

**BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Santa Clara, California

v.

Enron Power Marketing, Inc.

)
)
)
)
)

Docket No. EL04-__-000

**COMPLAINT OF CITY OF SANTA CLARA, CALIFORNIA,
AGAINST
ENRON POWER MARKETING, INC.**

TABLE OF CONTENTS

I.	EXECUTIVE SUMMARY	2
	A. EPMI’s Purported Termination Based on a Disputed Payment is Not Permitted by EPMI’s Jurisdictional Contract and is an Unjust and Unreasonable Practice.....	2
	B. EPMI’s Alternative Grounds for Termination are Invalid and Further Demonstrate EPMI’s Unjust and Unreasonable Practices.....	3
	C. EPMI’s Cancellation is Void Due to EPMI’s Failure to Provide Notice of Cancellation	3
	D. Alternatively, Under the Circumstances EPMI Cannot be Permitted to Calculate a Termination Payment Using Market-Based Rates.....	4
II.	SUMMARY OF COMPLAINT	5
III.	COMMUNICATIONS AND DESCRIPTION OF PARTIES	13
	A. City of Santa Clara, California.....	13
	B. Respondent.....	14
IV.	BACKGROUND	15
	A. The Master Agreement and Transaction Confirmations.....	17
	B. EPMI’s Purported Cancellation of Long-Term Transactions.....	23
	C. EPMI’s Deteriorating Financial Condition Warranted City’s Demand for Security	26
	D. Existing Proceedings.....	30
	E. Commission Jurisdiction.....	31
	1. The Authority to Determine Whether EPMI’s Contract Cancellation Involves Just and Reasonable Rates, Charges, Terms, Conditions and Practices Rests Exclusively with the Commission	31
	2. The Commission Should Exercise Its Jurisdiction Because It Possesses Special Expertise with Regard to the Matter at Hand, Because Uniformity of Interpretation Is Required in Resolving the Matter at Hand, and Because the Matter at Hand is Important to the Commission’s Regulatory Responsibilities	37
	a) The Commission Possesses Special Expertise that Makes this Case Appropriate for Commission Decision	38
	b) Uniformity of Interpretation of the Questions Raised in This Dispute Is Necessary.....	41

	c)	This Case Is Important to the Commission’s Regulatory Responsibilities.....	42
F.		The Enron Bankruptcy Proceeding Neither Hinders Nor Diminishes the Commission’s Authority in this Proceeding.....	44
G.		Alternative Dispute Resolution.....	48
H.		The Commission’s Determination of City’s Complaint is Pursuant to the Just and Reasonable Standard.....	48
V.		COMPLAINT	50
A.		EPMI Violated the Master Agreement and Long-Term Confirmations by Purporting to Exercise Termination Rights Based on Pending Good Faith Dispute	52
B.		EPMI’s Post Hoc Arguments for Cancellation Are Invalid and Based on Unreasonable Practices	67
	1.	EPMI's "Margin Call" Does Not Provide Grounds for Cancellation	67
	2.	The City's Suspension of Deliveries Does Not Provide Grounds for Termination.....	74
C.		EPMI’s Purported Cancellation Is Void for Failure to Provide Notice in Compliance with Section 205(d) of the Federal Power Act	76
	1.	The Federal Power Act Requires Notice Prior to Cancellation of a Contract.....	78
	a)	The Commission’s Regulations under Section 205(d) Require Prior Notice	78
	b)	The Notice Requirement Applies to Long-Term Market-Based Rate Contracts	80
	2.	EPMI Failed to File Notice	86
	3.	EPMI’s Failure to Provide Notice Negates Cancellation	87
D.		EPMI Must be Prohibited From Applying Market-Based Rates to Calculate an Early Termination Payment	87
	1.	EPMI’s Use of Market-Based Rates after January 2000 was Based on False Information Provided to the Commission	93
	2.	The Commission’s Western Market Investigation Revealed and Documented Enron’s Violation of Its Market-Based Rate Authority as of January 2000 or Earlier.....	98
	3.	EPMI Had Sufficient Notice of the Potential for the Relief Demanded Based on its Violations	102
	4.	The Commission Possesses the Authority Necessary to Order This Alternative.....	106

5.	The Commission Should Adopt Alternative Relief Respecting EPMI's Market-Based Rate Authority to Avoid EPMI's Enjoyment of the Benefits of Market-based Rate Authority after June 25, 2003	112
6.	The Relief Sought Is Necessary to Protect City from Unjust and Unreasonable Charges and Practices	114
VI.	RELIEF REQUESTED.....	114

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Santa Clara, California)	
)	
v.)	Docket No. EL04-__-000
)	
Enron Power Marketing, Inc.)	

