project.

Edison is a California corporation with its principal place of business located at 2244 Walnut Grove Avenue, Rosemead, California 91770. It is an investor-owned utility and is engaged primarily in the businesses of generating, selling and purchasing electric energy in Southern California. Edison request that the following person be designated for service on the Commission's service list for these proceedings:

Russell C. Swartz  
James B. Woodruff  
SOUTHERN CALIFORNIA EDISON COMPANY  
P.O. Box 800  
Rosemead, CA 91770  
(626) 302-1924

THEREFORE, Edison respectfully requests that the Commission grant Edison's motion to intervene as a party in these proceedings.

Respectively submitted,

A handwritten signature in black ink, appearing to read "Russell C. Swartz", is written over a horizontal line. The signature is stylized and somewhat cursive.

Russell C. Swartz  
James B. Woodruff  
SOUTHERN CALIFORNIA EDISON  
COMPANY  
2244 Walnut Grove Avenue  
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Attorneys for Southern California  
Edison Company

Dated: April 2, 2002

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

Enron Corp, Application for Exemption )  
From the Provisions of the Public Utility ) File No. 070-09661  
Holding Company Act of 1935 Pursuant )  
Sections 3(a)(3) and 3(a)(5) )

MOTION TO INTERVENE AND OPPOSITION OF  
SOUTHERN CALIFORNIA EDISON COMPANY

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Edison Company

March 26, 2002

**EXHIBIT A**

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UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

Enron Corp, Application for Exemption )  
From the Provisions of the Public Utility ) File No. 070-09661  
Holding Company Act of 1935 Pursuant )  
Sections 3(a)(3) and 3(a)(5) )

**MOTION TO INTERVENE AND OPPOSITION OF  
SOUTHERN CALIFORNIA EDISON COMPANY**

Pursuant to Securities and Exchange Commission ("SEC" or "Commission") Rules 154(a) and 210(b), 17 C.F.R. §§ 201.154(a) and 201.210(b), Southern California Edison Company ("Edison"), hereby files this motion to intervene and opposition to the application of Enron Corp. ("Enron") for exemption from the provisions of the Public Utility Holding Company Act ("PUHCA" or the "Act") pursuant to Sections 3(a)(3) and 3(a)(5) thereof in the above-captioned proceeding.<sup>1</sup>

**I.**

**INTRODUCTION**

Since its initial filing in April 2000, Enron's circumstances have changed dramatically. As demonstrated below, Enron's recent bankruptcy filing as well as Enron's divestiture of significant assets, including its wholesale trading business, have substantially increased the materiality of the income generated by Enron's wholly-owned public-utility subsidiary, Portland General Electric Company ("PGE")

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<sup>1</sup> No date has been fixed for the commencement of the hearing in this proceeding; therefore this motion is timely under 17 C.F.R. § 201.210(c)(1). Edison has not previously sought to intervene in this proceeding. The recent change in Enron's circumstances, as detailed in this motion, however, has caused Edison to file this motion.

when compared to income generated by Enron's remaining business. As a result, Enron cannot meet the requirements for exemption under Sections 3(a)(3) and 3(a)(5) of the Act.

Recent filings by Enron with the Commission also call into question whether Enron should continue to benefit from the exemption afforded by Section 3(c) of the Act during the pendency of its application. For example, on November 8, 2001, Enron made a Form 8-K filing indicating that it would be restating its financial statements for the years 1997 through 2000 and that the previous financial statements and audit reports for those periods "should not be relied upon." According to the same filing, Enron's "current assessment" of the necessary revisions to its previous financial statements will entail several hundreds of millions of dollars of adjustments to Enron's net income, which, in turn, will necessarily affect any analysis of the materiality of PGE's income when compared to Enron's. Taken together, the revelation in recent months of massive accounting irregularities at Enron, the concealment of such irregularities for several years, the resulting retroactive adjustments to income and Enron's failure to update and correct the record in this proceeding to disclose these matters, cast considerable doubt on whether Enron's initial filing can be said to have been made in "good faith."

Insofar as its application for exemption under the Act is concerned, Enron has been content to leave the Commission completely in the dark concerning these changed circumstances. This is undoubtedly because, notwithstanding the obvious materiality of PGE's income when compared to Enron's overall business in light of

these changed circumstances, Enron continues to benefit from the *de facto* exemption accorded by Section 3(c) of the Act. Because this exemption effectively insulates Enron and its subsidiaries from any scrutiny by the Federal Energy Regulatory Commission ("FERC") concerning whether Enron have violated or is now in violation of federal statutes and regulations restricting its ownership interest in numerous generation projects, Enron has little incentive to correct statements made in its April 2000 application, even though such statements, if made today, would be false and misleading.

Under these circumstances, Edison submits that it is appropriate for the Commission to dismiss Enron's application *nunc pro tunc*. Alternatively, the application should be summarily dismissed, and the Commission should open a separate inquiry into whether, in view of all of the circumstances, Enron's initial application was made in "good faith" as required by Section 3(c) of the Act. At the very least, it is appropriate for the Commission to schedule hearings concerning Enron's application. Because of the significant public interest at stake in this application, Edison further requests expedited treatment of this motion and opposition.

## II.

FACTUAL AND PROCEDURAL BACKGROUNDA. Enron's Application For Exemption.

On April 14, 2000, Enron filed an application under the Act seeking an order finding that Enron is exempt from all provisions of PUHCA (other than Section 9(a)(2)) pursuant to Section 3(a)(3) of the Act, or, in the alternative, Section 3(a)(5). As succinctly stated in its application, Enron is "seeking relief under Section 3(a)(3) or 3(a)(5) as a means of obtaining relief from the 'qualifying facility' or 'QF' ownership restrictions" under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). App. at 7, emphasis added. Indeed, this was the only reason for seeking the exemptions under Sections 3(a)(3) and 3(a)(5) because Enron was already exempt under Section 3(a)(1). *Id.*, at 3 and 7. The latter exemption, however, does not shield public utility holding companies from the ownership restrictions of FERC's regulations implementing PURPA.

Enron seeks the exemption requested in its application because, under PURPA, a QF cannot be owned by a person that is primarily engaged in the generation or sale of electric power. 16 U.S.C. § 796(18)(b). FERC's regulations implementing PURPA provide that a generating facility "shall be considered to be owned by a person primarily engaged in the generation or sale of electric power if more than 50% of the equity interest is held by an electric utility, or utilities, or by an electric utility holding company or companies, or any combination thereof." 18 C.F.R. § 292.206(b). A holding company that is exempt "by rule or order" under Section 3(a)(3) or 3(a)(5) of the Act, however, is also exempt from the 50% ownership

limitation of PURPA and FERC's implementing regulations. 18 C.F.R § 292.206(c)(1) and (c)(2). Although the Commission has not yet issued a "rule or order" exempting Enron under either Section 3(a)(3) or 3(a)(5) of the Act, Enron has nevertheless purported to enjoy the benefit of an exemption from the FERC ownership rules since April, 2000 because FERC interprets Section 3(c) of the Act as effectively exempting public utility holding companies from the QF ownership requirements during the *pendency* of an application made in "good faith" to this Commission.<sup>2</sup>

In its application, Enron asserts principally that it is entitled to an exemption under both subsections of Section 3(a) because PGE's gross revenue, as a percentage of the total gross revenue of Enron's business, is *de minimis* - less than 4% in 1999. According to Enron, this percentage fits "comfortably" within the range found acceptable by the Commission in a recent decision considering the "materiality" consideration common to both subsections (3) and (5) of Section 3(a) of the Act. *AES Corporation, Holding Co.* Act Release No. 35-27063 (Aug. 20 1999) ("*AES I*").<sup>3</sup> As shown below, Enron is now well outside this "comfort zone."

<sup>2</sup> Section 3(c) provides in pertinent part that:

The filing of an application *in good faith* under [Section 3(a)] by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon the application.

Emphasis supplied. FERC has determined that a "pending 3(a)(5) exemption application is equivalent to an SEC 'rule or order' exempting [such applicants] from the status of a holding company under PUHCA," and has therefore concluded that such an applicant is exempt from the QF ownership restrictions during the pendency of the SEC application. *Doswell Limited Partnership, etc.*, 56 FERC 61,170, 61,590 (July 31, 1991).

<sup>3</sup> In *AES I*, the Commission found that an exemption was warranted under Section 3(a)(5) where the subsidiary utility's adjusted gross revenues represented 10.35 % of holding company revenues on a consolidated basis.

**B. Nature And Extent Of Edison's Interest In This Proceeding.**

Enron seeks exemption from the Act under Sections 3(a)(3) and 3(a)(5) because of, among other things, its ownership interest in 20 QF projects with long-term power purchase agreements with Edison. In the absence of such relief, the status of those projects as QFs, and the resulting benefits under the long-term contracts, would be called into question.

**1. Implementation Of PURPA In California.**

Edison is an electric utility serving customers in Central and Southern California with its headquarters located in Rosemead, California. With a service territory encompassing approximately 50,000 square miles and approximately 4.3 million ratepaying customers, Edison is the seventh largest investor-owned electric utility ("IOU") in the United States.<sup>4</sup>

In the early 1980s, the California Public Utilities Commission ("CPUC") implemented PURPA in California by directing the three major IOUs in California to make available several forms of "standard offer" contracts to QF project developers. Such contracts typically had terms of 20 to 30 years. Before these offers were suspended by the CPUC, more than 600 project developers had entered into such contracts with Edison.<sup>5</sup> Edison remains a party to over 300 standard offer and nonstandard contracts with QFs at this time. A standard term in each of the

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<sup>4</sup> Ranked by sales of electricity in 1999 according to the U.S. Department of Energy. See, <http://www.eia.doe.gov/neo/rankings/salesbvutility.htm>.

<sup>5</sup> See, generally, *Re San Diego Gas & Electric, et al.*, 68 Cal. P.U.C. 2d 434, 442-4 (D.96-10-036), October 9, 1996, which provides a concise overview of the implementation and suspension of standard offer PURPA contracts in California.

agreements requires that the project maintain its status as a QF pursuant to PURPA and FERC's implementing regulations.<sup>6</sup>

Edison's long-term contracts with QFs account for approximately 5,000 MW of contract capacity and accounted for approximately 23.2 gWh of electricity deliveries to Edison in 2001. Since the inception of the PURPA program in California, Edison has paid over \$30 billion for energy and capacity pursuant to contracts with QFs, some \$17 billion of which represents "overpayments," i.e. above-market costs associated with certain fixed energy and capacity pricing terms in many of the contracts.<sup>7</sup> From May 1, 2002 through the end of the term of the QF contracts, Edison estimates additional payments for energy and capacity to QFs of approximately \$20 billion.

## 2. The Enron Agreements.

On January 6, 1997, Enron acquired Zond Corporation ("Zond"). At the time, entities in which Zond, either directly or indirectly, owned an interest were parties to 21 long-term power purchase agreements with Edison (the "Enron Agreements"), of which 19 were ISO4 contracts, governing the sale of electric energy and capacity

<sup>6</sup> All but one of the projects in which Enron or a subsidiary has an interest (discussed *infra*) are Interim Standard Offer 4 ("ISO4") contracts. Section 4.4.12 of ISO4 provides "The Seller warrants that the Generating Facility meets the requirements of a Qualifying Facility as of the effective date of this Contract and continuing through the Contract Term." See also, *Re Pacific Gas and Electric Company*, 13 Cal P.U.C. 2d 84, 126-128 (D.83-10-093), October 19, 1983 (discussing contract requirement that projects maintain QF status under FERC regulations).

<sup>7</sup> Many of the contracts contained two energy pricing periods, known as the First Period and the Second Period. Pricing during the First Period was based on a forecast of energy pricing for the first half of the contract terms which assumed steadily increasing prices each year. As it turned out, the estimates were wildly overstated, resulting in billions of dollars above-market costs, or "overpayments," which ultimately were absorbed by the ratepaying public. 68 Cal P.U.C. 2d, *infra*, at 443.

to Edison from various QF projects (the "Enron Projects").<sup>8</sup> As a result, Enron obtained an upstream ownership interest in the QF projects holding contracts with Edison. Six months after its acquisition of Zond, Enron acquired a 100% ownership interest in PGE and became an electric public-utility holding company. Although Enron asserts the existence of an exemption under Section 3(a)(1) of the Act (exempting holding companies when the public utility operations are predominantly intrastate in scope), Enron did not seek an exemption from the Act under Sections 3(a)(3) and 3(a)(5) prior to its acquisition of PGE.<sup>9</sup>

The Enron Agreements account for approximately 277 MW of electric generating capacity. Each of the standard offer agreements has a 30-year term.<sup>10</sup> Entered into between June 22, 1984 and April 16, 1985, the Enron Agreements expire during the years 2014 through 2021. Under each of the Enron Agreements, the seller is paid for energy and capacity delivered to Edison. In the 19 standard-offer contracts, the energy rate is presently based on the short-run avoided cost of energy ("SRAC"), a variable value that is determined periodically by the CPUC as part of its continuing implementation of PURPA and updated on a monthly basis. The capacity rate is based on a forecast of capacity values from the early 1980's that

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<sup>8</sup> One of these contracts was terminated in July 1997 pursuant to a settlement agreement with Edison. Six of the projects were co-owned by partnerships in which Zond and Florida Power & Light (a public utility holding company) held interests dating to transactions consummated in 1989 and 1990. As a result of Enron's acquisition of Zond, the six projects were effectively owned 100%, directly or indirectly, by a combination of public utility holding companies. As discussed, *infra*, n. 9, Enron attempted to address this ownership issue through a transaction intended to minimize the appearance of joint ownership by the two holding companies.

<sup>9</sup> During the period between its acquisition of PGE on July 1, 1997 and the filings of the instant Application on April 2000, it appears that Enron attempted to avoid the ownership restrictions under PURPA through a series of convoluted transactions apparently intended to minimize the appearance of Enron's substantial ownership interest in the subject projects.

<sup>10</sup> The one non-standard contract has a 20-year term and ends in November 2004.

is now substantially overstated, resulting in above-market capacity payments.<sup>11</sup>

As a result of the energy crisis in California, Edison and the Enron Projects recently entered into a series of agreements which provide, among other things, that upon the occurrence of certain conditions, Edison will pay the Enron Projects for energy at a fixed rate of 5.37 cents/kWh for a period of five years commencing on May 1, 2002.<sup>12</sup> Assuming that such conditions have been satisfied and that the five-year fixed-pricing period commences, pricing will revert to SRAC as determined by the CPUC at the end of the five-year period. Based on Edison's current projections, the price of energy paid by Edison under the Enron Agreements will exceed forecast market prices during the five-year fixed-pricing period by a total of approximately \$114.3 million. This "overpayment" will ultimately be borne by Edison's ratepaying customers.

If the Commission were to deny the instant application for exemption, Enron would not have the benefit of the effectively automatic exception to the ownership rules set forth in 18 C.F.R. § 292.206(c)(1) and (c)(2) with respect to the Enron Projects in which Enron owns, either directly, or indirectly, a 50% or greater interest. Whether the Enron Projects would then meet the ownership status restrictions of PURPA and FERC's implementing regulations would need to be

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<sup>11</sup> FERC's regulations define "avoided cost" as the "incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(c)(6).

<sup>12</sup> Edison reserves all rights concerning these agreements and the underlying Enron Agreements, including, but limited to, whether pricing and other terms in such agreements are or will be affected by further action of this Commission, FERC and/or the CPUC concerning the exemptions sought by Enron in the instant application, or otherwise.

determined by FERC.<sup>13</sup> A determination by FERC adverse to Enron would establish a breach of the warranties in the Enron Agreements requiring that the Enron Projects maintain QF status throughout the terms of the agreements, thereby establishing a potential payment refund obligation on the part of the projects. *Order Instituting Rulemaking No. 2*, 10 Cal. P.U.C. 2d 553, 596-599 (D.82-12-115), December 30, 1982.

### III.

#### ARGUMENT

A. Enron Cannot Meet The Requirements For Exemption Under Section 3(a)(3) and 3(a)(5).

As indicated by Enron in its application, a common element of the exemptions afforded by Sections 3(a)(3) and (5) is the requirement that the holding company not derive "directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public utility company."<sup>14</sup> Enron cannot meet this test, and therefore, its application for exemption under both subsections of Section 3(a) of the Act must be denied.

In the Commission's most recent decisions addressing the issue of materiality under subsections (3) and (5), the Commission compared the relative size of the holding company and the subsidiary utility based on the gross revenues, operating

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<sup>13</sup> In a number of open FERC dockets concerning QF ownership status, Enron has advised FERC that it need not take further action because of the pendency of Enron's application for exemption before this Commission.

<sup>14</sup> *AES 1* ("Since the same language ('material part of its income') appears in all three exemptions involving the relative size criteria of an applicant's public-utility subsidiaries. . . . it obviously makes sense to take a consistent approach to the interpretation of this language").

income and net assets of the two companies. In *AES 1*, the Commission concluded that the public utility subsidiary (CILCO) had contributed 10.35 % of the holding company's adjusted revenues, a contribution level which the Commission found acceptable under all of the circumstances. The Commission was also persuaded that the percentage was declining over time. In a subsequent Commission decision concerning AES, however, the Commission concluded that AES' acquisition of a second utility (IPL) would result in the combined gross revenues, net operating income and net income of IPL and CILCO (16.94%, 14.20% and 15.99%, respectively) exceeding a permissible percentage of these values for AES. *AES Corporation, Holding Co. Act Releases Nos. 35-27363 and 70-9779 (March 23, 2001) ("AES 2")*.<sup>15</sup>

In its application, Enron asserts that for the reporting years 1998 and 1999, PGE contributed "less than 4%" of Enron's gross revenues. That situation has clearly changed. On December 2, 2001, Enron filed for protection under the

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<sup>15</sup> In *AES 2*, the Commission granted "temporary relief" to AES by allowing an exemption under Section 3(a)(5) conditioned upon AES' divestiture of CILCO within two years of the date of closing of the transaction pursuant to which AES proposed to acquire IPL. Enron may assert that it, too, should be granted "temporary relief" because of a pending sale of PGE to Northwest Natural Gas Company ("NNG"). Enron's application should be distinguished, however, for a number of reasons. First, AES sought approval by the Commission of an exemption as part of its closing with IPL; by contrast, Enron did not seek such approval until almost three years after acquiring PGE, and has failed to advise the Commission of the pending sale to NNG. Furthermore, Enron's application has already been pending for almost two years, during which time it has benefited from the interim exemption afforded by Section 3(c) of the Act. Moreover, during this period, Enron had more than ample time to accomplish a sale of PGE, and in fact advised the Commission that it had executed a sale agreement with Sierra Pacific Company as a part of its initial application, although it did not expressly rely on the sale as a basis for seeking an exemption. Enron failed to advise the Commission that the sale agreement with Sierra Pacific has terminated. Finally, Edison notes that the NNG sale may be burdened by Enron's recent bankruptcy filing. Neither the Oregon Public Utilities Commission nor the Washington Utilities and Transportation Commission have approved the transaction. Furthermore, in a Form 8-K filing by NNG on February 7, 2002, NNG stated that if it determines that PGE is exposed to liabilities in connection with Enron's bankruptcy that have a material adverse effect

bankruptcy laws. *In Re Enron Corp., et. al.*, United States Bankruptcy Court Case No. 01-16034 (AJG) (filed December 2, 2001 in the Southern District of New York) ("*Enron*"). On January 18, 2002, the Court in *Enron* issued an order approving the terms and conditions of licensing and sales agreements concerning the sale of Enron's entire wholesale trading business to UBS Warburg. On February 14, 2002, Enron filed an 8-K briefly describing the sale of its wholesale trading business and providing a copy of the "master agreement" governing the sale. Based on these documents and Enron's most recent 10-K filing, it can be concluded that Enron's gross revenues will decline by at least 90%, while it may also be safely assumed that PGE's gross revenues will remain relatively unchanged.

In 2000, Enron's wholesale services "segment" accounted for over 90% of its reported gross revenues of \$100,789,000,000.<sup>16</sup> During the same period, the transportation and distribution "segment" of Enron's business (which includes PGE) accounted for \$2,742,000,000 of gross revenues of which \$2,253,000,000 was attributed to PGE operations.<sup>17</sup> Eliminating the very large revenues attributable to Enron's wholesale services segment from the previously reported gross revenues for Enron's entire business necessarily results in the revenues attributable to PGE operations constituting a substantially higher percentage of Enron's resulting, diminished gross revenues. In 2000, the last year for which Enron filed a 10-K,

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PGE, NNG may choose not to acquire PGE. NNG further indicated that the existence of such liabilities could result in NNG being unable to secure financing.

<sup>16</sup> Enron's 10-K filing for 2000 breaks its business into several "segments" and reports revenue separately for each such segment. It appears that the "wholesale services" segment described in the 10-K filing is the same as the "wholesale trading business" sold to UBS Warburg, and described in the February 14, 2002 8-K filing.

<sup>17</sup> Compare Enron's 2000 10-K with PGE's 2000 10-K, which itemize the same gross revenue amount.

eliminating \$93 billion of revenues attributable to Enron's wholesale services segment would result in PGE's gross revenues representing *over 26%* of Enron's gross revenues in 2000.

PGE's operation over the last six years has yielded fairly level values for annual operating revenues, NOI and net income. For the six-year period ending December 31, 2000, PGE averaged gross operating revenues of \$1,385,830,000. For the last reported fiscal year, 2000, however, PGE's gross operating revenue increased by almost \$1 billion over the average and over the preceding year, to \$2,253,000,000. For the same six-year period, PGE's net operating income averaged \$205,830,000, and its net income averaged approximately \$125 million. Based on PGE's 10-Q filings for 2001, PGE's gross revenues, NOI and net income are consistent with the preceding six-year average.

It is reasonable to assume that PGE's operations have been relatively unaffected by Enron's crisis -- PGE still has the same retail and wholesale customer base, the same operating assets and a regulated rate of return. It is also reasonable to conclude that such values will remain fairly constant going forward. On the other hand, given Enron's bankruptcy filing and likely continuing sales of Enron operating assets,<sup>18</sup> it is reasonable to conclude both that Enron's gross revenues will continue to decrease (at least in the near term) and that PGE's revenues therefore will become an increasingly material percentage of Enron's income over time.<sup>19</sup>

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<sup>18</sup> For example, on March 21, 2002, Sempra Trading, the wholesale commodity trading subsidiary of Sempra Energy, announced the acquisition of Enron Metals and Commodity Corp. for \$43.5 million in cash, subject to final audit and bankruptcy court approval.

<sup>19</sup> The foregoing analysis also supports the conclusion that the second consideration for Section 3(a)(3) exemption -- that the utility operations are only "incidental" to the holding company's

Indeed, it appears likely that PGE revenues will substantially dominate Enron's revenues as further Enron assets are divested.

**B. Enron Should Not Have The Benefit Of The Section 3(c) "Good Faith" Exemption.**

Recent disclosures concerning Enron's finances and accounting practices also call into question whether its initial filing in April 2000 can be considered to have been made in "good faith." As noted above, in its November 8, 2001 8-K filing, Enron advised as follows:

Enron intends to restate its financial statements for the years ended December 31, 1997 through 2000 and the quarters ended March 31 and June 30, 2001. As a result, the previously issued financial statements for these periods and the audit reports covering the year-end financial statements for 1997 to 2000 should not be relied upon.

In other words, Enron intends to restate its financial statements for every year since the acquisition of PGE on July 1, 1997. A press release attached to the 8-K states that:

Enron's *current* assessment indicates that the restatement will include a reduction to reported net income of approximately \$96 million in 1997, \$113 million in 1998, \$250 million in 1999 and \$132 million in 2000. . . . These changes are the result of the retroactive consolidation of JEDI and Chewco beginning in November 1997, the consolidation of the LJM1 subsidiary for 1999 and 2000 and prior year proposed audit adjustments.

Emphasis added. The potential implications of such adjustments for the materiality analysis which must be conducted by the Commission in connection with Enron's pending application are enormous.

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business - cannot be met. With the divestiture of Enron's wholesale energy services segment, the PGE operations must now be viewed as a core business for Enron, not as merely "incidental" to other operations.

