

101 FERC ¶ 61, 076
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.¹ 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.

¹The 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).

Background

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:

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(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).

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.^[2]

Recertification of Enron-affiliated Facilities in 1997

²Indeck 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).

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.³ The applicant in each application for recertification also acknowledged that as a result of the merger, 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.⁴ 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

³Enron Corporation, 78 FERC ¶ 61,179 (1997).

⁴Zond 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).

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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 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,⁵ 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),⁶ 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

⁵United States of America v. Andrew Fastow, Case No. H-02-889-M, United States District Court of the Southern District of Texas, Houston Division.

⁶United States Securities Exchange Commission v. Andrew Fastow, Civil Action No.H-02-3666, United States District Court of the Souther District of Texas, Houston Division.

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.

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.⁷ 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.

⁷18 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.

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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 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.

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(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 (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.