**COMPLAINT OF CITY OF SANTA CLARA, CALIFORNIA,
AGAINST
ENRON POWER MARKETING, INC.**

Pursuant to Sections 206, 306 and 309 of the Federal Power Act, 16 U.S.C. §§ 824e 825e, and 825h (2000), and Rule 206 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. § 385.206 (2003), the City of Santa Clara, California (“City”), hereby petitions the Commission to grant relief from Enron Power Marketing, Inc.’s (“EPMI”) tariff violations, unjust and unreasonable charges and conduct with respect to the jurisdictional contracts under which EPMI contracted to serve City. City requests the Commission: (1) find that EPMI violated its jurisdictional contracts and seeks unjust and unreasonable charges based on its purported cancellation of contracts with City despite a pending unresolved good faith dispute regarding payment; (2) determine that EPMI’s actions seeking to cancel its contracts despite good faith disputes are unjust and unreasonable practices; (3) rule that EPMI’s purported cancellation of the two long-term transactions with City is void due to EPMI’s failure to provide notice to, and obtain prior approval from, the Commission; and (4) in the alternative, order EPMI to calculate any Early

Termination Payment on a cost-of-service basis and/or revoke EPMI's market-based rate authority effective at least as of January 2000.

I. EXECUTIVE SUMMARY

1. This Complaint seeks remedies for EPMI's unjust, unreasonable and unlawful attempts to terminate its contracts with City. The long-term energy contracts at issue resulted from requests for proposals issued by City. EPMI's proposals utilized EPMI's unique contract form, and were required to be backed by the purported financial strength of EPMI's corporate parent, Enron Corp. In the midst of the turmoil resulting from the disclosures of Enron Corp.'s true financial condition City disputed a payment obligation, relying on unique language in the agreement drafted by EPMI. City did not terminate the agreement or seek to modify it; City attempted to continue the bargain it struck for long-term energy deliveries from a financially sound counterparty. While City worked with EPMI to assist EPMI's anticipated assignment of the agreements to a creditworthy counterparty, EPMI chose to fabricate a termination claim to "drag money in" from City.

A. EPMI's Purported Termination Based on a Disputed Payment is Not Permitted by EPMI's Jurisdictional Contract and is an Unjust and Unreasonable Practice

2. This Complaint addresses EPMI's attempt to use the disruption caused by its financial collapse to manufacture an Early Termination payment claim. The reason for termination stated by EPMI, that City defaulted on a payment obligation, is invalid. The payment in question was disputed by City. In its haste to create a termination, EPMI unreasonably and unlawfully ignored City's dispute. EPMI's bad faith disregard of City's notice does not nullify City's good faith dispute. Because

disputed payments cannot cause a Default under the terms of EPMI's jurisdictional contract, EPMI's purported termination is unlawful. EPMI's internal correspondence demonstrates that EPMI's unlawful conduct against City was an intentional attempt to force a termination to "drag money in" to address Enron's liquidity problems caused by the disclosure of Enron Corp.'s financial accounting practices.

B. EPMI's Alternative Grounds for Termination are Invalid and Further Demonstrate EPMI's Unjust and Unreasonable Practices

3. Although its Termination Notice to City relied only on EPMI's claim of a payment default EPMI later erroneously claimed City's suspension of deliveries, and EPMI's demand for margin as additional grounds for termination. City's suspension of deliveries was justified and, in any event, cannot create a Default under the terms of EPMI's jurisdictional contract. Likewise, EPMI's margin call does not provide grounds for termination because it was materially defective and inconsistent with the terms of the Master Agreement, it was not permitted under applicable state law, City promptly disputed the margin call, and EPMI abandoned its claim for margin from City. Furthermore, as demonstrated by EPMI's internal correspondence, the margin call was part of EPMI's unjust and unreasonable practice of misusing collateral provisions in jurisdictional contracts as a source of cash, and as a means for forcing purported terminations of jurisdictional agreements.

C. EPMI's Cancellation is Void Due to EPMI's Failure to Provide Notice of Cancellation

4. EPMI purported to cancel its jurisdictional agreements with City, but failed to notify the Commission, as required by Section 205 of the Federal Power

Act.¹ Section 205 requires notice to the Commission before a rate schedule, or part thereof, is changed. The Commission and the courts have ruled that cancellation of a contract is a change requiring notice to the Commission. This is particularly the case where, as here, the cancellation is not permitted by the terms of the jurisdictional contract (e.g., seeking to cancel based on a disputed payment obligation, which is expressly excluded from being an Event of Default).

D. Alternatively, Under the Circumstances EPMI Cannot be Permitted to Calculate a Termination Payment Using Market-Based Rates

5. Disregarding, *arguendo*, the invalidity of EPMI's cancellation, EPMI cannot be permitted to use market-based rates to calculate an Early Termination Payment. The Commission's investigations into EPMI reveal violations of its market-based rates Tariff and the Federal Power Act, beginning on or before January 2000.

6. In January 2000, EPMI was permitted to continue using its market-based rates by misleading the Commission regarding EPMI's market power. Due to EPMI's conduct, its Tariff violations, misrepresentations to the Commission, and unreasonable practices under its jurisdictional contracts with the City, the totality of the circumstances warrant a prohibition against EPMI's use of its market-based rates to calculate a charge for energy it has not delivered. Thus, even if the Commission concludes that EPMI is not completely prohibited from charging an Early Termination Payment under the circumstances, to prevent a windfall to EPMI from its wrongful conduct, EPMI must be required to calculate any Early Termination Payment using cost-based rates. Alternatively, the Commission should revoke EPMI's market-based rate

¹ 16 USC § 824d(d)(2000).

authority effective as of January 2000, and require all charges for undelivered energy during periods after January 2000 to be calculated using cost-based rates.