The adjustments currently contemplated for 1997 will yield *net income for Enron of \$9 million compared to net income for PGE of \$126 million* during the same year. In other words, the public utility subsidiary's net income was *14 times greater* than the holding company's! Although somewhat less dramatic, the proposed adjustments for 1998 and 1999 also yield startling results which cannot pass muster under the materiality criteria established by the Commission in *AES 1* and *AES 2*. The adjustments to net income contemplated by Enron's November 9, 2001 8-K for 1998 and 1999 would yield adjusted net income for those years of \$590 million and \$643 million respectively. PGE's net income for those years was \$137 million and \$126 million respectively, meaning that PGE net income, as a percentage of Enron net income was *19.59%* in 1999 and *23.22%* in 1998.

Enron's application must be read as if these highly unusual retroactive adjustments had been made at the time of its initial filing on April 14, 2000. Had Enron's true financial condition been disclosed fully in 1997, 1998 and 1999, Enron's April 2000 application would not then have been credible. It would be inequitable to permit Enron to benefit from its own failure to make full and appropriate disclosures during the years leading up to its April 2000 filing, much less to profit from its repeated failure to disclose material changes in circumstances after the filing, such as the failure of the Sierra Pacific sale and the divestiture of its wholesale trading business. Unless the Commission dismisses the application *nunc pro tunc*, however, that is precisely what will happen because of Section 3(c) and FERC's interpretation of Section 3(c). Section 3(c) was clearly intended to apply only to "good faith" filings, not those which are rendered misleading by the

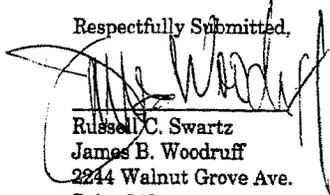
applicant's failure to make required disclosures or to supplement its filings to account for materially changed circumstances.

IV.

**CONCLUSION**

WHEREFORE, Edison respectfully requests that the Commission either (1) deny Enron's application for Section 3(a)(3) and 3(a)(5) exemption under the Act *nunc pro tunc*; (2), in the alternative, summarily deny Enron's application and open an appropriate investigation or other proceeding to ascertain whether Enron's April 14, 2000 application was filed in "good faith" within the meaning of Section 3(c) of the Act; or (3) in the alternative, schedule expedited hearings concerning Enron's application. Because of the unique circumstances described herein, and because of the significant public interest entailed in a prompt resolution of Enron's exemption status, Edison also requests expedited treatment of this motion and opposition.

Respectfully Submitted,

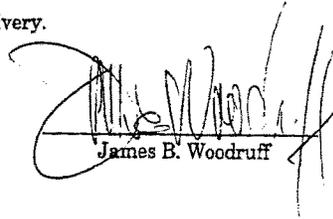


Russell C. Swartz  
James B. Woodruff  
2244 Walnut Grove Ave.  
Suite 342  
Rosemead, CA 91770

Attorneys for Southern California  
Edison Company

CERTIFICATE OF SERVICE

I hereby certify that, on this 26<sup>th</sup> day of March 2002, I have served the foregoing document upon the Applicant's designated representatives in this proceeding listed below by overnight delivery.



James B. Woodruff

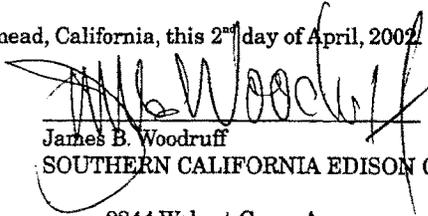
Robert D. Eikenroht  
Assistant General Counsel  
Enron Corp.  
1400 Smith Street, E.B. 4859  
Houston, Texas 77002-7361

Joanne Rutkowski  
LeBoeuf, Lamb, Greene & MacRae, L.L.P.  
1875 Connecticut Avenue, N.W.  
Washington D.C. 20009-3728

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing **MOTION TO INTERVENE OF SOUTHERN CALIFORNIA EDISON COMPANY** upon each person designated on the official service list compiled by the Secretary in these proceedings.

Dated at Rosemead, California, this 2<sup>nd</sup> day of April, 2002.



James B. Woodruff

SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue  
Post Office Box 800  
Rosemead, California 91770  
Telephone: (626) 302-1924

765

Service List for qf99-92

VICTORY GARDEN POWER PARTNERS I LLC

<b>Principal/Party Name/Address</b>	<b>Representative Name/Address</b>
VICTORY GARDEN POWER PARTNERS I LLC	Adam Wenner ENRON WIND CORP 1455 Pennsylvania Ave NW Washington, DC 20004-1008
VICTORY GARDEN POWER PARTNERS I LLC	Adam Wenner Vinson & Elkins L.L.P. 1455 Pennsylvania Ave NW Washington, DC 20004-1008
VICTORY GARDEN POWER PARTNERS I LLC	ADAM S. UMANOFF ENRON WIND CORP 444 S Flower St Los Angeles, CA 90071-2901

766

Service List for QF90-43

VICTORY GARDON PHASE IV PARTNERSHIP

**Principal/Party Name/Address**

**Representative Name/Address**

ROBERT H. GATES SR. V. P.  
VICTORY GARDEN PHASE IV PARTNERSHIP  
A CALIFORNIA GENERAL PARTNERSHIP  
13000 Jameson Rd  
Tehachapi . CA 93561-8157

## Service List for QF91-59

## SKY RIVER PARTNERSHIP

Principal/Party Name/Address	Representative Name/Address
SKY RIVER PARTNERSHIP	James B Vasile Steptoe & Johnson 1500 K Street, NW Suite 450 Washington, DC 20005-1272
KENNETH C. KARAS PRESIDENT SKY RIVER PARTNERSHIP PO Box 1910 Tehachapi, CA 93581-5910	
Chief of Engineers US Army Corps of Engineers Office of the Chief of Engineers 20 Massachusetts Ave NW Washington, DC 20314-0001	
CHIEF, FOREST SERVICE US Department of Agriculture 14TH STREET & INDEPENDENCE AVENUE S.W. OGC - ROOM 4636 - SOUTH BUILDING Washington, DC 20250-0001	
OFFICE OF THE SECRETARY OTH US Department of the Interior 1849 C STREET, N.W., MS 2430 OFFICE OF ENVIRON. POLICY & COMPLIANCE Washington, DC 20240-0001	
WILLIAM SHOPE US Geological Survey MAIL STOP 405 12201 Sunrise Valley Dr Reston, VA 20192-0002	
KENNETH C. KARAS PRESIDENT ZOND SYSTEMS INC 1300 JAMESON ROAD TEHACHAPI, CA	James B Vasile Steptoe & Johnson 1500 K Street, NW Suite 450 Washington, DC 20005-1272

Service List for QF95-186

## CABAZON WIND DEVELOPERS

<b>Principal/Party Name/Address</b>	<b>Representative Name/Address</b>
CABAZON POWER PARTNERS LLC	
CABAZON POWER PARTNERS LLC	Adam Wenner Vinson & Elkins L.L.P. 1455 Pennsylvania Ave NW Washington, DC 20004-1008
CABAZON POWER PARTNERS LLC	JOHN S. DECKER Vinson & Elkins L.L.P. THE WILLARD OFFICE BUILDING 1455 Pennsylvania Ave NW Washington, DC 20004-1008
ADAM S. UMANOFF ZOND DEVELOPMENT CORP PO Box 1910 Tehachapi , CA 93581-5910	SHARON L. TAYLOR ARNOLD & PORTER 555 12th St NW Washington, DC 20004-1200

769

Service List for qf87-365

ZOND SYSTEMS INC

**Principal/Party Name/Address**

**Representative Name/Address**

STEPHEN E. PICKETT  
Southern California Edison Company  
PO Box 800  
Rosemead , CA 91770-0800

Kevin J Lipson  
Hogan & Hartson, L.L.P.  
Columbia Square  
555 13th St NW  
Washington, DC 20004-1109

KENNETH C. KARAS PRESIDENT  
ZOND SYSTEMS INC  
1300 JAMESON ROAD  
TEHACHAPI, CA

Adam Wenner  
Vinson & Elkins L.L.P.  
1455 Pennsylvania Ave NW  
Washington, DC 20004-1008

ZOND WINDSYSTEMS HOLDING CO

KENNETH C. KARAS PRESIDENT  
ZOND WINDSYSTEMS HOLDING CO  
1300 JAMESON ROAD  
TEHACHAPI, CA

ADAM S. UMANOFF  
Morrison & Foerster  
555 W 5th St Ste 3500  
Los Angeles, CA 90013-1080

May 28, 2002

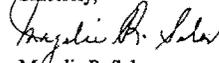
James B. Woodruff, Esq.  
Senior Attorney  
Southern California Edison Company  
P.O. Box 800  
Rosemead, California 91770

Dear Mr. Woodruff:

On April 3, 2002, you filed on behalf of Southern California Edison Company (So Cal Edison) a motion to intervene in the following proceedings involving notices of self-recertification of certain qualifying facilities (QFs) under the Public Utility Regulatory Policies Act of 1978:

Victory Garden Power Partners I, LLC	Docket No. QF99-92
ZWHC LLC	Docket No. QF87-365
Victory Garden Phase IV Partnership	Docket No. QF90-43
Sky River Partnership	Docket No. QF91-59 and
Cabazon Power Partners LLC	Docket No. QF95-186

Please be advised that there is no pending proceeding involving these notices of self-recertification, and thus there is no pending proceeding in which to intervene. However, it appears that your pleading may constitute a petition for declaratory order concerning the QF status of these facilities. If that is your intention, please remit within 15 days of the date of this letter the requisite fee for such filings of \$16,530, pursuant to 18 C.F.R. § 381.302(a) of the Commission's Regulations, along with a statement that you wish for the Commission to process your April 3, 2002, pleading as a petition for declaratory order. If it is not your intention to file a petition for declaratory order, your April 3, 2002, pleading will be deemed withdrawn.

Sincerely,  
  
Magalie R. Salas  
Secretary

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FILE  
OFFICE OF THE  
SECRETARY  
James B. Woodruff  
Senior Attorney  
James.Woodruff@sce.com

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July 1, 2002

FEDERAL ENERGY  
REGULATORY COMMISSION

Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

ORIGINAL

Re:	Victory Garden Power Partners I, LLC	Docket No. QF99-92
	ZWHC LLC	Docket No. QF87-365
	Victory Garden Phase IV Partnership	Docket No. QF90-43
	Sky River Partnership	Docket No. QF91-59
	Cabazon Power Partners LLC	Docket No. QF95-186

Motion to Intervene of Southern California Edison Company,  
Filed April 3, 2002

Dear Ms. Salas:

This will acknowledge receipt of your letter dated May 28, 2002.

The principal purpose of the Motion to Intervene filed by Southern California Edison Company ("Edison") in the referenced dockets on April 3, 2002 ("Motion") was to advise the Commission of Edison's motion to intervene and opposition filed on March 26, 2002 at the Securities and Exchange Commission ("SEC") with respect to the April 2000 application by Enron Corp. ("Enron") for exemption pursuant to Sections 3(a)(3) and (5) of the Holding Company Act. Edison took this action because it did not appear that Enron had updated any of its filings at either the SEC or this Commission to account for the change in circumstances discussed in Edison's motion to intervene and opposition at the SEC, a copy of which was attached to Edison's Motion.

Inasmuch as Enron has previously advised the Commission in its self-certification filings in the referenced dockets that it is in compliance with the Commission's QF ownership standards of the Commission's regulations by virtue of its pending application at the SEC, Edison believes that it was, and remains, material that the SEC now has before it substantial evidence of changed circumstances that may affect the status of the claimed exemption, not only under Sections 3(a)(3) and (5) of the Holding Company Act, but also under Section 3(c) thereof. In view of the

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Secretary  
Page 2  
July 1, 2002

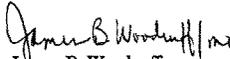
materiality of Enron's exemption status under Sections 3(a)(3) and (5) of the Holding Company Act and of representations made in the referenced dockets for purposes of considering Enron's self-certification filings, Edison believed that the Commission should be aware of the status of the SEC proceedings, and moved to intervene in the referenced dockets for that limited purpose.

On June 25, I spoke with S. L. Higgenbottom of the General Counsel's office and confirmed that Edison does not intend to file a petition for declaratory order with respect to the referenced projects at this time in view of the pending application for exemption at the SEC. During this conversation, Mr. Higgenbottom also confirmed that is not necessary for Edison to formally withdraw its motion and that, although the motion will not be acted upon by the Commission for the reason set forth in your letter dated May 28, 2002, Edison's filing will nevertheless remain a part of the Commission's official, public file in the above-referenced dockets.

Naturally, Edison assumes that the subject wind energy projects will promptly bring to this Commission's attention any changes in their claimed qualifying status whether resulting from action taken by the SEC based on Edison's pending opposition to Enron's application for exemption at the SEC or for other reasons.

Should you have any questions concerning the foregoing, please do not hesitate to contact the undersigned.

Very truly yours,

  
James B. Woodruff

JBW:gh:LW021510032

cc: Service List  
Catherine Fisher (SEC)  
Lars E. Bergmann  
Susan J. Kappelman  
Russell C. Swartz  
J. Eric Isken

Committee on Governmental Affairs  
EXHIBIT #A-21

May 28, 2002

James B. Woodruff, Esq.  
Senior Attorney  
Southern California Edison Company  
P.O. Box 800  
Rosemead, California 91770

Dear Mr. Woodruff:

On April 3, 2002, you filed on behalf of Southern California Edison Company (So Cal Edison) a motion to intervene in the following proceedings involving notices of self-recertification of certain qualifying facilities (QFs) under the Public Utility Regulatory Policies Act of 1978:

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Cabazon Power Partners LLC	Docket No. QF95-186

Please be advised that there is no pending proceeding involving these notices of self-recertification, and thus there is no pending proceeding in which to intervene. However, it appears that your pleading may constitute a petition for declaratory order concerning the QF status of these facilities. If that is your intention, please remit within 15 days of the date of this letter the requisite fee for such filings of \$16,330, pursuant to 18 C.F.R. § 381.302(a) of the Commission's Regulations, along with a statement that you wish for the Commission to process your April 3, 2002, pleading as a petition for declaratory order. If it is not your intention to file a petition for declaratory order, your April 3, 2002, pleading will be deemed withdrawn.

Sincerely,

*Margalie R. Salas*  
Margalie R. Salas  
Secretary

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UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman,  
William L. Massey, Linda Breathitt,  
And Nora Mead Brownell.

Investigation of Certain Enron-Affiliated QFs    Docket Nos.    EL03-17-000

Zond Windsystems Holding Company	QF87-365-005
Victory Garden Phase IV Partnership	QF90-43-004
Sky River Partnership	QF91-59-005

ORDER INITIATING INVESTIGATION AND HEARING

(Issued October 24, 2002)

1. In this order we initiate an investigation into Enron Corporation (Enron) and its ownership of three associated small power production facilities.<sup>1</sup> Each of the facilities is a wind farm affiliated with Enron. Each submitted an application in 1997 for recertification as a Qualifying Facility (QF) under the Public Utility Regulatory Policies Act of 1978 (PURPA). On the basis of those applications for recertification, the Commission recertified the facilities as QFs. It has come to the attention of the Commission that in criminal and civil proceedings in the United States District Court for the Southern District of Texas, the United States of America through its Department of Justice, and the United States Securities and Exchange Commission (SEC), have alleged that in 1997 Enron improperly retained QF benefits for these facilities by fraudulently transferring its ownership in the QFs to partnerships indirectly controlled by Enron. In this order, we are setting for hearing the issue of whether the three facilities in fact satisfied the statutory and regulatory requirements for QF status following the 1997 transfer of ownership interests in the facilities. This order benefits customers by assuring that generating facilities fairly and accurately disclose all relevant information in seeking the benefits of QF status before the Commission.

**Background**

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<sup>1</sup>The three small power production facilities are: Zond Windsystems Holding Company (Zond Windsystems), Victory Garden Phase IV Partnership (Victory Garden), and Sky River Partnership (Sky River).

### Statutory and Regulatory Background

2. The Public Utility Regulatory Policies Act of 1978 (PURPA) was designed to lessen the country's dependence on foreign oil. Congress believed that increased use of non-utility energy resources would reduce the demand for traditional fossil fuels. See FERC v. Mississippi, 456 U.S. 742, 750-51 (1982) (citing legislative history of PURPA). In passing PURPA, Congress identified two major obstacles that had served in the past to stifle non-utility powerplant development: (1) the reluctance of traditional electric utilities to purchase power from and sell power to non-traditional utilities; and (2) the substantial burdens of pervasive federal and state regulation. Congress in PURPA sought to remove these obstacles.
3. As directed by Congress in Section 210(a) of PURPA, 16 U.S.C. § 824a-3(a), -3(b) (1994), the Commission prescribed regulations designed to encourage the development of cogeneration and small power production. As directed by Congress, the Commission's regulations required electric utilities to purchase electricity from and sell electricity to QFs. The Commission further required that electric utilities purchase electric energy from QFs at "avoided costs rates." 18 C.F.R. §§ 292.301-292.308. The Commission also removed certain state and federal regulation that QFs would otherwise be subject to, by granting QFs exemptions from most such regulation. 18 C.F.R. §§ 292.601-292.602 (2002).
4. In Subpart B of the Commission's PURPA regulations, under the sections of PURPA that modified the Federal Power Act (FPA), the Commission set forth criteria and procedures for becoming a QF. 18 C.F.R. §§ 292.201-292.211 (2002).
5. One of the criteria for being a QF relates to ownership of the QF. Sections 3(17)(C) and (18)(B) of the FPA, 16 U.S.C. §§ 796(17)(C)(ii) and (18)(B)(ii)(1994), provide that a QF must be:

owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

The Commission's regulation implementing this statutory requirement states that:

(a) General Rule. A cogeneration facility or small power production facility may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

(b) Ownership test. For purposes of this section, a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest in a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.

18 C.F.R. § 292.206(a) and (b) (2002).

6. The Commission has summarized its ownership requirements for QF status:

The Commission's regulation thus equates "ownership interest" with "equity interest," but does not define the term "equity interest." This definitional issue has been most problematic in cases involving partnerships as opposed to corporations. This is because the stated percentage of partnership interests in partnership agreements does not always correspond with specific provisions in the partnership agreements concerning control of and/or division of benefits from the partnership assets. The Commission has therefore looked to the entitlement to profits, losses, and surplus after return of initial capital contribution, as well as the share of control of the venture, to help it in determining whether the division of equity interests in a partnership complies with the statutory and regulatory ownership requirements for QF status.<sup>[2]</sup>

#### **Recertification of Enron-affiliated Facilities in 1997**

7. In May 1997, the three Enron-affiliated QFs, Zond Windsystems, Victory Garden, and Sky River filed applications for recertification as QFs. In each application for recertification, the applicant noted that on February 27, 1997, the Commission issued an order approving the merger of Enron and Portland General Corporation.<sup>3</sup> The applicant in each application for recertification also acknowledged that as a result of the merger,

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<sup>2</sup>Indeck North American Power Fund, L.P., 85 FERC ¶ 61,239 at 62,001-02 (1998)(footnote omitted), order noting withdrawal of reh'g and denying motion to vacate, 86 FERC ¶ 61,123 (1999).

<sup>3</sup>Enron Corporation, 78 FERC ¶ 61,179 (1997).

Enron's interest in affiliates which owned interests in the facilities would be considered ownership by an "electric utility holding company" for purposes of 18 C.F.R. § 292.206, the Commission's regulation concerning the ownership requirements for QF status. In order to comply with the ownership requirements for QF status, each applicant committed that the Enron affiliates would transfer ownership interests to partnerships which they claimed would be unaffiliated with Enron.

8. Zond Windsystems, prior to the merger, was owned by an Enron affiliate. According to the application, the Enron affiliate proposed to transfer enough of its ownership to partnerships known as RADR ZWS MM, LLC and RADR ZWS, LLC (RADR partnerships) so that the Enron affiliate would own only 50 percent of the facility. Enron alleged in the application that none of the owners of the RADR partnerships was primarily engaged in the generation or sale of electric power, so that following the merger the facility would meet the Commission's ownership requirements.

9. Sky River and Victory Garden, prior to the merger, were each owned in partnership (1) by affiliates of the FPL Group, Inc., which for purposes of the Commission regulations is an "electric utility holding company" and (2) by affiliates of Enron. According to the applications, the Enron affiliate proposed to transfer its ownership interests to the RADR partnerships so that following the merger each facility would meet the Commission's ownership requirements for QF status (with the FPL Group Inc. affiliates being the only partners acknowledging "electric utility holding company" status).

10. On June 30, 1997, the Commission recertified as QFs the three Enron-affiliated facilities.<sup>4</sup> In the orders, the Commission approved the transfer of the Enron subsidiaries' interests to the RADR partnerships. In each of the three cases, the order recited that Enron Renewable Energy Corp, would be providing a loan to RADR ZWS, LLC at an interest rate described as "consistent with rates for projects with similar risk profiles." (In Zond Windsystems, the loan was "to assist" RADR ZWS in its acquisition of 50 percent interest in the facility; in Victory Garden and in Sky River, the loan was "to finance the purchase" of RADR ZWS's interest). The Commission approved each of the new ownership structures, applying its standard ownership test applicable to partnerships, finding in each case that electric utility interests would not exercise greater than 50 percent control over the facilities, and would not receive greater than 50 percent of the stream of benefits from the facility. The Commission's recertification in each case was

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<sup>4</sup>Zond Windsystems Holding Company, 79 FERC ¶ 62,236 (1997)(Zond Windsystems); Victory Garden Phase IV Partnership, 79 FERC ¶ 62,238 (1997)(Victory Garden); and Sky River Partnership, 79 FERC ¶ 62,237 (1997)(Sky River).

based on the provision that each "facility is owned and operated in the manner described in the application and this order."

11. In the criminal complaint against Andrew Fastow,<sup>5</sup> it is alleged that Andrew Fastow and Michael Kopper created the RADR partnerships to disguise Enron's interest in the wind farms "so that the wind farms could continue to receive beneficial regulatory treatment while they secretly remained under Enron's control." Also, according to the complaint, the partners in the RADR partnerships understood that proceeds from the partnerships were to be paid to Fastow, Kopper and their designees.

12. In a civil action filed against Andrew Fastow by the Securities and Exchange Commission (SEC),<sup>6</sup> it is alleged that the RADR partnerships were what is described as a "Friends of Enron" deal which was a:

scheme to enrich [Fastow] and others while enabling Enron to maintain secret control over, and achieve off-balance-sheet treatment, of assets that it had "sold" to a supposedly independent [Special Purpose Entity].

13. The RADR transactions were described as a:

"Friends of Enron" transaction related to Enron's effort to appear to divest itself of its interest in certain wind farms in California, so that the farms would continue to receive beneficial regulatory treatment, while Enron secretly retained control over the farm. Under applicable federal and state regulations, the wind farms qualified for financial benefits conferred on alternative energy sources that met certain requirements ("qualifying facilities" or "QF"). Wind farms that were more than fifty percent owned by an electric utility or electric utility holding company, however, were ineligible for QF status. In early 1997, Fastow and others were aware that Enron's wind farms would soon lose their QF status because Enron was in the process of acquiring Portland General Electric, an electric utility in Portland, Oregon, and would become an electric utility holding company.

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<sup>5</sup>United States of America v. Andrew Fastow, Case No. H-02-889-M, United States District Court of the Southern District of Texas, Houston Division.

<sup>6</sup>United States Securities Exchange Commission v. Andrew Fastow, Civil Action No. H-02-3666, United States District Court of the Southern District of Texas, Houston Division.

In approximately March 1997, Fastow, Kopper, and others devised a scheme whereby Enron would "sell" a portion of its interest in the wind farms to a partnership comprised of "Friends of Enron."

#### Discussion

14. As described above, serious allegations have been made that Enron affiliates never intended to relinquish control of the wind farms whose ownership structure changed in connection with the Enron/Portland General merger. If these allegations are true, they conflict in material respects with the representations made by the small power producers, Zond Windsystems, Victory Garden, and Sky River, in the 1997 applications for recertification as QFs.<sup>7</sup> We, therefore, will institute a proceeding, pursuant to 18 C.F.R. § 292.204 (d)(1) (2002), to determine whether Zond Windsystems, Victory Garden, and Sky River have failed to conform with the representations presented in their 1997 applications for re-certification or whether these QFs otherwise failed to meet the QF ownership criteria as a result of the 1997 RADR transactions.

15. The Commission in the past has revoked some of the benefits of QF status in cases involving a failure to comply fully with the requirements for QF status. In those cases, where the failure to comply was not willful, the Commission revoked the QF's exemption from section 205 of the FPA and determined that the QF was not entitled to charge QF avoided cost rates during the period it had failed to comply with the requirements for QF status, redetermined the applicable rates, and ordered refunds for the period of non-compliance with the requirements for QF status. See LG&E-Westmoreland Southampton, 76 FERC ¶ 61,116 (1996), order granting clarification and denying reh'g, 83 FERC ¶ 61,132 (1998); New Charleston Power I, L.P., 76 FERC ¶ 61,282 (1996), order denying reh'g and ordering settlement judge proceedings, 83 FERC ¶ 61,281, order denying reh'g in part and granting reh'g in part, 84 FERC ¶ 61,286 (1998). Those orders left open the possibility of a greater revocation of QF benefits (e.g., revocation of a QF's

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<sup>7</sup>18 C.F.R. § 292.207(d)(1) (2002), which is the Commission's regulation providing for revocation of QF status, states that failure to conform with any material facts or representations in an application for re-certification means that the Commission order certifying QF status may no longer be relied on. Under 18 C.F.R. § 292.207(d)(ii) (2002), the Commission:

may, on its own motion, or on the motion of any person, revoke the qualifying status of a facility that has been certified under paragraph (b) of this section, if the facility fails to conform to any of the Commission's qualifying criteria under this part.

Docket No. EL03-17-000, et al.

- 7 -

exemption from other sections of the Federal Power Act, see 18 C.F.R. § 292.601 (2001), and revocation of a QF's exemption from the Public Utility Holding Company Act and certain State law and regulation, see 18 C.F.R. § 292.602 (2001)), as well as a permanent revocation of QF benefits in more serious cases.

16. At this time, we are setting for hearing whether Zond Windsystems, Victory Garden, and Sky River have failed to conform with the representations presented in their 1997 applications for re-certification, i.e., whether the Enron affiliates actually transferred their ownership interests in the facilities, and thus whether those certifications can be relied on. We are also setting for hearing the issue of whether each facility actually satisfied the Commission's ownership requirements for QF status following Enron's merger with Portland General. If following review of the Initial Decision resulting from the hearing ordered herein, we find that Zond Windsystems, Victory Garden, and Sky River have failed to conform with the QF ownership requirements, we will then establish the appropriate remedies.

The Commission orders:

(A) A public hearing shall be held in Docket Nos. EL03-17-000, QF87-365-005, QF90-43-004, and QF91-59-005 concerning the matters discussed in the body of this order.

(B) The Secretary shall promptly publish a notice of the Commission's initiation of the proceeding in Docket No. EL03-17-000 in the Federal Register.

(C) A presiding judge to be designated by the Chief Judge shall convene a conference in this proceeding to be held within approximately fifteen (15) days of the date the Chief Judge designates the presiding judge, at a hearing room of the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions

Docket No. EL03-17-000, et al.

- 8 -

(except motions to dismiss), as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.

Committee on Governmental Affairs <b>EXHIBIT #A-23</b>
-----------------------------------------------------------

**Date:** 9/6/02 3:44 PM  
**Sender:** Susan Kappelman  
**To:** david berick  
**cc:** Amy.Ford J.Eric.Isken Lars.Bergmann  
**Priority:** Normal  
**Subject:** Analysis of Enron above-market payments

---

David,  
I apologize for taking a couple of extra days to get this to you. We reorganized and summarized the data so you can see how the data relate to the various FERC filings. Note this analysis begins with July 1997, which is when the merger between Portland General Electric (PGE) and Enron was finalized (after receiving Oregon and FERC approvals).  
(See attached file: Enron by Law Suit Groups v2.xls)

Susan Kappelman



Date: 9/30/02 9:20 AM  
 Sender: kberky  
 To: david berick  
 Priority: Normal  
 Subject: FW: Zond (Enron Wind) Corp. transactions

-----Original Message-----  
 From: Susan Lauscher  
 Sent: September 29, 2002 6:28 AM  
 To: Karen Berky  
 Subject: FW: Zond (Enron Wind) Corp. transactions

Karen - Here's your confirmation from Laurel.

-----Original Message-----  
 From: Laurel Mayer  
 Sent: Sat 9/28/2002 8:21 PM  
 To: Susan Lauscher  
 CC:  
 Subject: RE: Zond (Enron Wind) Corp. transactions

Hi Sue--Just to confirm, I'm not aware of any transfer of ownership rights.

Thanks.  
 -----Original Message-----  
 From: Susan Lauscher  
 Sent: Fri 9/27/2002 8:53 AM  
 To: Laurel Mayer  
 Cc: Karen Berky  
 Subject: Zond (Enron Wind) Corp. transactions

Hi, Laurel - In connection with the Enron investigation in Congress, a question has arisen as to whether TNC had ownership rights. We have "assignment agreements" in 1997 and 1998 for Tehachapi and Cabazon wind turbines in which TNC is given "net profit rights." There has apparently been some assertion that TNC was subsequently given ownership rights before the agreements were terminated (we have those 1999 and 2000 terminations).

Kathy Kimura Barnes has searched the files and has come up with no other documents. Would you please confirm for Karen that you know of no transfer of ownership rights?

Thanks.  
 Susan

Susan Lauscher  
 Senior Attorney  
 The Nature Conservancy

## ASSIGNMENT AGREEMENT

This Assignment Agreement (this "*Assignment*") is made as of this 18th day of November, 1998, by Zond Cabazon Development Corporation, a California corporation ("*Assignor*"), in favor of The Nature Conservancy, a nonprofit corporation of the District of Columbia ("*Assignee*").

## RECITALS

Assignor will construct, own and operate a 39.5 Megawatt wind power project (the "Cabazon Project") which will be located near Cabazon, California and will be comprised of 53 Zond 750 KW wind power turbines (such wind turbines being herein collectively referred to as the "*Wind Turbines*").

By this Assignment and subject to the terms hereof, in order to benefit the California and Texas programs of Assignee, Assignor desires to make a charitable contribution to Assignee of the right to receive 50% of the Net Profits (as defined below) generated by the Wind Turbines.

## AGREEMENT

NOW, THEREFORE, in connection with and in consideration of the charitable contribution made hereunder by Assignor to Assignee, Assignor and Assignee hereby agree as follows:

1. *Grant of Net Profits Rights.* (a) Subject to the terms and conditions hereof, as a charitable contribution, Assignor does hereby transfer, convey and assign unto Assignee, effective as of June 30, 1997, the right to receive 50% of the Net Profits generated by the Wind Turbines during the term hereof (such right being herein referred to as the "*Net Profits Rights*").

(b) As used herein, the term "*Net Profits*" shall mean, with respect to a given calendar quarter, the following:

(i) the sum of all revenues received by Assignor that are attributable to the operation of the Wind Turbines during such quarter, including, without limitation, any payments received for the sale of electric energy generated by the Wind Turbines during such quarter,

(ii) less the sum of:

(A) all costs and expenses paid by Assignor that are attributable to the ownership, operation, management and/or administration of the Wind Turbines during such quarter,

(B) on and after the Commercial Operation Date, all capital expenditures incurred and paid by Assignor with respect to the Wind Turbines that are attributable to the ownership or operation of the Wind Turbines during such quarter;

(C) to the extent necessary due to the cyclical nature of the revenues generated by the Wind Turbines, any reserves that Assignor deems in its reasonable discretion, consistent with industry practice, to be necessary and appropriate to provide for future payments of the type referred to in clauses (A) and (B) above; and

(D) as used herein the term "Commercial Operation Date" shall mean the date on which the testing and commissioning of all the Wind Turbines and the related infrastructure shall have been completed by the contractor constructing the Cabazon Project.

(d) During the term of the Net Profits Rights, Assignor shall pay to Assignee its share of the Net Profits generated by the Wind Turbines on a quarterly basis, with each payment being payable on or before the 60th day following the end of the applicable calendar quarter. In connection with each such payment, Assignor shall deliver to Assignee a statement that summarizes its calculation of Net Profits with respect to such quarter.

2. *Term.* (a) Subject to the terms of Section 2(e) below, the Net Profits Rights assigned to Assignee by Assignor hereunder shall have an initial term that extends through December 31, 1998; provided, however, that unless Assignor delivers a Termination Notice (as defined below) to Assignee on or before the 5th day immediately preceding the expiration of such initial term or any renewal term, the term of such Net Profits Rights shall automatically be extended for an additional one-month period.

(b) On or before the 5th day immediately preceding the expiration of the initial term of the Net Profits Rights or any renewal term thereof, Assignor shall have the right, exercisable by delivery of written notice to Assignee, to terminate the Net Profits Rights effective as of the expiration of the then-current term (any such notice being herein referred to as a "Termination Notice").

(c) Notwithstanding any terms hereof to the contrary, Assignee shall have the right at any time to terminate the Net Profits Rights effective as of the 90th day following the delivery by Assignee to Assignor of written notice to such effect.

3. *Assignor as Manager of Wind Turbines.* Assignor and Assignee acknowledge and agree that Assignor shall oversee the management of the Wind Turbines for the joint benefit of Assignor and Assignee, which role shall include, among other things, ensuring that the Operator performs its duties under the Operating Agreement. In exchange for such services, Assignee acknowledges and agrees that Assignor shall be entitled to retain an annual fee of \$40,000 out of the revenues generated from the Wind Turbines, which fee shall be escalated commencing January 1, 1998, based on changes in the Consumer Price Index during the preceding year. Assignee acknowledges and agrees that such fee shall be prorated during the term hereof and taken into account on a quarterly basis in connection with the calculation of Net Profit.

4. *Regulatory Matters - Assignor.* Without limiting the management rights of Assignor referenced in Section 3 below and subject to the limited rights of Assignor set forth in this Section 2, during the term of the Net Profits Rights, Assignor shall not (i) have the right to take any unilateral action that would adversely affect the percentage or calculation of the Net Profits Rights assigned to Assignee hereunder, or (ii) enter into any contract for the purchase or sale of any good or service from

any "affiliate" as defined in Section 2(a)(11) of PUCHA (defined below) unless such contract has been ratified by Assignee.

5. *Regulatory Matters - Assignee.* (a) Assignee represents and warrants to Assignor that, to the best of its knowledge, it (i) is not engaged in the generation for sale of electric power, (ii) does not own 10% or more of the voting securities of a "public utility company" (as defined in PUCHA), (iii) is not the owner of an ownership or operating interest in any electric facilities other than Qualifying Facilities (as defined below), "eligible facilities" as "exempt wholesale generators" under Section 32(a) of PUHCA (as defined below), or electric facilities as "foreign utility companies" under Section 33(a) of PUHCA, or (iv) is not an affiliate of Enron Corp. or any "electric utility" or "electric utility holding company" within the meaning of 18 C.F.R. § 292.206. As used herein, the term "Qualifying Facility" shall mean a "qualifying cogeneration facility" or "qualifying small power production facility" within the meaning of Section 3(18)(B) or 3(17)(C), respectively, of the Federal Power Act, as amended from time to time. As used herein, the term "PUCHA" shall mean the Public Utility Holding Company Act of 1935, as amended, and the rules and regulations thereunder.

(b) During the period of time beginning on the effective date of this Assignment and continuing throughout the term hereof, Assignee will use reasonable efforts not to take or fail to take any action that would cause the representation and warranty set forth in subparagraph (a) immediately above to cease to be true with respect to Assignee.

(c) Assignee agrees and acknowledges that Assignor will enter into an operations and maintenance agreement (the "Operating Agreement") with Zond Maintenance Corporation or one of its affiliates for the operation and maintenance of the Cabazon Project following the commercial Operation Date. The Operating Agreement shall be deemed to be ratified by Assignee so long as it is in substantially the same form as the Operations and Maintenance Agreement dated as of June 30, 1997 between Zond Systems, Inc. and Zond Maintenance Corporation. Assignee agrees to ratify any other service or other agreement between Assignor and any of its affiliate relating to the provision of services for the Cabazon Project so long as the terms and conditions of such agreement and consistent with industry practice.

(d) In no event shall the aggregate liability of Assignee for breach of Section 5(a), (b) or (c) above exceed an amount equal to the total amount of Net Profits paid by Assignor to Assignee hereunder.

#### 6. *Miscellaneous*

(a) *Entire Agreement.* This Assignment constitutes the entire agreement between the parties and supersedes all prior written and oral and all contemporaneous oral agreements and understandings with respect to the subject matter hereof.

(b) *Amendments.* This Assignment may not be amended except by an instrument in writing signed by both parties.

(c) *Severability.* If any term or provision of this Assignment is invalid, illegal or incapable of being enforced by any rule of law or public policy, all other conditions and provisions of this Assignment shall nevertheless remain in full force and effect so long as the

economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon determination that any term or provision is invalid, illegal or incapable of being enforced, the parties hereby shall negotiate in good faith to modify this Assignment so as to effect the original intent of the parties as closely as possible in an acceptable manner to the end that transactions contemplated hereby are fulfilled to the extent possible.

(d) *Notices* All notices, directions and other communications provided for hereunder shall be in writing and may be personally delivered, mailed (by registered or certified mail, postage prepaid) or sent by telecopy, telegraph or other direct written electronic means, to the applicable party at the address indicated below:

If to Assignor: Zond Cabazon Development Corporation  
c/o Enron Wind Corp.  
444 S. Flower Street, Suite 4545  
Los Angeles, California 90071-2946  
Attention: John A. Lamb  
Telecopy No.: (213) 452-4888

If to Assignee: The Nature Conservancy  
201 Mission Street, 4th Floor  
San Francisco, California 94105  
Attention: Steve McCormick  
Telecopy No.: (415) 777-0244

or as to any party, at such other address as shall be designated by such party in a written notice to the other parties complying as to delivery with the terms of this provision. All such notices, when personally delivered shall be deemed to have been validly and effectively given on the date of such delivery, when transmitted by telegraph, telecopy or other direct written electronic means shall be deemed to have been validly and effectively given on the day on which it is transmitted, or, if mailed, shall be deemed to have been validly and effectively given when deposited in the mail.

(e) *Governing Law*. This Assignment shall be governed by and construed in accordance with the laws of the State of California without giving effect to the principles of conflict of laws thereof.

(f) *Counterparts*. This Assignment may be executed in counterparts, each of which shall be deemed to be an original, but all of which shall constitute one and the same agreement. Upon execution of this Assignment, counterpart signature pages may be delivered by facsimile transmission.

(g) *Assignment*. Assignee may not assign the Net Profits Rights or its rights hereunder without the prior written consent of Assignor, which consent shall not be unreasonably withheld. Assignor may assign and delegate its rights and duties under this Agreement to any third party without the prior consent of Assignee. Assignee understands and acknowledges that

Assignor presently intends to assign and delegate its rights and duties under this Agreement to Cabazon Power Partners.

(b) *Indemnity.* Assignor, on behalf of its affiliates, successors and assigns, agrees to indemnify, defend and hold harmless Assignee, its directors, officers, agents and employees from and against any and all claims, liabilities, demands, damages and costs of any kind, including, without limitation, attorneys' fees and litigation costs, that arise out of or in connection with the Wind Turbines, the Operating Agreement, this Assignment or any rights under this Assignment, including, but not limited to, claims arising from or in any way connected to any requirements of local, state and/or federal laws, regulations, ordinances, permits, licenses and other governmental requirements or payment of any net profits, except to the extent any such claims, liabilities, demands, damages and costs are attributable to the gross negligence or willful misconduct of Assignee. Assignor's obligations under this Section 5(h) shall survive the termination of this Assignment.

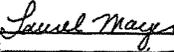
(c) *Not a Joint Venture.* Notwithstanding any other provision of this Assignment, Assignee is not a partner, joint venturer, alter ego, manager, controlling person or other business associate or co-participant of any kind or nature whatsoever of Assignor and Assignee does not intend to assume such status. Assignee shall not be deemed responsible for or a participant in any acts, omissions or decisions of Assignor.

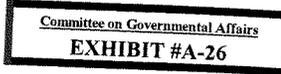
IN WITNESS WHEREOF, the parties hereto have executed this Assignment as of the date and year first above written, but effective as herein provided.

ASSIGNOR: ZOND CABAZON DEVELOPMENT CORPORATION

By:   
Adam Umaroff  
Senior Vice President

ASSIGNEE: THE NATURE CONSERVANCY

By:   
Name: Laurel Mays  
Title: Vice President



LEXSEE 85 ferc 61355

Coso Energy Developers (BLM Facility), Coso Finance Partners (Navy I Facility), Coso Power Developers (Navy II Facility), Salton Sea Power Generation, L.P. (Salton Sea III Facility), Del Ranch, L.P., Elmore, L.P., Vulcan/BN Geothermal Power Company, Power Resources, Inc., Salton Sea Power Generation, L.P. (Salton Sea IV Facility), Saranac Power Partners, L.P., Norcon Power Partners, L.P., Yuma Cogeneration Associates, Salton Sea Power Generation, L.P. (Salton Sea I Facility), Leathers, L.P., Salton Sea Power Generation, L.P. (Salton Sea II Facility)

Docket Nos. QF86-590-007, QF84-327-005, QF86-591-007, QF86-1043-004, QF86-727-006, QF86-647-005, QF85-199-005, QF86-930-005, QF95-9-002, QF90-114-006, QF89-299-004, QF90-143-003, QF87-511-005, QF88-543-003, QF89-297-004

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

85 F.E.R.C. P61,355; 1998 FERC LEXIS 2566

ORDER DENYING APPLICATIONS FOR RECERTIFICATION AS QUALIFYING FACILITIES

December 16, 1998

PANEL:

[\*1] Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hebert, Jr.

OPINION:

In this order the Commission addresses the 15 applications for recertification of qualifying facility (QF) status filed by the entities named above. CalEnergy Company, Inc. (CalEnergy) owns a 50 percent or greater interest in 13 of the 15 QFs which seek recertification, and owns a substantial interest in the two remaining facilities. n1 CalEnergy has announced plans to acquire MidAmerican Energy Holdings Company, the sole stockholder of MidAmerican Energy Company (collectively, MidAmerican), an electric utility company. n2 CalEnergy assumes for purposes of these applications that, as a result, it will fall within the definition of "electric utility holding company" contained in the Commission's regulations under the Public Utility Regulatory Policies Act of 1978 (PURPA). The issue presented by the recertification applications is whether, after CalEnergy's acquisition of MidAmerican, the facilities will satisfy the ownership requirements for qualifying facility (QF) status under PURPA and the Commission's regulations implementing PURPA. As discussed below, we [\*2] find that the facilities will not, and thus we deny recertification.

-Footnotes-

n1 CalEnergy owns, through subsidiaries, a 100 percent interest in ten of the facilities. CalEnergy intends to retain the 100 percent interest in eight of the facilities and proposes to divest itself of a minority interest in two of the

facilities (CalEnergy plans to divest substantially less than 50 percent in each of those two). Two of the facilities are owned by partnerships in which CalEnergy holds minority ownership interests but where electric utility interests own a percentage of the partnerships and the total percentage of the combined electric utility/CalEnergy interests exceeds 50 percent of the partnership. CalEnergy owns 50 percent of another facility in which other electric utility interests own a percentage of the partnerships and the total percentage of the combined electric utility/CalEnergy interests exceeds 50 percent of the partnership. CalEnergy owns more than 50 percent, but less than 100 percent of the remaining two facilities.

Fourteen of the facilities are owned through partnerships; one of the facilities is owned by a corporation. While each application for recertification has been filed by the individual partnership (or corporation) which directly owns the facility at issue, for simplicity we will refer to the applications as being filed by CalEnergy. [\*3]

n2 MidAmerican has filed an application in Docket No. EC98-63- 000 seeking approval to merge with CalEnergy. We are approving the merger in an order issued today.

- - - - -End Footnotes- - - - -

I. Background

Statutory and Regulatory Background

Sections 3(17)(C) and (18)(B) of the Federal Power Act (FPA), 16 U.S.C. §§ 796(17)(C)(ii) and (18)(B)(ii)(1994), provide that a QF must be:

owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

The Commission's regulation implementing this statutory requirement states that:

(a) General Rule. A cogeneration facility or small power production facility may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

(b) Ownership test. For purposes of this section, a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation [\*4] or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company.

18 C.F.R. § 292.206 (a) and (b) (1998).

CalEnergy's Applications for Recertification and Responses to the

Applications

In the applications for recertification, CalEnergy acknowledges that it owns a greater than fifty percent interest in each of the QFs (except the three facilities, in which CalEnergy, in combination with other electric utility owners, owns a greater than fifty percent interest). CalEnergy also assumes for purposes of these applications that upon its acquisition of MidAmerican it will become an electric utility holding company. CalEnergy claims that each facility will remain a QF following CalEnergy's acquisition of MidAmerican because:

(1) Over the life of each facility, on a net present [\*5] value basis, n3 the electric utility and electric utility holding company owners (including CalEnergy after it becomes an electric utility holding company) will receive less than fifty percent of the stream of benefits of the facility;

-Footnotes-

n3 CalEnergy has submitted a discounted cash flow analysis with each application. Most of the information filed in CalEnergy's applications for recertification has been filed pursuant to a request that it be treated as privileged under 18 C.F.R. § 388.112 (1998).

-End Footnotes-

(2) Where there are non-utility partners in a facility, the non-utility partners will have voting rights equal to CalEnergy's voting rights with respect to control over the allocation of the stream of benefits. Where CalEnergy is the 100 percent owner, non-utility directors, unaffiliated with and not controlled by CalEnergy, will be appointed and those non-utility directors will have voting rights equal to CalEnergy's voting rights with respect to control over the allocation of the stream of benefits;

(3) Each facility will be [\*6] subject to an irrevocable shareholder resolution or other appropriate governing document (true up provision) n4 which shall provide that if it is anticipated at any time in the future that events will cause the utility owners of the facility to receive over fifty percent of the lifetime economic benefits of the facility, such excess shall be divested to non-utility owners or donated to a charity or non-profit organization so that no more than fifty percent of the stream of benefits are received by electric utilities, electric utility holding companies, or any combination thereof.

-Footnotes-

n4 As noted above, only one of the facilities has a corporate ownership structure; the other 14 are partnerships.

-End Footnotes-

CalEnergy reasons that measuring the benefits it receives over the life of the facility, first as a non-utility and separately after its status changes to an electric utility holding company, will satisfy both Commission precedent n5 and the underlying purposes of the ownership requirement contained in PURPA. CalEnergy claims that [\*7] measuring the stream of benefits in this manner, combined with the proposed true-up provision and the protection of having voting

"control" in the hands of persons claimed by CalEnergy to be independent of CalEnergy, will ensure that the facilities satisfy the ownership requirements for QF status following CalEnergy's acquisition of MidAmerican.

-----Footnotes-----

n5 CalEnergy cites to several orders issued pursuant to delegated authority. CalEnergy claims that these orders are precedent for measuring the economic benefits received by different owners (who were to change during the life of the facility) over the life of a facility to determine whether the utility owners would receive more than 50 percent of the stream of benefits from the facility.

-----End Footnotes-----

Notices of the applications were published in the Federal Register, with comments, protests or interventions due on or before November 16, November 30 or December 9, 1998. n6

-----Footnotes-----

n6 Coso Energy Developers (BLM Facility), QF86-590-007, 63 Fed. Reg. 58,025 (1998) (due date - November 16); Coso Finance Partners (Navy I Facility), QF84-327-005, 63 Fed. Reg. 58,025 (1998) (due date - November 16); Coso Power Developers (Navy II Facility), QF86-591-007, 63 Fed. Reg. 58,025 (1998) (due date - November 16); Salton Sea Power Generation, L.P., QF86-1043-004, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Del Ranch, L.P., QF86-727-006, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Elmore, L.P., QF86-647-005, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Vulcan/BN Geothermal Power Company, QF85-199-005, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Power Resources, Inc., QF86-930-005, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Salton Sea Power Generation, L.P., QF95-9-002, 63 Fed. Reg. 60,327 (1998) (due date - December 9); Saranac Power Partners, L.P., QF90-114-006, 63 Fed. Reg. 60,327 (1998) (due date - December 9); Norcon Power Partners, L.P., QF89-299-004, 63 Fed. Reg. 58,025 (1998) (due date - November 16); Yuma Cogeneration Associates, QF90-143-003, 63 Fed. Reg. 60,327 (1998) (due date - December 9); Salton Sea Power Generation, L.P., QF87-511-005, 63 Fed. Reg. 60,326 (1998) (due date - December 9); Leathers, L.P., QF88-543-003, 63 Fed. Reg. 60,327 (1998) (due date - December 9); Salton Sea Power Generation, L.P., QF89-297-004, 63 Fed. Reg. 63,048 (1998) (due date - November 30).

-----End Footnotes-----

[\*8]

Southern California Edison Company (SoCal Edison) has filed motions to intervene opposing recertification in eleven of the dockets filed by CalEnergy. n7 SoCal Edison states that it is the utility-purchaser of power produced by the facilities in those eleven dockets. SoCal Edison states that if the Commission grants the recertification applications, "despite utility ownership interests in excess of 50 percent, Edison could be required to continue to purchase power at above-market QF prices from facilities that should not be entitled to benefits under PURPA." n8 SoCal Edison argues that the:

stream of benefits test should not be permitted to function as an after-the-fact device to "average out" utility affiliate equity interests over

the life of a project. If a utility affiliate holds no equity interest in a project for the first four years and a 100 percent equity interest for the next four years, the utility affiliate cannot be said to hold a 50 percent equity interest at every point in time during such an eight years period. Yet this is precisely the conclusion CalEnergy's tortured theory would produce. n9

-----Footnotes-----

n7 Coso Energy Developers (BLM Facility), QF86-590-007; Coso Power Developers (Navy II Facility), QF86-591-007; Coso Finance Partners, QF84-327-005, Vulcan/BN Geothermal Power Company, QF88-199-005; Del Ranch, L.P., QF86-727-006; Elmore, L.P., QF86-647-005; Leathers, L.P., QF88-543-003; Salton Sea Power Generation L.P., QF87-511-005; Salton Sea Power Generation L.P., QF89-297-004; Salton Sea Power Generation L.P., QF86-1043-004; and Salton Sea Power Generation L.P., QF95-9-002. [\*9]

n8 SoCal Edison Motion to Intervene in Docket Nos. QF88-199- 005, QF86-727-006, QF86-647-005, QF88-543-003, QF87-511-005, QF89-297-004, QF86-1043-004, and QF95-9-002 at 6.

n9 Id. at 13.

-----End Footnotes-----

SoCal Edison states that if the Commission grants CalEnergy's requests in these dockets, it will effectively remove all restrictions on utility involvement in existing QFs provided evidence can be provided that more than 50 percent of the utility's benefits have already been obtained by non-utility interests.

SoCal Edison argues that if the Commission does not deny CalEnergy's applications, it must set the applications for hearing because the stream of benefits analyses, and the mechanisms proposed by CalEnergy to assure that it does not "control" a facility in which it holds a 100 percent ownership interest raise many factual issues which cannot be answered without further scrutiny of the facts. SoCal Edison asks the Commission, if it does not summarily deny the applications, to consolidate the recertification dockets with the merger docket, to hold a hearing, and to provide intervenors with access to the [\*10] information filed under seal in the recertification dockets, subject to a protective order.

New York State Electric & Gas Corporation (NYSEG) has filed motions to intervene in all of the recertification dockets. NYSEG states that it is a purchaser of long-term power from Saranac Power Partners, L.P., one of the entities owned by CalEnergy and the subject of one of the applications for recertification. NYSEG states that:

the definition of a QF calls for an evaluation of the electric utility status of the "owner" (singular) at the time of the inquiry, not the "owners" (plural) over the life of the facility. Nothing in the statute suggests that ownership benefits enjoyed by another party prior to or after utility involvement can somehow be used to dilute or offset the utility's interest for the purpose of determining QF status. Indeed, if that were the case, then any time a QF's expected benefit stream is 50 percent exhausted, any electric public utility in the country could buy a 100 percent interest in the facility without disturbing

the QF status.

NYSEG intervention in Docket No. QF86-591-007 at 5.

NYSEG asks that the Commission deny CalEnergy's request for confidential treatment [\*11] of the applications. NYSEG also asks that all the CalEnergy recertification applications be consolidated for decision. Finally, NYSEG asks the Commission to set the matters raised by the applications for recertification for hearing.

San Diego Gas & Electric Company (SDG&E) filed a timely motion to intervene in Docket No. QF90-143-000; SDG&E is the utility-purchaser of the power produced by Yuma Cogeneration Associates (Yuma), the QF seeking recertification in that docket. SDG&E states that CalEnergy now owns 100 percent of Yuma, which has been operational for 4.5 years. SDG&E states that CalEnergy plans to divest itself of part of the partnership interests in Yuma. SDG&E states that CalEnergy intends to continue to own 75 percent of Yuma. SDG&E claims that the 75 percent ownership raises doubts about the facility's QF status.

The American Forest & Paper Association (American Paper) has filed motions to intervene in eleven of the recertification dockets. n10 American Paper asks the Commission to deny recertification of CalEnergy's facilities as QFs following the acquisition of MidAmerican. American Paper states that:

CalEnergy cites to [Commission] precedent, above, that prospectively [\*12] allows utilities to receive more than 50% of the "stream of benefits" from a QF in any one year, as long as the utility does not receive more than 50% of such benefits over the life of the facility. CalEnergy plans to apply this test retroactively to allow it to take into consideration the "stream of benefits" that flowed to it as a non-utility owner in the past, and thereby permit it to own more than 50% of the QFs in the present and future as a utility. n11

-----Footnotes-----

n10 Vulcan/EN Geothermal Power Company, QF88-199-005; Del Ranch, L.P., QF86-727-006; Elmore, L.P., QF86-647-005; Leathers, L.P., QF88-543-003; Power Resources, Inc., QF86-930-005; Saranac Power Partners, L.P., QF90-114-006; Yuma Cogeneration Associates, QF90-143-000; Salton Sea Power Generation L.P., QF87-511-005; Salton Sea Power Generation L.P., QF89-297-004; Salton Sea Power Generation L.P., QF86-1043-004; and Salton Sea Power Generation L.P., QF95-9-002.

n11 American Paper Intervention in Docket No QF86-727-006 at 3.

-----End Footnotes-----

Roger J. Skinner, the President of [\*13] Skinner & Damulis, Inc. of Richfield Springs, New York, and Skinner Sales of Herkimer, New York, both of which are truck and auto dealerships filed a letter opposing the recertification of the facility owned by Saranac Power Partners, L.P. (Saranac). n12 Mr. Skinner alleges that NYSEG pays inflated prices for the power from Saranac. Mr. Skinner states that as a result, he pays inflated prices for power from NYSEG. Mr. Skinner, as a result, must charge his customers higher prices. Mr. Skinner continues:

Even more outrageous, as I understand the Saranac situation, the owner of Saranac, CalEnergy, is taking the profits earned from New York's businesses and citizens and purchasing another utility, MidAmerican. When this acquisition is final, Saranac will be owned by an electric utility. How can one electric utility force another electric utility to buy its above-market electricity? How can the Commission stand idly by and allow this to happen? Surely this cannot be the result intended by Congress. n13

-----Footnotes-----

n12 Saranac Power Partners, L.P. is 100 percent owned by CalEnergy.

n13 Skinner comments at 1.

-----End Footnotes-----

[\*14]

Gary J. Rockhill of Peru, New York, Geoffrey A. Smith, President of Medial Coaches Incorporated of Oneota, New York, and Mike Kroft of Endwell, New York also filed comments opposing recertification of Saranac.

The New York State Consumer Protection Board (New York Board) filed a timely protest in Docket No. QF90-114-006 (Saranac). The New York Board opposes recertification. The New York Board states that the Commission's fifty percent equity interest rule is straight forward and should be used to deny recertification to the Saranac facility.

The Community Arts Partnership of Tompkins County, New York, and those additional individuals and entities listed in Appendix A filed timely motions to intervene in Docket No. QF90-114-006 (Saranac) in opposition to recertification.

CalEnergy has responded to the interventions and comments. CalEnergy claims that NYSEG has no legitimate interest in any of the proceedings other than the Saranac proceeding and asks the Commission to deny its requests for intervention in other proceedings. CalEnergy asks the Commission to deny the requests that the recertification applications be consolidated with each other and with the merger proceeding; in support, [\*15] CalEnergy alleges that each recertification application is fact specific, with different ownership structures and interests, and different fuels, different contracts, different present value analyses, different utility purchasers and different technical criteria.

CalEnergy also asks that the Commission deny requests for hearing in these proceedings. CalEnergy states that the requests for hearing and disclosure of commercially-sensitive materials are inconsistent with the Commission's practice in QF cases and must be denied. CalEnergy argues that QF certification and recertification proceedings are narrow in scope and effect and limited to a determination of whether, under the facts presented by the applicant for certification, the facility will satisfy the ownership and technical requirements for QF status. Finally, CalEnergy opposes any disclosure to intervenors of the information filed under seal. CalEnergy points out that the information for which it has requested privileged treatment is confidential, proprietary and sensitive in nature.

## II. Discussion

## A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1998), the [\*16] timely, unopposed motions to intervene serve to make the persons which filed them parties to the proceedings in which they intervened. Further, notwithstanding CalEnergy's opposition to NYSEG's intervention in all of the dockets excepting one, we find that good cause exists to grant NYSEG's motions to intervene. We are satisfied that it has expressed an interest in the outcome of these proceedings that is not represented by another party and that its participation is in the public interest. Accordingly, we shall grant the motions to intervene.

We will deny the motions for technical conference, for hearing and to consolidate the recertification dockets with each other and with the merger docket filed in Docket No. EC98-63-000. Our denial of recertification and the rationale for our denial make these motions moot. A trial-type hearing is not necessary to our determinations in this case. Also, we need not consolidate cases that we do not set for trial-type hearing.

## B. QF Status Following CalEnergy's Acquisition of

## MidAmerican

We will deny the applications for recertification of QF status filed by CalEnergy. In each of the applications, the Commission is asked to declare that a facility [\*17] which, upon CalEnergy's acquisition of MidAmerican, will be owned more than 50 percent by electric utility entities will nevertheless satisfy the statutory requirement that a QF must be:

owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

CalEnergy has offered a novel theory on how its facilities will satisfy the ownership requirements for QF status. As described above, CalEnergy would have the Commission look at the stream of benefits over the life of the facility, and determine that the facility is owned by a person not primarily engaged in the generation or sale of electric power, because more than fifty percent of what CalEnergy projects as the stream of benefits over the life of the facility were or will be paid out to non-utility interests (including CalEnergy before it becomes an electric utility holding company). CalEnergy also proposes to assure that the control of the facilities is in non-utility hands.

However, looking at the past stream of benefits, and putting certain limited decision making procedures concerning future benefits into the [\*18] hands of independent directors, does not make the facilities owned by "a person not primarily engaged in the generation or sale of electric power." First we note that both the stream of benefits test and the control test n14 were developed by the Commission as an aid in determining whether an electric utility or electric utility holding company owned more than 50 percent of the equity of a partnership claiming QF status. n15 These tests were never intended to supplant the statutory n16 and regulatory n17 requirement that a facility be "owned by a

person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities)." Even if we were to give a liberal interpretation to the 50 percent equity interest aspect of our QF ownership regulation (through adjusting the measurement of the stream of benefits), we fail to see how the literal language, or the intent, of PURPA's "primarily engaged" test would be met if a QF's ultimate owner also owns 100 percent of an electric utility "engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities [\*19] or small power production facilities)". n18

-----Footnotes-----

n14 CalEnergy's claim of QF status rests primarily on its claim of satisfying these two tests.

n15 Indeck North American Power Fund, L.P., et al., 85 FERC P61,239 at 62,001-02 (1998).

n16 16 U.S.C. § 796(17)(C)(ii) and 18(B)(ii) (1994); see supra at 2.

n17 18 C.F.R. § 292.206 (a) and (b) (1998); see supra at 2.

n18 We note that the cases relied upon by CalEnergy did not address factual patterns similar to the facts presented by CalEnergy's applications, nor were they intended to provide guidance for such fact patterns. We have never used the stream of benefits test or the analysis of control to justify complete or majority ownership of a QF by an electric utility holding company from the date the latter gained such status until the facility's economic benefits are exhausted. Moreover, in each of the cases cited by CalEnergy, the Commission looked at the stream of benefits on a prospective basis, without considering past benefits as CalEnergy would have us do. To the extent a broader approach is suggested in any cases decided under delegated authority, those cases are not binding as precedent on the Commission. Phoenix Hydro Corporation, 26 FERC P61,289 (1984), aff'd 775 F.2d 1187, 1191 (D.C. Cir. 1985). Furthermore, the Commission has interpreted the ownership requirements of PURPA strictly. See, e.g., Connecticut Valley Electric Company, Inc. v. Wheelabrator Claremont Company, L.P., et al., 82 FERC P61,116, reh'g denied, 83 FERC P61,136 (1998).

-----End Footnotes-----

[\*20]

As we noted above, eight of the fifteen facilities are 100 percent owned by CalEnergy and CalEnergy does not propose to divest itself of any portion of those facilities. We do not see how we can find that a facility 100 percent owned by an electric utility holding company satisfies the statutory requirements for QF status. As the Commission pointed out when it promulgated its regulations implementing the ownership requirements of PURPA, while Congress intended that an electric utility could participate in the ownership of a qualifying cogeneration or small power production facility:

the thrust of section 201 of PURPA is to limit the advantages of qualifying status to cogeneration and small power production facilities which are not owned primarily by electric utilities or their subsidiaries. [ n19 ]

-----Footnotes-----

n19 Order No. 70, FERC Stats. & Regs., Regulations Preambles 1977-1981, P 30,134 at 30,953-54; 45 Fed. Reg. 17959 at 17970-71 (1980).

-----End Footnotes-----

We will accordingly deny CalEnergy's applications for recertification. [\*21]

Our reasoning applies equally to the other facilities CalEnergy seeks to recertify. Each of those facilities is owned more than 50 percent by electric utility interests. CalEnergy owns 100 percent of two of those facilities and proposes to divest well under 50 percent of the ownership of each of those facilities to a non-utility. Three other facilities are owned by CalEnergy and other utility interests. CalEnergy's arguments are no more persuasive here than for the facilities addressed above.

CalEnergy's attempt at showing that it will no longer control the facilities is also without merit. CalEnergy, in its appointment of independent directors, does not intend to divest itself of the full range of powers normally associated with ownership. CalEnergy's proposal to give control to independent directors relates primarily to the control over the stream of benefits. Moreover, for eight of the facilities, there is only one owner capable of receiving the facility benefits -- CalEnergy. The provision for independent directors with control of the stream of benefits and other limited issues in those eight cases is insufficient to demonstrate compliance with the statutory and regulatory requirements. [\*22]

Our action today does not mean that CalEnergy's ownership of the facilities is prohibited. It merely means that when CalEnergy becomes an electric utility holding company, the facilities will no longer qualify for the benefits of QF status, unless CalEnergy reduces its current level of ownership sufficiently.  
n20

-----Footnotes-----

n20 Id. at 17971.

-----End Footnotes-----

The Commission orders:

- (A) The timely, opposed, motions to intervene of NYSEG are hereby granted.
- (B) The applications for recertification of qualifying facility status filed in these proceedings are hereby denied.

By the Commission.

APPENDIX:

Appendix A

(Additional Intervenors in Docket No. QF90-114-006)

85 F.E.R.C. P61,355; 1998 FERC LEXIS 2566, \*22

The Broome Chamber of Commerce of Binghamton, New York  
The New York Farm Bureau of Glenmont, New York  
New York State Automobile Dealers, Inc. of Albany, New York  
The Cheektowaga Chamber of Commerce of Cheektowaga, New York  
The Elmira Area Retired Teachers Association of Pine City, New York  
Eric W. Rhodes of Binghamton, New York  
Colleen M. Dundon of Conklin, [\*23] New York  
Kathryn M. Mele of Endicott, New York  
Bonnie McLaud of Berkshire, New York  
Paul T. Nugride of Endwell, New York  
Charles Trick of Port Crane, New York  
Sharon Powers of Waterloo, New York  
Deborah W. Fenwick of Binghamton, New York  
The Disabled American Veterans, Thomas Poldino Chapter 185, of Lindenhurst, New York  
David Comfort of Schuyler Falls, New York  
The Southern Tier Independence Center of Binghamton, New York  
The Friends to the Elderly, Youth and Family Center, Inc. of Buffalo, New York  
Stephen Vincent of Auburn, New York  
The American Military Retirees Association, Inc. of Plattsburgh, New York  
Edward J. Personius of Binghamton, New York  
The Tioga County Chamber of Commerce of Owego, New York  
James G. Sprague of Apalachin, New York  
William Gorman of Apalachin, New York  
David S. Miller III of Apalachin, New York  
Auburn Vacuum Forming of Auburn, New York  
George E. Bonner of Apalachin, New York  
The Broome County Arts Center of Binghamton, New York

85 F.E.R.C. P61,355; 1998 FERC LEXIS 2566, \*23

Richard Bence of Owego, New York  
The Council of Churches of the City of New York  
William McCann of Vestal, New York  
Lauren Massey of Binghamton, New York  
Margaret M. Cerchiara [\*24] of Endwell, New York  
David A. Petersen of Vestal, New York  
The Village of Alden, New York  
The New York State Grange of Cortland, New York  
Tony Morrow of Dansville, New York  
Ann T. Carnrike of Norwich, New York  
The Tioga County Legislature of Owego, New York  
Jim Salmon of Mechanicville, New York  
The American Heart Association, Mid-State Region of Binghamton, New York  
Walter Savichky of Binghamton, New York  
Alexander J. Kalicki of Auburn, New York  
Daniel Carden of Endwell, New York  
The National Association of Letter Carriers, Branch 2094 of College Point, New York  
Patricia F. Lanter of Binghamton, New York  
William Morrison of Brewster, New York  
The Vietnam Veterans of America, Inc, New York State Council  
Tad Palmer of Binghamton, New York  
Paul Wachtler of Binghamton, New York  
First Heritage Federal Credit Union of Painted Post, New York  
Christine Swart of Vestal, New York  
David Greenfield of Lockport, New York  
New York State Dairy Foods, Inc. of Syracuse, New York  
Sonoco Crellin of Chatham, New York

85 F.E.R.C. P61,355; 1998 FERC LEXIS 2566, \*24

Don Reynolds of King Ferry, New York  
Warwick Valley Church of the Nazarene of Warwick, New York  
Tioga State Bank of Spencer, New York  
Country [\*25] Club Chevrolet and Otsego Automotive of Oneonta, New York  
Ericka Fothergill of Geneva, New York  
Toby Wollin of Binghamton, New York  
The Town of Binghamton, New York  
Chris Argetsinger of Binghamton, New York  
Colleen Anderson-Labosky of Binghamton, New York  
Milt Newbitt of Binghamton, New York  
Marlene L. Wolfinger of Binghamton, New York  
Wallace H Benjamin, Jr. of Chenango Forks, New York  
Jim Turner of Binghamton, New York  
Brian J. Eldridge of Orchard Park, New York  
Village of Poret Dickinson, New York  
Thomas R. Tefft of Vestal, New York  
Keith Lorenzetti of Vestal, New York  
Kenneth Francisco of Vestal, New York  
Robert Perkins of Plattsburgh, New York  
David Cheeseborough of Vestal, New York  
Brenda Patton of Montecello, New York  
Town of New Lebanon, New York  
Jay Hershowitz of Binghamton, New York  
Alan P. Zdimal of Endicott, New York  
George Mouton, of Binghamton, New York  
Carol L. Stankevich of Binghamton, New York  
John C. Putos of Binghamton, New York

William W. Weiman of Auburn, New York  
H. Gerald Willower of Geneva, New York  
Sarah Ferro of Auburn, New York  
Robert Williams of Auburn, New York  
Richard A. Bullock of Owego, New York  
[\*26]  
Elizabeth Sparby of Windsor, New York  
Susanne A. Dwyer of Endwell, New York  
Mike Tesla of Conklin, New York  
Stanley LaComb of Conklin, New York  
Martin S. Hahn of Vestal, New York  
Matthew J. Cook of Endwell, New York  
Christine H. Bonner of Chenango Forks, New York  
William B. Crawford, Jr. of Owego, New York  
Mary H. Merrit of Binghamton, New York  
Patricia A. Seketa of Binghamton, New York  
Cheryl M Buckley of Apalachin, New York  
Jeffrey Allen of Binghamton, New York  
Albert J. Dauphinais of Harporsville, New York  
David L. Gridley of Port Crane, New York  
Patricia A. Boynton of Port Crane, New York  
Kathryn A. Granger of Endwell, New York  
Kenneth Gillette of Endicott, New York  
Monica Weslowski of Auburn, New York  
Dennis White of Vestal, New York  
Paul DeAndrea of Franklin, New York  
Suzanne J. Ford of Berkshire, New York  
Virginia Shriner of Freeville, New York

Peter Foster of Binghamton, New York  
Phyllis Felker of Kirkwood, New York  
Pamela J. Scott of Vestal, New York  
Alan Hertel of Apalachin, New York  
Karen Kalata of Vestal, New York  
Jack Jessop of Endwell, New York  
Marino D. Martello of Endicott, New York  
John Zdimal of Endwell, [\*27] New York  
Vicky L. Szalach of Vestal, New York  
Bob Lowell of Somers, New York  
William Dobins, Jr., Owner/Manager of Vance Metals of Geneva, New York  
Owen Loudon of Geneva, New York  
Susan King, Owner/Manager of A Country Basket of Geneva, New York  
Lewis J. Davis of Auburn, New York  
Frank Inglese of Depew, New York  
Denny Mastro of Ithaca, New York  
Raymond C. Glover of Pine City, New York  
Elizabeth A. Ruggiero of Horsehead, New York  
Mike Markov of Windsor, New York  
Western New York teamsters Local Joint Council #46 of Cheektowaga, New York  
Thomas and Betts Corporation of Horsehead, New York  
Theodore E. Anderson of Otego, New York  
Ken Isaman, Legislator, Steuben County, Arkport, New York  
Ghent Fire Protection District of Ghent, New York  
Bob Counihan of Brewster, New York  
Thomas Farell of Ithaca, New York  
Richard Charsky of Ithaca, New York

Marilyn Malone Agency of Owego, New York  
Les Buchanan of Ithaca, New York  
Tim Karski of Ithaca, New York  
Stephen W. Mauersberg of Waverly, New York  
BDC Management of Corning, New York  
Robert Baderscher of Endicott, New York  
Richard Peterson of Trumansburg, New York  
Noel Desch of Ithaca, New York  
[\*28]  
Binghamton Imagination Celebration of Binghamton, New York  
Purolator Products, Inc. of Elmira, New York  
LaBarge Companies of Syracuse, New York  
Andy Sciarabba of Ithaca, New York  
Southern Tier Economic Growth, Inc of Elmira, New York  
Diane L. Chester of Endicott, New York  
Rural Opportunities, Inc. of Rochester, New York  
La Resurreccion United Methodist Church of New York  
Hope Line/Resource Center for Community Development of Bronx, New York  
Chemung County, New York  
The American Legion Post 234 of Ballston Spa, New York  
Three Rivers Development Corporation of Corning, New York  
Buffalo Niagara Partnership of Buffalo, New York  
The International Brotherhood of Electrical Workers of Coraopolis, Pennsylvania  
The New York State Automobile Dealers Association of Albany, New York  
The First Reformed Church of Hastings-on-Hudson, New York  
The Albany Branch of the NAACP  
Greater Corning Area Chamber of Commerce of Corning, New York  
United Transportation Union of Albany, New York

Southern Saratoga County Chamber of Commerce of Clifton Park, New York

Town of Ellenburg, New York

United Way of Broome County, Inc. of Binghamton, New York

William Magee, [\*29] Assemblyman 11th District, the Assembly, State of New York

Donald L. Wells of Benice Center, New York

Vince Taylor of Bainbridge, New York

Town of Altona, New York

Town of Chazy, New York

Tom Machalek of Endicott, New York

A.J. Christopher Wood of Vestal, New York

Northern Tier Aging Services of Berlin, New York

Frank Sarday of Johnson City, New York

Committee on Governmental Affairs  
EXHIBIT #A-27

January 11, 1999

Laurel Mayer, Esq.  
The Nature Conservancy  
201 Mission Street, 4<sup>th</sup> Floor  
San Francisco, California 94105

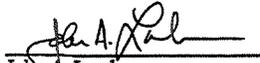
Re: ZCDC/Nature Conservancy Assignment Agreement

Dear Laurel:

Please reference the Assignment Agreement (the "Agreement") dated November 18, 1998 between The Nature Conservancy and Zond Cabazon Development Corporation ("Zond Cabazon"). Pursuant to Section 2 of the Agreement, Cabazon Power Partners, LLC ("Cabazon"), as successor by merger to Zond Cabazon, desires to terminate the Agreement, including the Net Profits Rights (as defined in the Agreement).

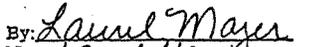
In consideration of your agreement to terminate all rights, title, and interest to the Agreement, including but not limited to the Net Profits Rights, and to waive the applicable notice provision thereunder, Cabazon hereby agrees to pay to The Nature Conservancy the amount of \$10,000. By your acknowledgment of this letter in the space provided below, the Agreement and the Net Profits Rights will be terminated effective as of January 8, 1999.

CABAZON POWER PARTNERS LLC

  
John A. Lamb

ACKNOWLEDGED AND AGREED TO BY:

The Nature Conservancy

By:   
Name: Laurel Mayer  
Title: Vice President

1\WBUSLM1460\ENR100\CABAZON\NATURB1.DOC

EVE 1788500.0001

Federal Energy Regulatory Commission  
Washington, D.C. 20426

Committee on Governmental Affairs  
EXHIBIT #A-28

August 16, 2001  
**CONFIDENTIAL**  
**NON-PUBLIC**

MEMORANDUM TO : Kevin P. Madden  
General Counsel

Daniel L. Larcamp  
Director, Office of Markets, Tariffs and Rates

Donald J. Gelinas  
Associate Director, Office of Markets, Tariffs and Rates

John M. Delaware  
Deputy Director, Office of the Executive Director

FROM : Marvin Rosenberg, Economist  
Perry L. Brown, Economist  
Energy Markets Division  
Office of Markets, Tariffs and Rates

Kim G. Bruno, Attorney  
Market Oversight and Enforcement  
Office of General Counsel

KB

Mary C. Laueremann, Auditor  
Division Regulatory Audits  
Office of the Executive Director

Subject : Inquiry into EnronOnline

In May, 2001 you asked a team, comprised of staff from OMTR, OGC and the ED, to initiate an inquiry into the scope and development of electronic trading in the electric power and natural gas markets. The team was asked to evaluate EnronOnline's dominant position in electronic trading in the energy industries and to determine its impact on the natural gas and electric markets. The attached team report is a preliminary review of EnronOnline. The Office of General Counsel is currently drafting a comprehensive memorandum concerning the Commission's jurisdiction over online trading.

## Report on EnronOnline

### Introduction

The marketing of both natural gas and power are relatively recent developments. Natural gas marketing began with the deregulation of the price of natural gas in 1978 and expanded with the Commission's Pipeline Open Access Rule, Order No. 636, in 1992. In the decade since Order No. 636, natural gas marketing has developed into a large robust activity with many marketers trading over 65 Tcf per year.<sup>1</sup>

The Energy Policy Act of 1992 stimulated the development of the trading of wholesale electric power. The Commission's Electric Utility Open Access Rule, Order No. 888, in 1996 spurred its development. Electric power marketing is not as developed as natural gas marketing, but there are about 100 active marketers trading approximately 4.5 billion MWh per year.<sup>2</sup>

Electronic trading (e-trading) platforms began to appear several years after Order No. 636. But it wasn't until the popularization of the Internet that real success was attained. Since its founding in November 1999, EnronOnline (EOL) has become the overwhelmingly dominant e-trading platform for natural gas and electric power. EOL's dominance of e-trading combined with Enron's position as the largest marketer of natural gas and electric power, raises the question that the team was asked to investigate:

Given Enron's size as the largest marketer of natural gas and electric power and EnronOnline's dominant position in e-trading in the energy industries, what is the impact of EnronOnline on the natural gas and electric markets?

This report is the result of a two-month inquiry into EOL and e-trading in the natural gas and power industries. During this period staff discussed energy trading, electronic trading and energy derivatives with members of the industry, as well as searching the trade and popular press for background material. At the beginning of the inquiry, the team met with Enron personnel to learn about EOL. Following this meeting, the team met with Dynegy regulatory and technical staff to learn about Dynegydirect, a rival e-trading platform that uses the same business model as EOL. In addition, the team

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<sup>1</sup>*Natural Gas Intelligence*, "Top Gas Gorillas Show Phenomenal Volume Growth," February 21, 2001. Note that there is more gas traded than consumed because the same gas can be traded multiple times.

<sup>2</sup>Power Marketer Week, February, 26, 2001.

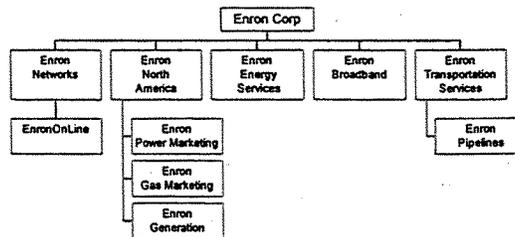
met with energy traders at Allegheny Energy Global Markets, Dynegy, Enron, Reliant and PG&E National Energy Group. The team also met with representatives of the New York Mercantile Exchange (NYMEX) and the New York Stock Exchange (NYSE) to learn of their experiences with electronic trading and any problems they foresee with energy e-trading as it evolves. In addition, the team met with representatives of Kiodex, a financial software firm, that is developing a new e-trading system for the NYMEX and whose risk management software is made available on EOL to its customers. The members of the team also took courses in energy derivatives and financial and energy market trading.

### **Background**

The business concept underlying EOL is simple. Trading on EOL using the Internet replaces marketing that previously took place by telephone and fax. On EOL, Enron marketers are on one side of every trade just as they are when they use phone and fax to trade. EnronOnline is a computer system operated by an Enron subsidiary called Enron Networks, Inc. Enron marketing subsidiaries Enron Power Marketing, Inc. (EMPI) and Enron North America, Inc. (ENA) conduct Enron's electric power and natural gas trading, respectively. Figure 1 is a stylized organization chart of Enron Corp. showing where EOL is located in relation to gas and power marketing, and the pipelines.

EOL uses a one-to-many trading model, where Enron takes one side of every transaction taking place on EOL. EOL differs from traditional exchanges like the NYSE

Figure 1  
Organization Chart of Enron Corp



and the NYMEX. These exchanges determine price by matching the buy and sell orders of many traders. On EOL, price is determined when a buyer or a seller accepts an offer or bid price posted by an Enron trader. Energy trading platforms such as Altra and Intercontinental Exchange (ICE), which use a many-to-many model, are more like a traditional exchange because price is determined by the many buyers and sellers.

Enron marketers post bids and offers for the natural gas and electric power products that are traded on EOL. Figure 2 shows a sample web page from EOL. The screen shows some of the physical and financial products that are traded and bids and offers that Enron has set. To purchase a product from Enron, a trader clicks on the offer price. To sell a product to Enron, a trader clicks on the bid price.

Figure 2  
Sample page from EnronOnline

The screenshot shows a web browser window titled "EnronOnline - Microsoft Internet Explorer" with the URL "https://www.enrononline.com/home". The page header includes "EnronOnline" and navigation links for "PURCHASE", "MY NOTES", "POSITIONS", "TRANSACTION HISTORY", and "MARKERS". The main content is a table with columns for product name, quantity, unit, bid price, offer price, and quantity. The table lists various US Gas Daily products with their respective bid and offer prices.

				Bid	Offer	
US Gas Daily	NGI GD/O PGCEcy	Aug01	USD/MM	5.3901	-0.0751	-0.04
US Gas Daily	SoCal	25-31 Jul01	USD/MM	5.0000	4.201	4.40
US Gas Daily	NGI GD/O SoCal	Aug01	USD/MM	5.3000	3.01	3.06
US Gas Daily	TXE M3	25-31 Jul01	USD/MM	15.0000	3.2925	3.3125
US Gas Daily	TXE M3	Aug01	USD/MM	15.0000	3.2175	3.24
US Gas Daily	IF GD/O TexOk E	Aug01	USD/MM	10.0000	-0.0125	-0.0025
US Gas Daily	NGPL TXOK East	Aug01	USD/MM	10.0000	2.9651	2.995
US Gas Daily	Transco Z6 NY	25-31 Jul01	USD/MM	20.0000	3.3425	3.3625
US Gas Daily	Transco Z6 NY	Aug01	USD/MM	15.0000	3.3375	3.36
US Gas Daily	IF GD/O T Z6 NY	Aug01	USD/MM	5.0000	-0.0125	-0.0025
US Gas Daily	Trunkline ELA	Aug01	USD/MM	10.0000	2.8175	2.8425
US Gas Daily	IF GD/O Waha	Aug01	USD/MM	20.0000	-0.035	-0.025
US Gas Daily Opt	GD/O TCO - IF TCO	Nov01-Mar02	USD/MM	10.0000	0.295	0.295
US Gas Daily Opt	GD/O TCO - IF TCO	Nov01-Mar02	USD/MM	10.0000	0.26	0.23
US Gas Daily Opt	GD/O PEPL - IF PEP	Nov01-Mar02	USD/MM	10.0000	0.245	0.295

NEW! West Power NATURAL GAS/CAPACITY/POWER/WEATHER MAIN NATURAL GAS

EOL screens do not show prices or volumes of completed transactions, nor does EOL indicate when a deal has been made. EOL displays changes in bids and offers, but traders outside of Enron do not know whether changes are the result of a transaction or Enron changing the bid and offer price. In addition, if a product disappears from the screen traders outside of Enron do not know whether trading has ended in that product for the day or just suspended for a while.

#### **Natural Gas and Power Marketing**

Most natural gas and power trading is accomplished through traditional methods, although the use of e-trading, discussed below, is growing. Table 1 shows the sales of the 20 largest natural gas marketers during 1999 and 2000, ranked by sales in 2000.<sup>3</sup> To compute the table, the team summed the annual sales of the 20 largest wholesale natural gas sellers and computed each seller's share of that sum for each year. The team emphasizes that these are shares of an amount that is less than the total amount of natural gas sales for the respective years. Therefore, the shares appearing in the table are larger than each marketer's share of the nationwide annual natural gas sales. For this reason the team cautions against treating them as national "market" shares. In addition, they reveal nothing about the size or number of sellers in smaller regional or local areas.<sup>4</sup>

The individual shares of the 20 largest marketers ranged from 2.3 percent to 15.9 percent. During 2000, Enron's natural gas sales grew nearly 80 per cent from 1999, and its share of aggregate natural gas sales in 2000 is twice that of its nearest competitor.

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<sup>3</sup>*Natural Gas Intelligence*, February 19, 2001.

<sup>4</sup>The team has not conducted a rigorous analysis of trading markets for lack of time and sufficient and reliable data.

-Table I  
 Top 20 North American Gas Marketers  
 Ranked by 2000 Sales Volume\*  
 (Bcf/d)

2000 Rank	Company <sup>1</sup>	2000	1999	2000 Share (%)**	1999 Share (%)**
1	Enron (1)	23.8	13.3	15.9	10.4
2	Duke (2)	11.9	10.5	7.9	8.2
3	Aquila (3)	10.5	10.4	7.0	8.1
4	Coral (4)	10.2	9.8	6.8	7.7
5	Dynegy (5)	9.7	8.8	6.5	6.9
6	Sempra (11)	8.9	5.8	5.9	4.5
7	Reliant (7)	8.7	6.8	5.8	5.3
8	BP Amoco (12)	8.4	5.4	5.6	4.2
9	El Paso (8)	6.9	6.7	4.6	5.2
	Miram <sup>2</sup> (12)	6.9	5.4	4.6	4.2
11	Axia <sup>3</sup> (10)	6.5	6.5	4.3	5.1
12	TransCanada (9)	6.4	6.6	4.3	5.2
13	PG&E (6)	5.0	8.4	3.3	6.6
14	Williams (14)	4.3	4.2	2.9	3.3
15	Texaco (16)	3.9	3.4	2.6	2.7
16	AEP (21)	3.8	2.7	2.5	2.1
17	ExxonMobil (15)	3.7	3.6	2.5	2.8
18	Chevron (17)	3.4	3.2	2.3	2.5
	Conoco (17)	3.4	3.2	2.3	2.5
	TXU (19)	3.4	3.0	2.3	2.3
	Total	149.7	127.7		

\* Volumes represent North American physical natural gas sales and exclude financial transactions. Sales volumes are provided by company officials.

\*\* Share of 20 largest marketers.

<sup>1</sup> Number in ( ) indicates 1999 ranking.

<sup>2</sup> Formerly Southern Energy, Inc.

<sup>3</sup> Formerly Koch Energy Trading and Energy Power Marketing Co.

Source: Natural Gas Intelligence, February 19, 2001

Table 2 shows the sales of the 24 largest power marketers during 1999 and 2000, ranked by sales in 2000. Each seller's share is based on an estimated 4.5 billion Mwh sold in 2000. We have no comparable annual aggregate sales estimate for 1999. In 2000, the shares of the 24 largest power marketers ranged from 1.0 percent to 13.0 percent. Enron's electric power sales increased by more than its natural gas sales, almost doubling its sales of power from 1999 to 2000.

Table 2  
Top 24 North American Wholesale Power Marketers  
Ranked by 2000 Sales Volume\*

2000 Rank	Company	2000 Power Sales (Mwh)	1999 Power Sales	2000 Share
1	Enron Power Mktg	590,203,540	299,291,856	13.04
2	American Electric Power	401,303,435	N/A	8.87
3	PG&E	283,028,196	174,708,763	6.25
4	Duke	276,239,139	84,813,982	6.10
5	Reliant	204,312,370	76,809,162	4.51
6	Mirant/Southern	202,627,106	165,005,787	4.48
7	Aquila	186,737,141	178,866,993	4.13
8	Edison Mission <sup>1</sup>	180,234,278	N/A	3.98
9	Cinergy	166,425,713	N/A	3.68
10	Constellation	162,409,998	50,437,888	3.59
11	Williams	138,398,312	61,076,042	3.06
12	Dynegy	137,700,000	60,000,000	3.04
13	El Paso	115,264,070	52,368,955	2.55
14	Avista	106,872,806	101,493,643	2.36
15	Pseg Power	100,702,555	N/A	2.23
16	Peco Energy	82,755,646	N/A	1.83
17	Koch Energy	76,311,750	39,621,885	1.69
18	Morgan Stanley	63,164,521	26,004,331	1.40
19	Allegheny Energy	61,886,191	3,023,115	1.37
20	PP&L	60,431,909	8,393,321	1.34
21	Sempra	59,182,334	15,074,461	1.31
22	Entergy	55,129,565	39,043,601	1.22
23	Merrill Lynch	53,579,665	N/A	1.18
24	Tractebel	47,723,370	50,932,092	1.05

<sup>1</sup>Citizens Power merged with Edison Mission  
Source: Power Marketer Week, February, 26, 2001.

The interpretation of Table 2 is similar to that of Table 1, with one exception. In this case we have an estimate of nationwide power sales for 2000. The shares we computed are likely to be closer to actual shares of a national market than the natural gas marketers' shares appearing in Table 1. We still suggest caution because the data in Table 2 are presented as accurate to the Mwh, but the nationwide power sales estimate is presented to the nearest 500 million Mwh and we are unsure of the source of the nationwide estimate.

The year 2000 was the first full year EOL was in operation, and Enron has credited EOL with helping Enron increase its sales. Enron spokesman Eric Thode said:

Gas and power use was up all across the United States [in 2000] for a variety of reasons and EnronOnline certainly brought a great deal more traffic to Enron than we had ever seen in the past. Whereas someone may

have done 10 transactions a month with us in the past last year they were doing 20.<sup>5</sup>

#### **EnronOnline's Share of Annual Natural Gas and Power Trading**

As shown above, Enron accounts for approximately 16-percent of gas trading and 13-percent of power trading. Enron has recently claimed that 60-70 percent of its gas and power trading in North America occurs on EOL. A very rough estimate of the share of gas and power trading over EOL can be obtained by applying the 70-percent figure to Enron's gas and power sales. The result suggests that trades on EOL account for about 9 percent of all wholesale power sold and 11 percent of the gas sold by the 20 largest gas sellers.

There are indications that Enron's phenomenal growth may be slowing. According to data from *Gas Daily*, Enron's gas sales for the first quarter of 2001 have declined while their competitors sales have increased, and Enron's share of total sales is off slightly from the last quarter of 2000.<sup>6</sup>

Neither Enron's share of the gas trading or power trading are very high – certainly not high enough to cause any concern at present. Given the youth of electronic trading, and the rapid changes in the industry, we believe it would be prudent to keep watch over all forms of trading, electronic or otherwise.

#### **Electronic Trading of Natural Gas and Power**

The Team found that e-trading is not a separate market from traditional phone and fax. In addition to having EOL and at least one other Internet trading platform on their desktop computers, traders have links to many voice brokers. It is not unusual for a trader to be linked directly to eight voice brokers. Thus, a trader can quickly obtain price quotes from many sources when making a trade.

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<sup>5</sup>*Natural Gas Intelligence*, "Top Gas Gorillas Show Phenomenal Volume Growth," February 21, 2001.

<sup>6</sup>*Gas Daily*, "Top Marketers by Volume," for first quarter of 2001 and last quarter of 2000.

*Size of e-trading*

E-trading of natural gas and electric power began to grow rapidly only after EOL started operation. Forrester Research, Inc., estimates that 38 percent of physical natural gas, and 17 percent of physical electric power marketed in the United States during 2001 will be traded on line. Forrester Research estimates that by 2005, 72 percent of gas and 45 percent of power will be traded on line.<sup>7</sup>

Appendix A shows a list of electronic trading platforms identified by the team. The Appendix shows the ownership of the platform (where available), the type of exchange (many-to-many or one-to-many) and an indication of the volume of transactions on the platform.

**Analysis of Competition Faced by EnronOnline**

Early e-trading, such as on Altrade, allowed buyers and sellers to post their bids and offers. The general opinion in the industry was that this many-to-many model would be how e-trading would develop.

Today there are more many-to-many platforms, but the most successful platform, EOL, uses the one-to-many model. Appendix A shows the reported volume and notional value<sup>8</sup> of the platforms. There appears to be considerable hype about trading volumes and we are not sure how much weight can be placed on the reported notional values.

The industry acknowledges that EOL is by far the leading exchange. EOL's current notional value is \$2.8 billion per day.<sup>9</sup> Ken Lay, the Chairman of Enron, recently said that EOL's "four biggest competitors represent an eighth of what we [EOL] have."<sup>10</sup> Yet the ICE claims trades of \$700 million per day, roughly one-quarter the volume of EOL. Tradespark claims trades of \$456 million per day. While we cannot be sure whose

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<sup>7</sup>Forrester Research, "Net Energy Hits Hypergrowth," April 2001.

<sup>8</sup>The term notional value is usually used in conjunction with derivatives. In that context it means the principal of a contract multiplied by the number of units. For example, in a swap contract, the principal value of the underlying asset is its notional value.

<sup>9</sup>Slide presentation made by Dave Forster of Enron.

<sup>10</sup>*Gas Daily*, April 4, 2001.

claims are correct, to our knowledge no one has challenged Ken Lay's claim. In addition, in our discussions with energy traders, we were told that the partners of ICE (and perhaps Tradespark) are required to execute a certain amount of trades on that platform and that the reported trading on that platform may be limited to a few participants.

Late last year, Dynegy introduced a one-to-many e-trading platform to compete with EOL. Even though Dynegydirect uses the one-to-many platform, it has found that the one-to-many model alone does not guarantee success. As an enticement to traders, Dynegydirect offers next hour power products which are not offered by EOL. However, Dynegydirect has some usability problems. It requires installation of special software, and some traders have difficulty using Dynegydirect behind their corporate firewalls. Dynegy told us that they were in the process of writing a version of Dynegydirect that does not use special software. Of all the traders we interviewed, the only ones who use Dynegydirect were traders at Dynegy itself.

In our tours of trading rooms, we found traders often had ICE on their desks in addition to EOL. One trader told us that he thought that ICE was coming along and might eventually be a real competitor of EOL.

NYMEX is also a potential competitor to EOL. NYMEX is designing an e-trading system, called enymex, to trade energy financial products tied to the NYMEX's liquid products. It is several months late and apparently will be many more months late. When we asked NYMEX staff about enymex, they did not respond. The staff at Kiindex said NYMEX fired the people writing the software for enymex and hired Kiindex to write it.

Forrester Research predicts that ICE and Tradespark, supported by their large partners, along with enymex will survive to supply competition to EOL.<sup>11</sup>

#### **Reasons for EnronOnline's Dominance of E-trading**

Before EOL, many traders were prejudiced against e-trading and believed that the personal touch was need for successful energy trading. There were many attempts at e-trading before EOL. As far as we can determine, they all used the many-to-many platform model, bringing together and then matching many buyers and sellers. They were often expensive to use and required dedicated communication lines and computer hardware. The cost for the service alone could approach \$1,500 per month. In addition, these exchanges would charge a fee for every transaction. Traders at one trading house

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<sup>11</sup>Forrester Research, "Net Energy Hits Hypergrowth," April 2001.

described these systems as sitting in an isolated area where no one would go to look at what was happening on them.<sup>12</sup>

EOL introduced several innovations that quickly overwhelmed its competition. What may be the most important innovation was designing EOL to be used with a Web browser. In addition, Enron does not charge traders to use EOL. Suddenly, every trader had access to electronic trading at no cost.

Still, EOL may not have been successful if it had been difficult for traders to use. Not only is EOL easy for traders to use, it was easier and cheaper for Enron to create than the competing many-to-many model.<sup>13</sup> One of the reasons it is easy to use is that all a trader need do to buy or sell a product is point and click on a price. In contrast, it is harder and more expensive to develop an easy to use many-to-many system because it must permit traders to post their own bids and offers, and then match the orders. A one-to-many system in which Enron's own traders do all the posting behind the scenes is less complex and easier to develop.

One of the problems plaguing e-trading before EOL was that traders could not be sure that the counterparty to a transaction would perform. On organized exchanges this function is performed by a clearinghouse. Altrade attempted to solve this problem for gas trading by paying an insurance company to ensure performance. This increased the fees charged by Altrade. EOL solves the problem by placing Enron as a counterparty to every transaction and guaranteeing performance with Enron's reputation and credit.

Traders would be reluctant to use EOL if they had reason to believe that Enron is abusing the system. For example, technology exists that would allow Enron to show different prices to different traders. If Enron were to show different prices, traders would not be able to trust EOL. This would likely result in loss of business that would cost Enron more than it could gain by this behavior. We were told in our interviews that traders in different firms occasionally compare prices on EOL to make sure Enron is not doing this. Traders also compare notes about their experiences with EOL. In our interviews, traders expressed positive opinions about EOL and often said it performed a useful service. We asked traders if they believed that Enron was abusing EOL. No trader expressed the opinion that he was cheated by EOL.

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<sup>12</sup> Interview with Allegheny Energy Global Markets, July 12, 2001.

<sup>13</sup> *The Economist*, E-strategy brief: Enron, June 28, 2001 (EOL was created at a cost to Enron of approximately \$20m or so in back-office upgrades.).

The success of EOL has proven the viability of energy e-trading and encouraged others to develop their own e-trading platforms in competition with EOL.

#### Analysis of EnronOnline

*EOL provides Enron with the advantages of better price discovery, lower costs, lower risk exposure and better market information*

Enron is the only large energy marketer or trader to transact a significant portion of its business using e-trading. The result is that EOL provides Enron with a number of competitive advantages that have allowed Enron to increase its share of the energy trading market. Among the competitive advantages are:

- EOL provides Enron's traders with wider access to the market.

EOL puts Enron's bids and offers on the desktop screens of almost every wholesale gas and power trader. The first set of prices traders check are often those on EOL.

- EOL reduces transactions costs.

EOL reduces Enron's transactions costs. These cost reductions allow Enron to buy at a higher prices and sell at a lower prices and maintain the same profit margins (narrower bid-offer spread). All trading firms have computerized back office record keeping and risk management systems. Once a deal is completed, information is manually entered into these systems. EOL reduces Enron's cost of entering transaction data by electronically moving the information directly from EOL to Enron's back office data processing systems. Enron claims that EOL has reduced its transactions costs by 75 percent.<sup>14</sup>

- EOL reduces costs by increasing trader productivity.

At the same time that it reduces data entry costs, EOL allows Enron's traders to be more productive. Thus Enron's costs are further reduced by allowing more business to be transacted by fewer people. Enron's *2000 Annual Report* states that "EnronOnline has pushed productivity through the roof." Transactions per "commercial person" rose from 672 in 1999 to 3,084 in 2000.<sup>15</sup>

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<sup>14</sup>Enron Corp., Press Release, May 23, 2001.

<sup>15</sup>Enron Corp., *2000 Annual Report*, p. 9.

- EOL reduces transaction time and limits Enron's risk exposure.

The automated nature of EOL decreases time needed to process a transaction, thus EOL reduces Enron's exposure to price fluctuations. The time between the placement of an order and its execution has been reduced from as much as two hours to a "split-second."<sup>16</sup>

- EOL provides Enron's traders with better market intelligence.

The ability to capture all transactions on EOL in real time allows Enron to build a data base of these transactions. Some traders interviewed by the team believe that Enron uses analytical software to keep its traders up-to-date on what is happening in the markets. They believe that the real time analyses allow Enron's traders to be better informed than other traders.

#### *What traders have told us about EOL*

The traders we interviewed told us that prices on EOL are very competitive. No trader interviewed by the team accused Enron of market manipulation. In fact, the Commission's Hotline has not received complaints about anticompetitive activities by Enron through EOL.

Some of the traders we interviewed told us that during the tumultuous markets earlier this year, when the market dried up Enron, through EOL, was willing to make a market for power in some areas.

One trader told us that the wide range of products on EOL often provides him with a way to liquidate a position where none existed before. He said that he may lose something on the sale to Enron, but that a small loss is better than losing it all.

#### *Effects of EOL on Enron's Share of the Energy Sales*

E-trading has been very successful for Enron. While it took Enron nearly a decade for its daily gas transactions to reach 13.9 Bcf in 1999, in its first year EOL helped nearly double daily gas transactions to 24.7 Bcf in 2000.<sup>17</sup>

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<sup>16</sup>*The Economist*, E-strategy brief: Enron, June 28, 2001.

<sup>17</sup>Enron Corp., *2000 Annual Report*, p. 9.

*An Additional Consideration - Credit Impacts*

As part of our review of EOL, we compared bilateral trading, such as EOL's one-to-many format, with exchange trading, which follows a many-to-many format. In bilateral trading, publishing transactions prices and volumes is at the discretion of the trading parties. Price and volume data for individual transactions in the energy industry are almost never made public.<sup>18</sup> However, publishing transaction prices and volumes normally is a feature of many-to-many exchanges.

Another difference between the two trading types is less frequently discussed. This relates to credit limits on the participants. On a many-to-many exchange, the risk of any party defaulting is spread over all the counterparties trades. In a bilateral trade, the risk of any party defaulting is borne by the one party making the one-to-many market.

Thus, with regard to credit, the many-to-many exchange and bilateral trade are in sharp contrast. In a many-to-many exchange, credit risk is dispersed among all market participants. Accordingly, a market participant in a many-to-many exchange may be able to buy more products than a single seller in a one-to-many market can sell to him.

In contrast to a many-to-many exchange, the one party making a one-to-many market will shoulder all the risk of possible defaults by counter parties. If the market maker of a one to many market does not carefully control its exposure to the risk of default by an opposite party, it may find its financial stability compromised.

The problem described above leads to the concern that the market maker on a one-to-many exchange might fail as a result of overextending credit and being unable to collect what others owe him. This, in turn, raises the issue of how such a failure might affect the physical market in which it occurs.

At present, we see no reason to believe such failure is a likely event. We do believe, however, that Commission policies and individual decisions may affect the risk of default by parties who are themselves affected by Commission actions. We therefore urge the Commission and staff to consider that possibility as they contemplate policies and decisions, with an eye to preventing default risk arising as an "unintended consequence" of a particular action.

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<sup>18</sup>While marketers often report information about transactions to the trade press, the press does not usually publish prices and volumes associated with individual transactions.

**Price Transparency and Indexes Based on Trading on EOL**

In addition to our main task, the team was asked to consider the Commission's response if Enron should request the Commission to approve an index based on EOL transactions. In addition to providing price indications for various products, the indexes could be used to set prices for contracts and swaps.

Natural gas and power indexes reported in the press typically are anecdotal. To develop an index, a reporter usually surveys a number of traders and uses the results to compute the index. The reporter has no way to verify that the prices and volumes reported represent actual trades. There is no price transparency. Even with these shortcomings, industry participants rely on them, recognizing their limitations.

Recently, Natural Gas Intelligence (NGI) and Gas Daily began to publish gas price indexes based on e-trading. *NGI* states that the data in its index are provided only by EOL, but invites other e-trading platforms to contribute to the indexes. *Gas Daily* does not identify the e-trading platforms used to compile its indexes. Enron does not provide actual transaction prices and volumes to these publications. It only provides them with weighted average prices.<sup>19</sup>

Reportedly, on July 1, 2001, Enron began providing the Natural Gas Exchange Canada (NGX), with actual transactions for several products traded on EOL. The transaction data are used to compute indexes published by NGX.<sup>20</sup>

Since EOL does not make transaction prices and volumes public, there would be no way to tell if an index supplied by EOL was being manipulated by Enron. Therefore, we recommend that a condition of approval be that EOL post all transactions in products covered by the index.<sup>21</sup> The posting should include the name of the product traded,

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<sup>19</sup>Telephone conversation with Enron representatives, July 27, 2001.

<sup>20</sup>Gas Daily, May 16, 2001.

<sup>21</sup>In a recent Commission decision, the Commission rejected Portland General Electric Co.'s (PGE's) request to use EOL to make inter-affiliate sales. The Commission rejected PGE's tariff amendments because there were insufficient protections to prevent EOL from selling power to PGE at above-market prices and to permit unaffiliated customers and others to monitor inter-affiliate transactions. Portland General Electric Company, 96 FERC ¶ 61,093 at 61,379 (2001).

price, volume, date and time of each transaction used in the computation of the index.<sup>22</sup> In this way, traders will be able to police the index. The Commission should also ensure that there is reasonably active trading in the products included in the index to prevent Enron from using a few "sweetheart" trades to set the index value.

#### **Conclusion and Recommendations**

Given Enron's size as the largest marketer of natural gas and electric power and EnronOnline's dominant position in e-trading in the energy industries, is there cause for concern on the part of the Commission?

Trading on EOL replaces marketing (bilateral trading) by Enron that previously took place by telephone and fax. EOL provides a more efficient method of bilateral trading and provides Enron with a competitive advantage. Our evaluation shows that there is no reason for concern about EOL at this time.

Enron is the largest marketer with a 16-percent share of sales by the 20 largest gas marketers and 13-percent share of all sales of power marketers. In addition to Enron, there are other large marketers in both industries.

E-trading is not a separate market segment. It is an integral part of the wholesale gas and power market. Traders usually have EOL and at least one other Internet e-trading platform on their desktop computers, plus links to many voice brokers.

EOL provides Enron with considerable competitive advantages, such as better access to the market, lower transactions costs and better information. EOL began operation in late 1999, and in the following year Enron significantly increased its sales and market shares in both industries. Enron executives readily credit EOL with helping to achieve these sales gains.

Trading on EOL replaces marketing (bilateral trading) by Enron that previously took place by telephone and fax. EOL provides a more efficient method of bilateral trading and provides Enron with a competitive advantage.

While we found that there is no reason for concern about EOL at this time, deregulation and the introduction of e-trading are causing rapid changes in the energy

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<sup>22</sup>These transactions should also be downloadable from EOL so that industry participants, the Commission and the public can analyze them.

industries. If Enron and EOL continue to grow at their current pace, competitive problems could develop. On the other hand, if viable competition to EOL develops, then EOL's competitive advantages will diminish. The team recommends that it continue to monitor EOL and electronic trading of natural gas and electric power to keep abreast of developments and to maintain the expertise developed by the team.

While the Commission has not received Hotline complaints about EOL, if a pattern of complaints should arise, the Commission should consider conducting an inquiry into Enron's practices in trading specific products.

Appendix A  
E-Trading Platforms

Platform	Company	Commodity	Volume	Year
Altra	Altra Energy Technologies, Inc.	Gas Liquids Nat. Gas Liquids Crude Oil Power	Many to many	1996 <sup>1</sup>
APX	Automated Power Exchange Bloomberg, L.P.	Power	Many to many	1996
Bloomberg PowerMatch		Gas Petroleum Power	Many to many	
CoralConnect	Coral Energy an affiliate of Shell	Gas	Many to many	1999
Dynegydirect	Dynegy, Inc.	Gas Nat. Gas Liquids Power	One to many	2000
Enemetrix Network	Alliant Energy Bank of America Cnergy DQE Enterprises, Inc. General Electric InSight Capital Partners Unitil Corporation Enron Corp.	Gas Power	Many to many	1999
EnronOnline		Bandwidth Coal Credit Derivatives Crude Oil & Products Emission Allowances Gas Metals NGLs, Peichems. & Plastics Power Pulp & Paper Shipping Steel Weather Derivatives	One to many	1999

E-Trading Platforms

HoustonStreet.com	<p>BayCorp Holdings (majority owner)</p> <p>Bowstreet Conoco Electrabel Elliott Associates LP Enron Equiva Trading Company Micro Arts Omega Advisors RWEE Thomas H Lee Company Viventel Vivendi and IRoad Ventures Williams Energy</p>	Many to many	Crude Oil Gas Power Refined Products	\$8.3 million per day <sup>6</sup>	2000
Intercontinental Exchange	<p>American Electric Power Agulla Energy BP Amoco Continental Power Exchange Deutsche Bank AG Duke Energy Eli Paso Goldman Sachs Mirant (formerly Southern Energy) Morgan Stanley Dean Witter Piedmont Energy Group Royal Dutch/Shell Group SG Investment Banking Totalima EIT</p>	Many to many	Crude Oil Gas Power Precious Metals	\$733 million per day <sup>7</sup>	2000
NGX-Natural Gas Exchange	OM Group of Sweden	Many to many	Natural Gas	Not available	1994

E-Trading Platforms

Nymex Energy Trading	Member companies	Many to many verdict	Crude Oil Gas Petroleum Products Future Products Coal Metals Power	Not applicable	Not operational
RedMeteor Inc.	RedMeteor, Inc.	Many to many	Crude Oil Gas Nat. Gas Liquids Power Refined Products	\$58 million per day <sup>a</sup>	2000
TradeSpark	Centor Fitzgerald Coral Energy Dominion Dynegy, Inc. Especc, Inc. Koch Energy Trading (Axa Energy) TXU Energy Trading Williams Energy Marketing & Trading	Many to many	Gas Power	\$387 million per day <sup>a</sup>	2000
True Quote.com	APB Energy Inc. Enform Technology LLC Microsoft Corp. PG&E National Energy Group (minority equity stake) Unitil (minority interest)	Many to many	Coal Gas Power	\$350 million per day <sup>b</sup>	June 2001
UnitGrid	Exelon Capital Partners (PECO Energy) ACE USA Power Products	Many to many	Gas Power Trans. Scheduling	Not available	2000

## E-Trading Platforms

1. *AMR Research, Inc., April 18, 2001* Altra Energy Technologies—Profitable, self-sustaining, and growing at a rapid rate with more than \$1 billion of transactions per month, Altra is working hard on integrating to back-office systems. (News article).
2. Established in 1996 as Altrade and renamed Altra in 1999. (Press release).
3. Approximately \$860 million in transactions were processed by APX in 2000. (Press release).
4. (BUSINESS WIRE)—April 17, 2001 Dynegydirect, the company's electronic commerce portal, recorded nearly \$9 billion in notional transactions during the first quarter 2001. North American gas volumes increased 11 percent to 10.7 billion cubic feet per day (Bcf/d) in the first quarter 2001, up from 9.6 Bcf/d in the first quarter 2000. Total power produced and sold increased 19 percent to 26.1 million megawatt hours (MM MWh) in the first quarter 2001, compared to 21.9 MM MWh in the first quarter 2000. (News article).
5. *Thursday, July 12, 2001* During the quarter, EnronOnline, Enron's eCommerce transaction platform, surpassed one million transactions since inception in late 1999, with over \$685 billion of total gross value transacted to date. EnronOnline continues to advance functionality and price transparency for customers, as well as increase Enron's transaction efficiencies and reduce costs. (Press release).
6. *PORTSMOUTH, N.H., Oct. 2, 2000* — Bolstered by ever-increasing trading volume and a shift toward doing business on the Web, HoustonStreet Exchange's crude oil and refined products platforms last week surpassed more than \$1 billion in trades in just over four months after going live. (Press release).
7. Atlanta, GA (July 16, 2001) —For the second quarter of 2001, IntercontinentalExchange™ traded more than 10.7 billion MMBTUs of natural gas (with a notional value of \$52 billion), and 272 million MWhs of power (with a notional value of \$14 billion). Current power volumes average 7.5 million MWhs daily while current natural gas "Exchange look-alike" volumes average in excess of 20% of corresponding daily NYMEX volumes. For crude oil and oil products combined, trade volume in the second quarter was almost 535 million barrels. Overall trading on the Exchange in the second quarter of 2001 was up 192% with total transactions on the exchange for the three-month period exceeding 77,000. (Press release).
8. Operating an energy exchange, RedMeteor provides a digital market for commercial trading of crude oil, refined products, natural gas, natural gas liquids, and power. Brokerage activity in our energy markets exceeds \$2 billion per month. *Press release of April 6, 2001* Total volume brokered in the first quarter 2001 through RedMeteor reached 185 million barrels with a notional underlying value exceeding \$5.3 billion.
9. New York, July 10, 2001 - TradeSpark experienced a 189% increase in the amount of natural gas MMBTUs traded, and a 29% increase for electricity megawatt hours over the previous quarter. For the second quarter 2001, the electronic energy marketplace traded more than 6.8 billion MMBTUs of natural gas instruments (with a notional value of over \$33 billion) and 155.3 million MWhs of electricity instruments (with a notional value of approximately \$9.2 billion). (Press release).
10. Represents the buy side for True Quote authorized agents. Includes gas, electricity and coal. (Telephone conversation)

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Committee on Governmental Affairs

EXHIBIT #A-29

United States Senate

COMMITTEE ON  
 GOVERNMENTAL AFFAIRS  
 WASHINGTON, DC 20510-6250

May 14, 2002

The Honorable Pat Wood, III  
 Chairman  
 Federal Energy Regulatory Commission  
 888 First Street, N.E.  
 Washington, DC 20426

Dear Mr. Chairman:

The Senate Governmental Affairs Committee is conducting a broad inquiry into whether the federal agencies charged with overseeing the activities of Enron Corp. appropriately discharged their regulatory responsibilities. As you know, the Federal Energy Regulatory Commission (FERC) is among the agencies whose activities we have been reviewing.

I write to express deep concern about information revealed during the course of our investigation. As discussed further below, our inquiry to date raises serious questions about whether FERC appropriately discharged its duties to monitor and regulate energy markets, followed through on warranted reviews of Enron's energy trading business, and heeded important warning signs of problems in Enron's business activities.

Specifically, the Committee's investigation has discovered that FERC launched an internal inquiry into Enron's electronic energy trading activities in May 2001—an inquiry that asked some of the right questions about Enron's market practices, but ultimately settled for incomplete, unconvincing, or incorrect answers to those questions. Equally disappointing, FERC failed to follow up on some of the most serious concerns raised in the course of its inquiry. All this occurred at a time when internal Enron documents uncovered during the Committee's investigation show the company placed a high priority on maintaining the unregulated status of its electronic trading activities. In the end, the 2001 FERC inquiry is ultimately more noteworthy for what it overlooked than for what it scrutinized, leaving consumers unprotected.

Going forward, these events add to the numerous warning flags already flying in FERC's view. As new energy markets emerge, the nation's consumers have the right to expect their government regulatory agencies to be as aggressive in protecting and promoting their interests as energy companies are in exploiting new markets. We simply cannot accept anything less than proactive and energetic efforts by FERC to understand, monitor and, where necessary, regulate changing market developments. Our inquiry thus far suggests that FERC has yet to prove it is up to this challenge. While we cannot at this point conclude that a more proactive FERC inquiry would have sounded the alarm about Enron's shaky financial condition, a better investigation may well

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have exposed the cracks in Enron's foundation sooner. At a minimum, a more searching inquiry into Enron's opaque trading practices would, we hope, have led FERC to question whether it truly was discharging its duty to maintain just and reasonable energy rates.

The troubling story of FERC's 2001 inquiry into Enron Online is laid out below. I would appreciate your reviewing the information contained in this letter and providing the Committee with assurances that FERC has a plan in place to redress the institutional failures that story reveals. I intend to call FERC before the Committee to review the matters discussed in this letter, as well as other issues currently under review by Committee staff.

\* \* \* \* \*

For the past 15 years, FERC has played a central role in transforming the wholesale natural gas and electric sectors from highly regulated systems dependent on FERC-approved cost-of-service rates to loosely regulated, highly competitive markets. This changing environment has given rise to new participants and market platforms as well as new corporate models -- such as the Enron Online trading service used by Enron Corporation -- seeking to take advantage of the new business opportunities it presented. Throughout this process, FERC has been required to play multiple roles: (1) continuing its traditional regulatory role in those cases where cost-of-service rates and regulatory approvals are still required, (2) taking on the new responsibility of leading the design and approval of untested market-oriented policies and institutional structures, and (3) maintaining throughout this period its statutory obligations to ensure that wholesale rates are just and reasonable, as required by the Natural Gas Act and the Federal Power Act and related statutes.

As evidenced by the catastrophic failure of the California electricity market, regional price spikes in both electricity and natural gas prices, and most recently the precipitous collapse of Enron -- the nation's largest energy marketer -- navigating the waters of this transition continues to be a complex and difficult process. It is this very complexity and difficulty that requires a new sense of vigilance on the part of FERC, the leading federal agency in this arena. While FERC has taken on such a proactive role in revising natural gas and electricity regulations to create new market-based utility practices, it has taken a decidedly reactive approach to fulfilling its obligations to ensure that rates are just and reasonable each and every day for America's businesses and consumers in these new, complex, and still evolving markets.

Despite the fact that deregulation of energy markets had opened the door for companies like Enron to create entirely new marketing models, such as Enron Online, and rapidly capture a sizable percentage of the market, it appears that FERC's efforts to understand and adjust its regulatory approach to these new entities was, and is, severely lagging. As recently released internal Enron memoranda make clear, that company sought to manipulate California's energy market and engaged in abusive trading practices during the 2000-2001 energy crisis in California and other Western states. Yet FERC apparently waited nearly two years after the first allegations of market dysfunctions arose before launching a formal inquiry into the potentially abusive actions of individual companies.

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In May 2001, FERC's General Counsel did initiate a related, staff-level inquiry -- one into the status of electronic trading in the electric power and natural gas markets, in general, and the role played by Enron Online, in particular. A report discussing electronic trading and Enron Online's operation and the significance of its dominant share of these markets was completed on August 16, 2001.

The report found that, unlike some online trading platforms which operate as third-party, "many-to-many" exchanges matching willing buyers and sellers, Enron Online appears to have operated as a proprietary extension of Enron's trading units, including entities regulated by FERC. In other words, an Enron trader was a party, either as a buyer or seller, to every trade on Enron Online. Therefore, only Enron would know valuable information about the actual volumes and prices transacted on its trading platform -- and, of course, how the prices charged in any particular transaction were set or how they compared to those charged in other, similar transactions.

The report also observed that Enron Online simply served as a trading platform for other Enron subsidiaries, shouldering no financial risk on its own. In other words, the financial risk of all the trades conducted through Enron Online remained with these other subsidiaries. This meant the solvency of Enron as a whole was important to the viability of Enron Online and to Enron's trading activity.

With that observation in mind, the report asked whether financial problems at Enron would threaten the energy markets. The report answered the question in two ways. First, it concluded that Enron did not have sufficient market share to disrupt the energy market if it failed. According to the report, Enron accounted for 16 percent of gas trading and 13 percent of electric power trading in North America, with the majority of Enron's trading transacted through Enron Online. In the report's view, the energy market could continue functioning smoothly absent Enron's market share. Second, the report concluded that, in any event, the chance of Enron failing financially was remote. The report provided little support for this conclusion.

Finally, the report found that Enron Online gave a competitive advantage to Enron's own trading units by reducing their transaction costs, giving them wider access to the market, and providing them better market intelligence.

In short, though the report identified a number of areas that ought to have troubled FERC as the federal government's lead energy regulator, it found no reason for concern and no cause for action. This, I am afraid, was a critical mistake.

First, though FERC staff identified the potential risk inherent in (a) a trading model that exposed the corporation to very large financial risks, and (b) the company's dependence on its corporate credit worthiness to maintain its trading capability and to fulfill its trading commitments, staff failed to take the logical next step to thoroughly understand the significance of this finding.

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Instead, they conducted only a cursory analysis of Enron's financial standing, concluding that Enron was unlikely to fail as a result of overextending credit to its trading customers. This was obviously a mistake; although the scenario imagined in the report did not come to pass, in fact Enron was financially unstable, and within two months, had collapsed completely.

Second, the analysis that led to the conclusion that Enron's market share was insufficient to negatively impact the market in the event of the company's failure was far too cursory. The report based its conclusion upon limited industry-supplied data that looked only at the national picture. FERC should have based its conclusion on more thorough data from actual regional markets, where market concentration would likely have been of greater concern.

Third, while FERC concluded that it need not worry about the competitive advantage that Enron Online provided to Enron traders, Congress has received testimony that this arrangement may well have been unfair. In fact, Enron had a dominant position in the market through Enron Online, and the system gave Enron traders exclusive access to valuable information about market conditions unavailable to other participants. The extent to which Enron took improper advantage of this opportunity is unknown, but recent disclosures, contained in internal memoranda provided to FERC detailing potentially abusive Enron trading practices in 2000 and 2001 in the California and Western energy markets must lead to a review by FERC of the possible use of Enron Online by Enron's traders to facilitate such abuse.

Fourth, FERC staff failed to follow up on many of the issues raised by the report. Most troubling, given the concerns identified in the report related to Enron's financial risk, it appears that there was never any formal process established within FERC for monitoring the financial status of Enron - North America's largest energy trader - not even following the unexpected resignation of Enron CEO Jeffery Skilling on August 14. This was a key red flag that occurred just days before the final report was transmitted to FERC managers and helped persuade staff at the Securities and Exchange Commission (SEC) to begin that agency's investigation into Enron's financial condition. Even once the full magnitude of Enron's financial problems began to take shape in mid-October following Enron's restatement of earnings and public confirmation of the SEC's investigation of the company, there appears to have been no formal effort within FERC to monitor the financial condition of the company or assess possible market impacts. FERC even failed to follow the recommendation made in the August 16 report that the team that prepared it continue to monitor effectively developments at Enron Online and other electronic trading platforms. There appears to have been no effort made at the agency to ensure that this recommendation was heeded.

The significance of FERC's failures to pay more attention to Enron's financial condition is underscored by the agency's reaction, late last year, to news of Enron's collapse. When Enron's demise became evident in November 2001, FERC officials were apparently troubled enough about the potential impacts of the collapse on the energy market - the very concern dismissed in their August report - to raise these matters with representatives of the Federal Reserve, the White House National Economic Council, and Enron itself.

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Another troubling facet of the August 2001 report is that it was apparently not distributed to you or to any commissioners prior to, or during, Enron's collapse to inform your decision-making, and it is unclear at what point any of the information contained in the report may have been provided to you or other commissioners. In other words, a report that might have served as a warning wound up being little more than a footnote in the story of Enron's collapse.

Even though FERC initiated this report examining Enron Online and other electronic trading platforms – suggesting some level of concern within the agency about their growing influence – and found that, in fact, the use of online trading platforms and their trading volume were expected to grow dramatically, the agency has fallen far short of giving these mechanisms the scrutiny they deserve.

In fact, an important task related to the Enron Online inquiry – the preparation of a comprehensive legal memorandum analyzing FERC's jurisdiction over online trading, including Enron Online -- was begun, but never completed. This, in my mind, is akin to the Food and Drug Administration (FDA) utterly failing to scrutinize the development of a major new class of drugs, so this effort should be quickly resurrected and completed. Completion of such a memo is also needed to clarify the jurisdictional boundaries between FERC and the Commodity Futures Trading Commission (CFTC) regarding energy trading activities and products, including online trading, and to better define the two agencies' respective market monitoring responsibilities in these developing markets. I also urge FERC to include examination of the role of electronic trading in its ongoing investigation into manipulation of the Western electric and natural gas markets.

These trading platforms are precisely the sort of emerging market institutions that one would expect FERC to anticipate, to understand, to monitor and to address as the federal government's lead regulatory agency as the natural gas and electricity sectors transition to open, competitive markets.

To date, the Committee's investigation has shown that many institutional watchdogs failed completely in their obligations to alert the public to the precariousness of Enron's business. The American people have every right to expect that federal regulatory agencies they fund with their tax dollars will act only on behalf of the public interest. It is therefore of great concern to me that FERC, having identified the specific red flag of Enron's credit and financial exposure and its potential risk to U.S. energy markets, not only concluded that such a failure was unlikely, but apparently took little action to ensure that this conclusion remained valid in the face of significant new developments – developments that prompted a sister agency to initiate first informal, and later, formal investigations. FERC's job is not simply to promote market changes, but to anticipate and monitor new developments and problems, and to protect the consumer against abuse. That latter role seems to have been neglected.

In order to further the Committee's inquiry, please provide answers to the following questions no later than May 28., 2002:

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- 1) Has the Commission reviewed the August 16, 2001 report and the circumstances leading up to and following it? Do the Commissioners believe they received the information contained in the report in a timely manner? If the Commissioners did not receive the information in a timely manner, what steps will you take as Chairman to ensure that relevant staff investigations and work products are provided to the Commissioners?
- 2) What conclusions has the Commission reached regarding the way staff handled the August 16 report and the follow-up anticipated by that report?
- 3) In light of the fact that we now know the August 16 report's conclusion regarding Enron's financial condition has been proven false, has FERC reevaluated its policies or approach to conducting financial evaluations? Does FERC have adequate statutory and regulatory authority to ascertain the financial condition of regulated entities and parent corporations, such as Enron? Does FERC have adequate requirements to ensure the creditworthiness of energy marketers?
- 4) Why did FERC apparently fail to implement the recommendation in the August 16, 2001 report to direct the inquiry team to continue to monitor Enron Online and other trading operations? What plans does FERC have for monitoring the development and operation of online trading platforms, as recommended by the August 16, 2001 report, including plans to coordinate such activities with CFTC?
- 5) Given the finding that Enron's trading model entailed significant financial risk, why did FERC take no formal action to monitor the financial status of Enron after the August 16 report, especially given changing circumstances?
- 6) Records provided by FERC show that there were interagency meetings with CFTC and with the SEC to discuss electronic exchanges, data collection, and market monitoring activities at the same time the inquiry that produced the August 16 report was underway. At the same time, FERC was also conducting an investigation into energy prices in the Northwest and a proceeding to determine whether the citizens of California were entitled to refunds from marketers like Enron. Were these apparently interrelated efforts coordinated?
- 7) Why was the legal analysis of the jurisdictional issues surrounding online trading abandoned? Does FERC intend to complete the legal analysis of the jurisdictional issues surrounding online trading originally initiated as part of the Enron Online inquiry and identified in the August 16, 2001 report? If so, when?

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Thank you in advance for your cooperation. If you have any questions concerning this request, please have your staff contact David Berick of the Committee staff at 202-224-3811.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Lieberman". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

Joseph I. Lieberman  
Chairman

FEDERAL ENERGY REGULATORY COMMISSION  
WASHINGTON, DC 20426

Committee on Governmental Affairs

EXHIBIT #A-30

May 28, 2002

OFFICE OF THE CHAIRMAN

The Honorable Joseph I. Lieberman  
Chairman  
Committee on Governmental Affairs  
United States Senate  
Washington, DC 20510

Re: Enron Corporation Investigation

Dear Mr. Chairman:

Thank you for your letter of May 14, 2002, expressing concern about information revealed during the course of your Committee's inquiry into whether federal agencies have appropriately discharged their regulatory responsibilities by overseeing the activities of Enron Corporation. In particular, you question whether the Federal Energy Regulatory Commission (FERC or the Commission) appropriately discharged its duties to monitor and regulate energy markets, conducted reviews of Enron's energy trading business, and heeded warning signs of problems in Enron's business activities.

Since I became Chairman in September 2001, the Commission has moved aggressively to protect the nation's energy customers by overhauling its market monitoring and enforcement functions, stepping up its non-public investigations into electric and natural gas market activities, and undertaking a number of generic rulemaking initiatives to develop market structures and market rules for the electric industry that will help prevent the exercise of market power and permit effective, ongoing market oversight. In addition, the agency is currently conducting a major, non-public investigation into potential market manipulation by Enron or any other entity in electric and natural gas markets in the West, since January 1, 2000. I anticipate presenting a report to Congress on this investigation this summer.

In addition, the Commission has undertaken the following initiatives to protect energy customers:

- **Office of Market Oversight and Investigation** - The Commission has appointed a director and continues to increase staffing for its new Office of Market Oversight and Investigation (OMOI). As soon as OMOI is fully staffed, it will serve as a key interface to market monitoring units (MMUs) of Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs). OMOI will coordinate closely with the MMUs with respect to local and regional market patterns and

problems, but will also look for patterns and problems across multiple regions and markets. OMOI will conduct monitoring and oversight and issue regular reports on the status of the nation's energy markets. It will also investigate possible market problems and participant misbehavior and recommend appropriate Commission responses (including enforcement actions and rule changes) to the problems it finds.

- **Regional Transmission Organizations (RTOs)** - The Commission continues to promote the development of properly structured and truly independent RTOs. RTOs will provide significant benefits to electric utility customers across the nation by eliminating obstacles to competition and enabling markets to operate more efficiently. By reducing bulk power prices and improving reliability, RTOs will benefit all electricity customers.
- **Revised Public Utility Filing Requirements** - The Commission recently issued a final rule requiring detailed quarterly electronic reporting by power sellers (including marketers) of their power sales and transmission services. This new filing requirement will improve market transparency and information accessibility by making the data publicly available, leveraging current information technology for better data analysis, and by equalizing reporting requirements between traditional utilities and power marketers. The information revealed by the new quarterly reports should enhance public confidence in the fairness of the markets and make it easier to detect and discourage inappropriate practices in the energy markets.
- **Standard Market Design** - Through its ongoing rulemaking initiative on standard market design, the Commission intends to reform public utilities' open access tariffs to reflect a standardized wholesale market design. The new tariffs will eliminate inefficiencies caused by having different rules for different types of customers using the same transmission facilities, and will provide market participants with additional wholesale power trading opportunities. The goals of this initiative include providing improved services to all wholesale market participants; reducing delivered wholesale electricity prices through lower transaction costs and wider trade opportunities; reducing opportunities to game electricity markets; improving reliability through better grid operations and expedited infrastructure improvements; and increasing certainty about market rules and cost recovery for greater investor confidence to facilitate much-needed investment. A sound market design plays a critical role in reducing the incentives and opportunities to manipulate the markets.

In addition, I believe this rule should require transmission providers to have independent administration of the day-ahead and day-of energy markets (the markets in which market power is most likely to exist) and also to have independent market monitoring units (MMUs). The MMUs would monitor market conditions and market participant behavior, identifying circumstances they believe may warrant remedial actions or rule changes in order to ensure protection of electricity customers from possible market manipulations or market power abuse. In effect, the MMUs will be a front line of defense for monitoring short-term power markets, and will work with the Commission to anticipate, prevent and remedy market problems.

- **Infrastructure** - The Commission continues to promote adequate infrastructure by anticipating the need for new generation and transmission facilities, determining the rules for cost recovery of new energy infrastructure, encouraging the construction of new infrastructure, standardizing the rules for interconnecting new generating facilities, and licensing or certifying hydroelectric facilities and natural gas pipelines.

In sum, these initiatives are designed to improve the effectiveness of competitive wholesale markets and minimize or prevent the potential for market power abuse. In furtherance of these goals, the Commission and its staff will continue to work with other federal agencies and with the states to protect the nation's energy customers and achieve the full benefits of wholesale competition within jurisdictional markets.

Your letter asks a number of specific questions regarding the Commission's actions involving Enron Corporation. I am pleased to reply to these questions as follows. For your convenience, I have repeated your questions before providing an answer.

- (1) Has the Commission reviewed the August 16, 2001 report [on Enron Online] and the circumstances leading up to and following it? Do the Commissioners believe they received the information contained in the report in a timely manner? If the Commissioners did not receive the information in a timely manner, what steps will you take as Chairman to ensure that relevant staff investigations and work products are provided to the Commissioners?

The report was concluded prior to a leadership transition at the Commission. Chairman Hébert and his General Counsel both left the agency shortly after the report was completed; I did not become Chairman until September 2001. Staff prepared the report to provide background information about the scope and development of electronic trading in the electric power and natural gas markets. You are correct that

the report does not constitute a comprehensive, critical investigation of Enron and electronic trading, but it does not appear to have been intended for that purpose. Different Commissioners received the report at different points in time, and the Commission has not taken formal action to accept or approve it.

For the future, the organizational structure of the Commission staff is being changed to create a new Office of Market Oversight and Investigation (OMOI), which will interface with RTOs' market monitoring units and will monitor markets to ensure that market rules are working. OMOI is charged with conducting aggressive investigations and enforcement efforts, and will share those with the Commissioners and Commission staff promptly through regular briefings and reports. Further, better coordination among the new office and the Commission's legal and policy offices is under way to ensure that the full Commission receives information that is relevant to our market design and protection responsibilities.

(2) What conclusions has the Commission reached regarding the way staff handled the August 16 report and the follow-up anticipated by the report?

The Commission has never formally considered the August 16 report. However, it should be noted that, while the report was not presented to the Commission for formal action, subsequent to the report, staff did continue to monitor online trading platforms and Enron's impact on the energy markets. The focal point of these monitoring efforts was to identify any significant risk to the adequacy of energy supplies or adverse effects on wholesale prices.

(3) In light of the fact that we now know the August 16 report's conclusion regarding Enron's financial conclusion has been proven false, has FERC reevaluated its policies or approach to conducting financial evaluations? Does FERC have adequate statutory and regulatory authority to ascertain the financial condition of regulated entities and parent corporations, such as Enron? Does FERC have adequate requirements to ensure the creditworthiness of energy marketers?

Historically, the Commission's economic regulation has focused on ensuring that energy markets deliver adequate energy at reasonable prices. The Commission's financial audits of public utilities generally are focused on ensuring the accuracy of information needed for determining cost-based rates. Cost-based ratemaking encourages utilities to maximize their claimed costs and minimize their expected revenues, to justify the highest possible rates. The Commission's financial audits are designed to ensure that utilities with cost-based rates do not overstate costs or understate revenues. These concerns

generally do not apply to entities such as Enron that sell at market-based rates to non-captive customers; and the 2001 examination of Enron was not a formal financial audit. Of course, the Commission is concerned about the possible market effects of any questionable trading behavior Enron and its subsidiaries may have engaged in before the company's financial collapse. That behavior is the subject of an extensive, ongoing inquiry at the Commission.

I do not believe the Commission needs more statutory authority to conduct the type of financial evaluations you suggest. The Commission has authority to obtain extensive financial information from public utilities and natural gas companies. The Federal Power Act (FPA) and the Natural Gas Act (NGA) have been construed by the Commission and the courts as focusing the Commission's role on ensuring adequate supplies of energy at reasonable prices. However, if Congress wants the Commission to play a broader role, including monitoring the financial health of market participants regardless of whether a participant's failure would adversely affect energy supplies or prices, legislative clarification of this intent may be appropriate (particularly with respect to the roles of the FERC, SEC and CFTC).

As to creditworthiness, the responsibility for ensuring creditworthiness of participants in wholesale energy trades lies primarily with the parties involved in those trades. Creditworthiness provisions are included in some contracts or tariffs filed at the Commission to date, and the Commission will consider including some broad creditworthiness provisions in the standard transmission tariffs that will be developed in its rulemaking on standard market design (to prevent the use of individual creditworthiness terms as discriminatory measures in specific geographic areas or against specific players). I do not think there is a need for legislation on creditworthiness issues in energy markets.

(4) Why did FERC apparently fail to implement the recommendation in the August 16, 2001 report to direct the inquiry team to continue to monitor Enron Online and other trading operations? What plans does FERC have for monitoring the development and operation of online trading platforms, as recommended by the August 16 report, including plans to coordinate such activities with CFTC?

The Commission staff did, in fact, continue to monitor Enron Online and other online trading platforms, such as the Intercontinental Exchange and Tradespark. In addition, staff contacted energy traders to find out if they were concerned about their financial exposure to Enron Online. In the future, the monitoring of market operations and developments, such as the development and operation of online trading platforms,

will be the responsibility of the new Office of Market Oversight and Investigation. Steps have begun to coordinate the activities of that office with the work of the CFTC.

(5) Given the finding that Enron's trading model entailed significant financial risk, why did FERC take no formal action to monitor the financial status of Enron after the August 16 report, especially given changing circumstances?

As noted earlier, the Commission's role in energy markets generally is to ensure adequate supplies of energy at reasonable prices, not to monitor the financial well-being of each market participant. The financial health of a market participant such as Enron, that sells power at market-based rates to non-captive customers, is important to the Commission's responsibilities if the company's failure could adversely affect energy supplies or prices. Although the collapse of Enron had devastating effects on shareholders and pension funds, the collapse itself did not adversely affect energy supplies or prices.

(6) Records provided by FERC show that there were interagency meetings with CFTC and with the SEC to discuss electronic exchanges, data collection, and market monitoring activities at the same time the inquiry that produced the August 16 report was underway. At the same time, FERC was also conducting an investigation into energy prices in the Northwest and a proceeding to determine whether the citizens of California were entitled to refunds from marketers like Enron. Were those apparently interrelated efforts coordinated?

The efforts you describe are not related. In May and June 2001, FERC staff met with staff at the SEC and the CFTC. The purpose of the meetings was to find out how those agencies were set up, and how they conducted their market oversight and enforcement responsibilities. It was intended to help the FERC staff identify best practices for FERC's own developing market oversight role. No specific cases or investigations were discussed in these meetings, since the focus was on the structure of the organizations and the processes used. In attendance at the meetings were some of the FERC staff who were working on various market inquiries potentially related to the jurisdiction of the SEC or CFTC. They attended in part to make contacts with staff at the other agencies who might be knowledgeable in areas of relevance and in part to determine whether the other agencies had done any work on issues of relevance to the inquiries. In short, these efforts focused on ways for the Commission's staff to gather information, identify circumstances warranting further attention and generally target its resources most effectively.

In contrast, the investigation into energy prices in the Northwest (Puget Sound Energy v. All Jurisdictional Sellers, et al., Docket No. EL01-10) and the proceeding on refunds in California (San Diego Gas & Electric Co. v. Sellers of Energy, Docket No. EL00-95) were formal judicial proceedings addressing requests for refunds in those markets. These proceedings address specific allegations that prices in those regions were not just and reasonable during 2000-2001. In the former proceeding, an administrative law judge has issued an Initial Decision, recommending against requiring refunds in the Northwest. The case is now pending before the Commission. In the latter case, a hearing is still pending before an administrative law judge. When the judge issues an Initial Decision, the Commission will determine the amount of any refunds.

In short, the meetings with the CFTC and the SEC broadly addressed the market monitoring process while the other matters you describe are adjudicatory proceedings. The laws of administrative procedure require us to maintain strict separation between contested adjudicated proceedings and other Commission activities such as the CFTC and SEC discussions.

(7) Why was the legal analysis of the jurisdictional issues surrounding online trading abandoned? Does FERC intend to complete the legal analysis of the jurisdictional issues surrounding online trading originally initiated as part of the Enron Online inquiry and identified in the August 16, 2001 report? If so, when?

In the summer of 2001, the Commission's prior General Counsel assigned an attorney in the Office of the General Counsel (OGC) to draft an analysis of jurisdictional issues related to Enron Online. An initial draft was completed in late August 2001 as an internal OGC document. This was followed by a time of transition at the Commission, including the departure of the then-Chairman and then-General Counsel. It should be noted that, under Commission precedent, the Commission has asserted jurisdiction only over the public utility sellers that sold electric energy through Enron Online and only where such energy actually went to physical delivery; further, there was no issue pending before the Commission of whether the Commission had jurisdiction over Enron Online itself or over derivatives trading over Enron Online. In recent months, however, additional factual and legal questions have arisen regarding Enron Online's role in power markets. OGC is in the process of finalizing a more comprehensive jurisdictional memo. We anticipate that this memo, which will represent privileged and confidential non-public attorney work product, will be given to all Commissioners in the next few weeks.

In summary, the Commission's August 2001 report on Enron Online is not representative of the type of investigation that the Commission is now conducting into Western energy market activities, nor of the approach we will take in the future once the OMOI is fully staffed. Our initiatives to promote standard market design and RTOs will do much to assure competitive electric markets and fair rules and OMOI will step in to enforce those rules and investigate aggressively as needed. I look forward to sharing more information on those initiatives with you and your Committee.

If I can be of further assistance, please do not hesitate to contact me.

Best regards,

A handwritten signature in black ink, appearing to read 'Pat Wood, III', written over a circular stamp or mark.

Pat Wood, III  
Chairman



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## Credit Quality for U.S. Utilities Continues Negative Trend in Second Quarter

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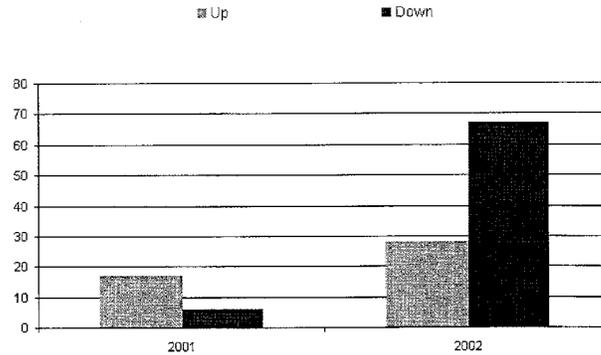
Rating activity was distinctly negative in the U.S. utility industry (electric, gas, pipeline, and water companies) in this year's very energetic first half. Although the negative trend mirrored that of the first six months of 2001, the actual number of rating changes has accelerated dramatically. Moreover, the rating actions were overwhelmingly on the negative side with an unprecedented 78 downgrades among holding companies and operating subsidiaries, compared with only six upgrades. In the second quarter alone, there were 58 downgrades and three upgrades. CreditWatch placements and outlook revisions were predominately negative. In contrast to this year's first half, there were 45 rating changes (28 downgrades, 17 upgrades) during the same period of 2001, with the bulk of the actions occurring in the first quarter. In addition, a handful of companies was placed on CreditWatch or had their outlooks changed, most of which were also negative.

The general weakening of credit quality in the U.S. power industry began well before the California and Enron Corp. debacles of 2001, but it has certainly been exacerbated by them. This deterioration can be traced to several causes:

- The erosion of bondholder protection parameters;
- Diminished liquidity and financing flexibility;
- Increased business risk derived from growing investments outside the traditional regulated utility business, particularly unregulated generation and energy trading and marketing;
- Regulatory challenges;
- Capital and corporate restructuring efforts; and
- To a lesser extent, by mergers and acquisitions.

These trends evolved as a result of companies' strategies to enhance shareholder value in an environment that had become increasingly uncertain and competitive.

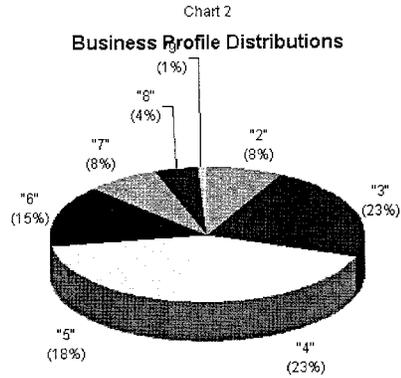
Chart 1  
Rating Actions Through June 30



#### Industry Ratings Entrenched in 'BBB+' Category

In just 12 months, the number of companies rated 'A' and above has significantly declined, while the number of firms rated 'BBB' and below has risen substantially. About 51% of the industry now carries a 'BBB' category rating, while 6% are rated below investment grade, including three companies that are rated 'D', compared with 39% and 4%, respectively, at the end of June 2001. About 43% of the utility industry carries ratings of 'A' and above, versus 55% one year earlier. It is important to note that although the average rating for the power sector as a whole has slipped into the high 'BBB' area, companies that continue to emphasize a vertically integrated structure are hanging onto an 'A-' average. But utility holding companies that have ventured too far afield from their core competencies have suffered a weakening in their market capitalization and in many instances rating downgrades.

Notwithstanding the industry's credit decline, the sector remains relatively highly rated, certainly compared with the average 'BB' category for U.S. industrials. This is a function of the large percentage of companies (86%) that have average or above-average business profiles.

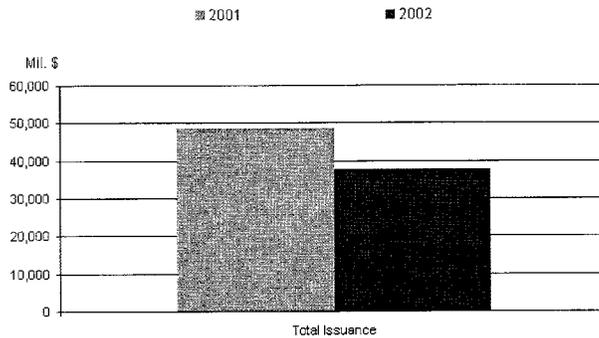


Business profiles are categorized from "1" (strong) to "10" (weak).

#### Capital Market Update

Financing activity declined in the past 12 months following a significant increase in 2000. The amount of debt and preferred stock issued during the first half of 2002 was about \$37.6 billion, compared with about \$48.5 billion issued during the first six months of 2001. The decrease is attributable to a number of factors, among them capital market jitters, especially for those issuers that require access to the capital markets, a consequent heavier reliance on bank debt, sliding wholesale electricity prices, and reduced capital expenditures across all sectors, but most significantly as the result of the postponement or cancellation of planned new power plants.

Chart 3

**Debt and Preferred Stock Issuance Through June 30****Weak Bondholder Protection Measures**

A rising incremental debt burden has driven down key financial parameters in the past two years. Total debt as a percentage of total capitalization stood at a liberal 59.4% at Dec. 31, 2001 (the latest period in which comparable data is available), versus 54% five years earlier. Much of the increase is attributable to debt raised at the parent or intermediate holding company level to fund unregulated operations. The increase in debt leverage has not been offset by a strengthening in cash flows, and the funds from operations (FFO) to total debt ratio has accordingly steadily declined, falling below 17% in 2001 from 22% in 1997. This key financial ratio is characteristic of 'BB' category companies with average business profiles. Funds flow coverage of interest and pretax interest coverage have also slipped, to 3.1 times (x) and 2.8x, respectively, in 2001 from 3.9x and 3.1x in 1997. These levels are just suitable for companies in the 'BBB' rating group. However, the aforementioned ratios actually rose, although very slightly, in 2001 from 2000 because of lower interest rates. Of course, there are several other financial and qualitative factors that determine credit quality, but given eroding financial parameters and the negative pressures on risk profiles, it may be increasingly difficult to sustain even a median 'BBB+' rating.

Chart 4  
Average Sector Pretax Interest Coverage

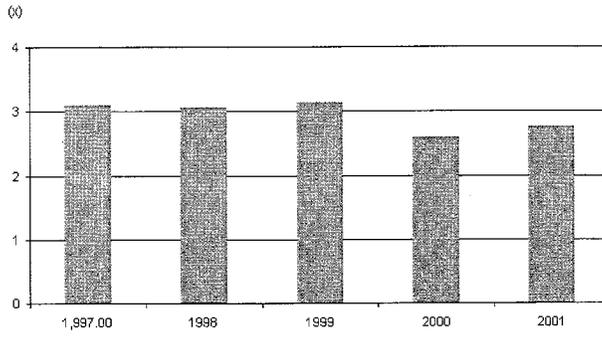


Chart 5  
Average Sector Total Debt as a % of Total Capitalization

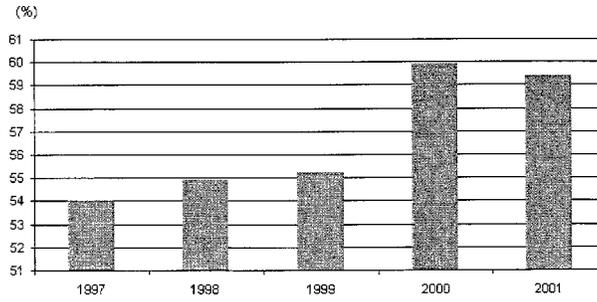


Chart 6  
Average Sector FFO Interest Coverage

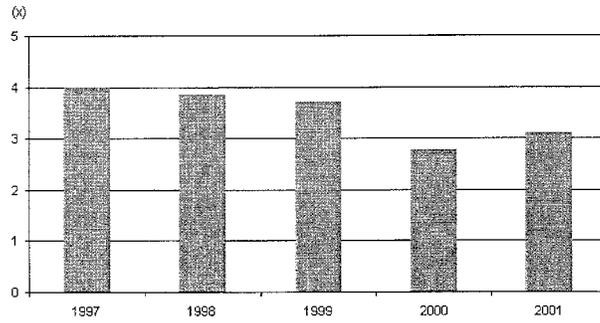
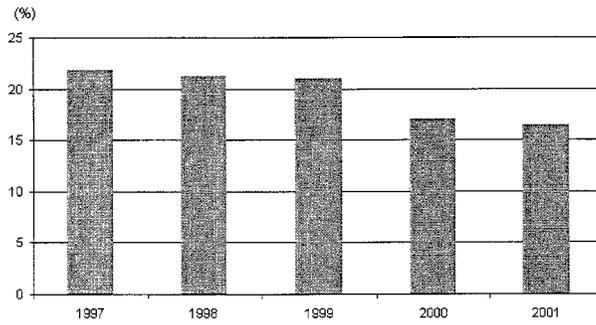


Chart 7  
Average Sector FFO as a % of Total Debt



**Looking Ahead**

At present, 62% of all utility rating outlooks are stable compared with 58% one year ago. The heightened stability is attributable mainly to the substantial

number of ratings that had carried a negative outlook and have since been downgraded. Nevertheless, the percentage of outlooks that are negative (21%) continues to strongly overshadow positive outlooks, which stand at just 1%. This negative bias results mostly from a proliferation of higher-risk business strategies, weak competitive positioning, regulatory uncertainty regarding industry restructuring, and volatility in the wholesale power market. The remaining 16% of companies are on CreditWatch--71% carry a negative listing, 16% positive, and 14% developing (which indicates that a rating may be raised or lowered). These percentages suggest that frequent rating changes will continue.

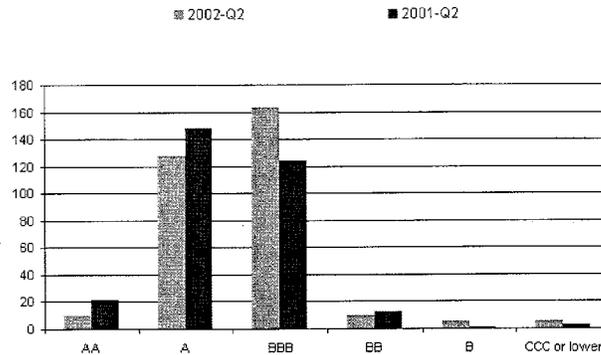
Standard & Poor's expects that most companies providing electricity and gas service will continue to maintain financial profiles that warrant, at a minimum, investment-grade ratings. This is because much of the energy industry still remains heavily regulated, with less and less near-term chance of much changing in that respect. Moreover, the momentum of the utility industry to disaggregate into its component parts appears, for now, to have stalled as companies such as Allegheny Energy Inc., Constellation Energy Group Inc., and Xcel Energy Inc have revised their strategies to remain more vertically integrated.

Utilities that merge with other companies and invest outside the traditional regulated utility business will be rated on the basis of the qualitative and quantitative fundamentals of the consolidated entities.

Vertically integrated utilities and transmission and distribution utilities are the antithesis of asset-light strategies, relying instead for earnings growth on the revenue-generating capabilities of hard, tangible, and easily definable assets. Investors have been harmed badly by strategies and business activities that were less than fully understood. As a result, just as they did after the last round of diversification mania in the 1980s, managers are de-emphasizing their nonutility investments, and if at all possible, focusing investors' attention on the amount of consolidated cash flow or operating earnings that their utility business provides. It is clear that investors are looking for companies with strategies that are simpler and more comprehensible, and with balance sheets to match.

Prospective rating revisions will likely reflect the degree to which nonregulated activity increases business risk, the degree of structural or regulatory insulation of the core utilities, and the evolution of industry restructuring among the states. However, the California deregulation debacle has caused many state commissions and legislatures to delay or reverse their initial plans, including California itself. Fewer than 20 states have any kind of retail choice at all, and in the Southeast and portions of the Midwest, regulators and politicians seem to flat out oppose deregulating and restructuring efforts. Without posting stronger earnings and cash flow measures and establishing more balanced capital structures to compensate for riskier business profiles, ratings could further deteriorate.

Chart 8  
 Second Quarter Rating Distributions, 2001-2002



#### California Update

The corporate credit rating on Southern California Edison Co. (SCE) was raised to 'BB' from 'D' on March 5 to reflect the utility's use of loan proceeds and cash on hand to cure all defaulted debt obligations. SCE also paid more than \$2.2 billion to power suppliers, the California Power Exchange, and the California Independent System Operator to resolve defaulted trade obligations.

SCE's ability to cure the defaults reflects the utility's ability to secure loans based on the sound cash flows that should be produced under the terms of a settlement with the California Public Utilities Commission (CPUC) in the litigation that SCE had commenced in federal court. The settlement agreement provides SCE with the right to recoup, within a definitive time frame, that portion of 2000's and 2001's power procurement costs that the CPUC had previously barred the utility from recovering. The rating is further supported by the fact that enforcement of the settlement agreement remains subject to the jurisdiction of the federal court.

SCE has made significant progress toward re-establishing its historically strong creditworthiness. However, the regulatory environment still leaves considerable uncertainty as to when its ratings can be restored to investment grade. Because the CPUC was instrumental in the precipitous deterioration of the utility's credit quality, future CPUC regulatory decisions, particularly evidence of sustained supportive ratemaking decisions made independently of actions mandated by the settlement agreement, will be critical to the direction of SCE's credit quality. The ratings are also premised on a favorable resolution of the outstanding judicial challenges to the SCE/CPUC settlement agreement.

Regarding Pacific Gas & Electric Co., the bankruptcy proceedings are continuing. At this time, it remains unclear when the utility will emerge from bankruptcy. The utility and the CPUC are mired in the process of advancing the merits of their competing reorganization plans. When this issue is

resolved, the timing of the utility's emergence from bankruptcy will be more predictable.

#### **Downgrades Continue to Dominate**

Ratings on Dynegy Inc. and subsidiaries Illinois Power Co., Ilinova Corp., and Dynegy Holdings Inc. were lowered twice during the second quarter. The first downgrade to 'BBB' followed a re-evaluation of the business risk of the company's various operating segments, its financial profile, capital adequacy, and liquidity position. On June 25, Standard & Poor's again lowered the ratings, to 'BBB-', following Dynegy's announcement of its new capital plan. Although the plan could bolster Dynegy's liquidity position, implementation will likely weaken Dynegy's capital structure and business profile. Specifically, consolidated credit protection measures are expected to be more in line with a 'BBB-' rating. The ratings remain on CreditWatch with negative implications owing to the firm's ability to generate sustainable cash flow at a level that supports the current rating, as well as a number of events such as the formal SEC investigation into the firm's Alpha transaction and dislocation in the capital and energy markets.

The ratings on Xcel Energy and subsidiaries Northern States Power Co., Northern States Power Wisconsin, Public Service Co. of Colorado, and Southwestern Public Service Co. were lowered, reflecting Xcel's decision to repurchase the 26% of shares of NRG Energy Inc. that Xcel had sold to the public. Xcel's ratings now incorporate NRG Energy credit risk. Xcel Energy now again owns 100% of NRG Energy, a wholesale power developer that owns generating plants, mainly in the U.S. At the same time, the corporate credit rating of NRG was raised to reflect the consolidated corporate credit rating of Xcel. The outlook is negative pending the outcome of management's plan to sell NRG's international assets and de-leverage NRG's balance sheet.

Lower ratings on Cinergy Corp.'s subsidiaries Cincinnati Gas & Electric Co. (CG&E) and PSI Energy Inc. (PSI) can be traced to Standard & Poor's methodology and assessment that the risk of default is the same throughout the consolidated enterprise. The levelization resulted in the downgrade of the corporate credit ratings of the regulated subsidiaries. However, the senior secured debt ratings at CG&E and PSI were affirmed due to the significant asset value of the property underlying the first mortgage bonds. The outlook is stable.

The ratings on The AES Corp. subsidiary IPALCO Enterprises Inc. and its unit Indianapolis Power & Light Co. were lowered due to their linkage to AES, whose ratings were downgraded. The outlook is negative.

PPL Corp.'s ratings were lowered, while those of subsidiary PPL Energy Supply LLC were affirmed based on the consolidated credit profile of PPL group after deconsolidation of PPL Electric Utilities Corp. (PPLEU) from the parent. Furthermore, PPL Corp.'s credit profile has eroded due to setbacks faced in international operations. PPLEU is structurally insulated from the rest of the PPL group because of ring-fencing, and PPL Corp.'s ratings reflect only the amount of dividend distributions expected to be made by PPLEU to PPL Corp. The outlook is stable.

The Williams Cos. Inc. and its subsidiaries had their ratings lowered due to the net effect of having to meet liquidity requirements and the assumption of \$1.4 billion of debt from Williams Communications Group Inc. Before Williams announced its debt-reduction plan, the adjusted after-tax cash flow interest coverage was low for a 'BBB' rating, with minimum and average ratios of 3x and 3.1x, respectively, for 2002 to 2004. The coverage assumes the consolidation of debt at Williams' subsidiaries and imputed interest for the debt-like tolling agreements and capital adequacy obligations associated with trading operations. The outlook is negative.

The corporate credit rating of Public Service Enterprise Group Inc. (Enterprise) subsidiary Public Service Electric & Gas Co. (PSE&G) was lowered to 'BBB' from 'A-'. While the utility's financial and operational profile present less credit risk than Enterprise's unregulated businesses, the corporate credit rating, following the downgrade, recognizes that Enterprise's unregulated subsidiaries are increasingly important to Enterprise's strategic growth objectives, the utility's dividends are critical to the accomplishment of those strategic goals, and Enterprise's unregulated subsidiaries enjoy heightened access to the capital markets on the strength of their affiliation with PSE&G and its contributions to their development. PSE&G's dividends are significant both in absolute terms and relative to the dividends paid to Enterprise by companies affiliated with PSE&G. The outlook is stable.

Lower ratings for American Electric Power Co. Inc. (AEP) and its many subsidiaries were lowered, reflecting the expected restructuring of AEP into its two main lines of business. The restructuring will benefit AEP's business profile through clearly defining the source of regulated and unregulated earnings and cash flows, but the financial profile of the restructured AEP is projected to support only a 'BBB+' corporate credit rating. The restructuring has received most of the required regulatory approvals and is likely to be in effect by the third quarter of 2002. The outlook is stable.

The ratings on Potomac Electric Power Co. (PEPCO), Delmarva Power & Light Co., and Atlantic City Electric Co. were lowered and the ratings of Conectiv were affirmed, reflecting the imminent merger of Conectiv with PEPCO. The outlook is stable.

The ratings of TECO Energy Inc. and subsidiary Tampa Electric Co. were lowered due to Standard & Poor's assessment of TECO's business strategy and the quality of the cash flow stream generated to support the level of risk being undertaken. TECO is challenged with a growing portfolio of higher-risk, nonregulated power development, as well as regulated utility plant-repowering expenditures, which stress the company's credit profile. The outlook is negative.

Laclede Gas Co. saw its ratings lowered due to deterioration in parent company Laclede Group Inc.'s consolidated financial profile. Bondholder protection parameters have eroded due to several successive warmer-than-normal winters and increasing debt leverage. The outlook is stable.

The ratings on Sierra Pacific Resources (Sierra Pacific) and its utility subsidiaries Nevada Power Co. and Sierra Pacific Power Co. were lowered and its CreditWatch implications were revised to negative from developing. Reduced creditworthiness reflects constrained liquidity and the considerable challenges that the company faces.

Lower ratings for Sempra Energy and its utility subsidiaries San Diego Gas & Electric Co. and Southern California Gas Co. reflect rapid growth in unregulated ventures. In addition, Sempra's consolidated financial profile no longer supports the increased business risk of the enterprise at the level of the former ratings. The outlook is stable.

The ratings of Allegheny Energy Inc. and its regulated subsidiaries, West Penn Power Co., Monongahela Power Co., and The Potomac Edison Co., were downgraded and equalized at 'BBB+' to reflect Allegheny's decision to abandon the announced spin-off of its nonregulated generating subsidiary, Allegheny Energy Supply Co. LLC, and instead to continue operating more as an integrated company. Standard & Poor's considers all of the company's core subsidiaries to have the same default risk, and thus the same corporate credit rating. The outlook is stable.

Lower ratings for Kansas City Power & Light Co. (KCPL) can be traced to a continued decline in parent Great Plains Energy Inc.'s financial profile. Great Plains' financial measures are subpar relative to its average business profile. Yet, financial improvement is expected given moderating construction activity, gradual debt paydown, and greater profits from Great Plains' unregulated units. Within two years, the company's financial profile is anticipated to be commensurate with its 'BBB' corporate credit rating. This expectation, however, depends on the magnitude of growth among the unregulated businesses and their financial performance. The outlook is stable.

The ratings of DQE Inc. and subsidiary Duquesne Light Co. were lowered due to weakness in DQE's financial condition and higher leverage due to a convergence of impairment write-offs and stock repurchases; continuing asset rationalization at AquaSource, DQE's water and wastewater management company; and limited customer growth opportunities in Duquesne Light's native markets. The outlook is negative.

The ratings on Reliant Resources Inc. and its subsidiaries were lowered owing to the acquisition of Orion Power Holdings. Subsequently, Reliant Resources' ratings were placed on CreditWatch with negative implications, reflecting the concern that a lack of market confidence or the risk that another rating agency would lower Reliant Resources' ratings to non-investment grade could create liquidity issues as counterparties demand increased collateral to maintain trading relationships. To a lesser degree, Standard & Poor's is concerned that management was until recently unaware of "wash" power transactions, the simultaneous sale and repurchase of electricity, usually at the same price, which are used to increase reported trading volumes. Standard & Poor's will review Reliant Resources' trading control systems and the steps that management is taking to ensure sustained and proper compliance.

Constellation Energy Group's corporate credit rating was lowered one notch, to 'A-' from 'A', and its subsidiary Baltimore Gas & Electric Co.'s (BGE) corporate credit rating fell two notches, to 'A-' from 'A+'. These actions reflect the heightened role that merchant energy plays within Constellation and the market volatility that Constellation's merchant energy businesses face. Despite the risks inherent in merchant energy, ratings remain in the 'A' category because bondholder exposure is tempered by expectations that the regulated utility will produce strong and stable cash flows, a portion of which will be available to support debt issued by the parent to finance the growth of the unregulated operations. Although BGE's cash flows exhibit considerable strength, the utility's ratings are constrained by its affiliation with the merchant energy business and Constellation's support and growth of unregulated operations. The outlook is stable.

IDACORP Inc and subsidiary Idaho Power Co saw their ratings fall to reflect the increased business risk that the company was incurring as a result of the rapid growth of nonregulated trading and marketing activities, as well as a financial profile that had been weakened by the western power crisis. Subsequently, at the end of the second quarter, the credit outlooks were changed to positive from negative to reflect management's decision to wind down the power marketing business of its IDACORP Energy subsidiary.

The ratings on Energy East Corp. and its operating subsidiaries, Rochester Gas & Electric Corp., New York State Electric & Gas Corp., Central Maine Power Co., Southern Connecticut Gas Co., and Connecticut Natural Gas Corp., were lowered to reflect weakened consolidated business and financial profiles, after accounting for the acquisition of Rochester G&E. The outlook is negative.

Water utility Azurix Corp.'s ratings were lowered to 'D' in light of completion of a tender offer on the company's debt for a price that is less than par value.

RWE AG and subsidiary Elizabethtown Water Co. saw their ratings lowered, reflecting deterioration in RWE's consolidated financial profile. The outlook is stable.

#### **Little Credit Improvement**

The upgrades occurred with Orion Power Holdings and PSEG Energy Holdings Inc. The upgrade for Orion Power can be attributable to the company's acquisition by Reliant Resources. PSEG Energy's corporate credit rating was raised reflecting the substantial financial benefits that the company derives from its affiliation with other members of the Public Service Enterprise Group (Enterprise) that exhibit significantly stronger stand-alone credit quality than PSEG Energy. The corporate credit rating upgrade reflects expectations that the risk of timeliness of payment is equivalent throughout the several companies that comprise Enterprise's family of companies. It is important to note that the 'BBB-' rating on PSEG Energy's unsecured debt was affirmed based on the weaker ultimate recovery prospects at PSEG Energy resulting from inferior asset quality.

#### **CreditWatch Listings Heat Up**

CMS Energy Corp. and subsidiaries Consumers Energy Co. and CMS Panhandle Pipeline Cos. had their ratings placed on CreditWatch with negative implications, reflecting the heightened political and regulatory uncertainty arising from the company's "round-trip" electricity trades and related issues.

The ratings on Ameren Corp. and subsidiaries Union Electric Co. and Central Illinois Public Service Co. were placed on CreditWatch with negative implications following the company's announcement of a definitive agreement with The AES Corp. to acquire lower rated CILCORP Inc. and its subsidiary Central Illinois Light Co. (CILCO). Ameren's unregulated generating subsidiary AmerenEnergy Generating Co. was placed on CreditWatch with positive implications. The CreditWatch implications on CILCORP and subsidiary CILCO were changed to positive from developing. An important consideration in resolving the CreditWatch listing is Standard & Poor's opinion that all operating subsidiaries are core to Ameren's business strategy, including CILCORP. This differs from our former perspective in which AmerenEnergy Generating and Central Illinois Public Service were rated based more on their stand-alone qualitative and quantitative credit factors. Upon completion of the acquisition, Standard & Poor's will view the default risk as being the same throughout the Ameren organization.

FPL Group Inc. and subsidiaries' ratings were listed on CreditWatch with negative implications following the announcement that the company will purchase an 88% interest in the 1,161 MW Seabrook nuclear power plant. The acquisition is negative because it increases the risk profile of the group and its subsidiaries, and will initially increase the company's debt leverage.

The CreditWatch listing on the ratings of Northern Natural Gas Co. (NNG) and Transwestern Pipeline Co. was revised to developing from negative reflecting the fact that neither company has been included in the Enron bankruptcy and uncertainty as to whether they will be drawn into the bankruptcy proceedings. In addition, for NNG, the change reflects Dynegy's announcement regarding its assumption of ownership of NNG from Enron. On July 2, 2002, NNG's ratings were raised due to the expiration of Enron's option to repurchase Northern Natural Gas Pipeline, therefore ensuring the firm remains a wholly owned subsidiary of Dynegy for the time being. The developing CreditWatch listing remains as a result of Dynegy's new capital plan, which states that a partial sale of the pipeline could be a source of funds.

#### **Outlook Changes Decidedly Negative**

The credit outlook on FirstEnergy Corp. and its seven operating utilities was revised to negative from stable because of several recent developments that will put pressure on the company's ability to meet the financial targets it set following the acquisition of GPU Inc. These developments include damage to the reactor vessel head at the Davis Besse nuclear power plant, an unfavorable ruling by the Pennsylvania Commonwealth Court regarding the GPU acquisition, and worsening market conditions for sales of some of FirstEnergy's remaining noncore assets. While the company has put in place a reasonable plan to mitigate these developments, Standard & Poor's believes that as a result of these developments, the company could find it difficult to reach its expected financial targets.

MDU Resources Group Inc. had its ratings outlook changed to negative from stable, reflecting the heightened risk associated with the company's expansion into unregulated operations.

The outlook revision on NiSource Inc. and its subsidiaries to negative from stable reflects the company's stressed financial condition that stems from the debt-financed acquisition of Columbia Energy Group in late 2000, a slowdown in the economy, higher bad debt expense, and sliding wholesale electricity prices and expectations for a rate cut. On June 24, 2002, subsidiary Northern Indiana Public Service Co. reached a rate settlement that calls for a 6% rate decrease, a level that is actually lower than expected. These factors, coupled with delays in completing sales of noncore assets, have resulted in a weaker-than-expected financial profile. Although continued merger synergies, aggressive cost controls, reduced capital expenditures in all business segments, and productivity enhancements will help to modestly improve NiSource's financial parameters, management will need to significantly reduce the company's extremely high level of debt. A substantial common equity issuance that NiSource plans for following Indiana commission approval of the recent rate settlement, with proceeds being applied to paring debt levels, will lift subpar financial measures. However, failure to continue the rapid strengthening of the balance sheet beyond the benefit realized by the pending equity sale will result in a ratings downgrade.

The outlook on DPL Inc. and subsidiary Dayton Power & Light Co. was changed to negative from stable reflecting increasing business and financial risks. Specifically, the likelihood of decreased cash flows from DPL's peaking plant facilities and write-offs associated with its investment portfolio could adversely affect credit protection measures and financing flexibility and liquidity.

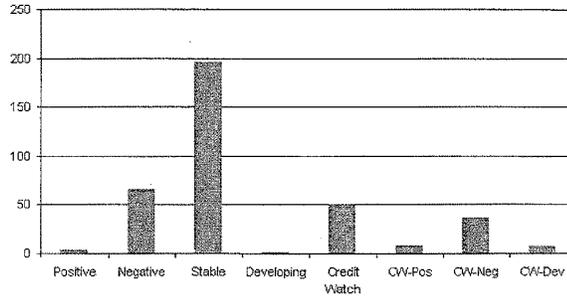
SEMCO Energy Inc.'s outlook was revised to negative from stable due to a weakened financial profile stemming from warm weather experienced during the recent heating season. Although Standard & Poor's recognizes the cyclical nature of the natural gas industry, another warm heating season will be detrimental to SEMCO's financial profile, which is already subpar for the current 'BBB' rating.

The outlook on UGI Corp. affiliates AmeriGas Partners L.P. and UGI Utilities Inc. was changed to negative from stable, reflecting the potential for financial degradation from the warm winter weather experienced in the recent heating season throughout the U.S. Although Standard & Poor's recognizes the cyclical nature of the propane and natural gas industries, another warm heating season will further harm AmeriGas' already weak financial profile. As a result, AmeriGas could place a credit drag on its parent and utility affiliate. The outlook revision also reflects the growing proportion of debt dedicated to nonregulated activities.

Progress Energy Inc. and its subsidiaries Florida Power Corp. and Carolina Power & Light Co. had their credit outlooks revised to negative from stable. The action can be traced to the increased business risk at nonregulated

subsidiary Progress Ventures, lower-than-projected credit protection measures, and a rate settlement for Florida Power, whose reduction in retail rates will decrease future revenue growth.

Chart 8  
Outlook Distribution



**Recent Stability**

The credit outlook on Hawaiian Electric Industries Inc. and utility subsidiary Hawaiian Electric Company, Inc. was revised to stable from negative owing to the diminishing effect on the heavily tourism-dependent economy from the Sept. 11 terrorist attacks.

**On a Positive Note...**

As mentioned earlier, the outlook on IDACORP and subsidiary Idaho Power was revised to positive from negative to reflect management's decision to exit the trading business, a strategy that may take up to two years to execute. Standard & Poor's will consider a ratings upgrade upon the successful execution of the new strategy, prospects for which would be enhanced by the issuance of equity or equity-like securities.

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