II. SUMMARY OF COMPLAINT

7. City seeks relief from EPMI's claim for unjust and unreasonable charges in direct violation of, and as a direct result of unjust and unreasonable practices in connection with, the Master Agreement² and long-term confirmations between City and EPMI.³ This Complaint seeks relief from EPMI's illegal, unjustified and unauthorized attempts to cancel certain power sales agreements, without consent of City, in an attempt to extract a \$147 million Early Termination Payment from City. *See* Section V. B., *infra*.

8. City has fully performed under its agreements with EPMI. In contrast, EPMI refused or was unable to perform under the agreements as of November 2001. Notwithstanding City's performance, City's willingness to continue performance with a creditworthy counterparty, and EPMI's lack of performance, EPMI attempted to force a termination of the contracts based on an unresolved payment dispute. EPMI used the purported termination of the agreements to claim a right to accelerate City's obligations to EPMI while at the same time evading EPMI's own obligation to perform. *See* Section V.A., *infra*.

9. The context of the purported termination is Enron Corp.'s disclosure of financial fraud and resulting financial collapse, which made EPMI's exit from the

² *See* Exhibit 2. The Master agreement was drafted by EPMI, and contains unique provisions, distinguishing it from Commission approved energy industry agreements.

³ *See* Exhibits 3 and 4.

wholesale energy markets inevitable. EPMI's internal correspondence demonstrates that, as its liquidity problems made EPMI's collapse inevitable, EPMI decided to force counterparties to provide cash to EPMI by demanding collateral from counterparties. EPMI's correspondence also describes EPMI's scheme to "drag money in" by forcing counterparties into early terminations by threatening them with unreliable service, threatening to assign the contract to an unreliable counterparty, threatening a termination by the bankruptcy trustee or, if the market again changed, EPMI would use bankruptcy to avoid responsibility to perform contracts favorable to its counterparties. EPMI's actions in furtherance of its plan are demonstrated by its aggressive tactics against City. First, EPMI demanded \$79 million in cash collateral without justification. Second, EPMI notified City that EPMI would not be able to fully perform its obligations to deliver energy to City. Third, EPMI sought City's consent to an assignment. Fourth, EPMI repudiated the agreed upon assignment after it filed for bankruptcy protection. Fifth, EPMI attempted to manufacture a basis for terminating the Master Agreement by ignoring City's good faith dispute of a payment obligation. *See* Sections V.A. and B., *infra*.

10. To protect itself from EPMI's change in financial condition and from EPMI's notice that it would not be able to meet its contractual obligations, City properly demanded Performance Assurance, which EPMI neither provided nor disputed. City then suspended its deliveries to EPMI pending receipt of Performance Assurance from EPMI and notified EPMI of City's calculations of the correct amounts mutually owed under the several transactions with EPMI. EPMI refused to acknowledge, much less respond to City's correspondence notifying EPMI of City's dispute regarding the

amounts owed with credits due under the Master Agreement. Ignoring City's letters explaining that no net amount was due from City, EPMI manufactured a claim for an Early Termination Payment by claiming City failed to pay the disputed invoice.

11. EPMI's refusal to recognize, discuss, or even respond to City's correspondence challenging the amounts due demonstrates the bad faith in EPMI's actions and shows that its purported cancellation violates the terms of the parties' agreements. EPMI's bad faith refusal to acknowledge City's correspondence does not negate the impact of City's good faith dispute; EPMI's termination based on a disputed invoice is not permitted by the Master Agreement or the long-term confirmations.⁴

12. This Complaint addresses EPMI's Tariff violations in connection with EPMI's attempt to resolve its self-inflicted liquidity crisis by extracting unjust and unreasonable payments from City based on a purported termination of the contracts with City, and seeks relief from EPMI's unlawful conduct and unreasonable practices as well as its exploitation of its market-based rate Tariff.

13. This Complaint falls squarely within the Commission's authority to determine whether rates, charges or terms and conditions of service for jurisdictional sales of electric energy are just and reasonable and the related authority to determine if a practice affecting a rate is unjust or unreasonable, and to determine if a change in a rate, term or condition is just, reasonable and otherwise lawful. Furthermore, the Commission's exercise of jurisdiction in this matter is warranted because the Commission possesses special expertise with regard to the matter at hand, because uniform determinations of reasonableness are required in resolving this matter, and

⁴ See Exhibits 2-4.

because the resolution of this dispute is important to the Commission's regulatory responsibilities. Specifically, through its ongoing investigations into EPMI's conduct,⁵ the Commission has developed a body of regulatory knowledge that provides it with a special expertise to understand the circumstances and market conditions surrounding EPMI's illegal actions in violation of the Federal Power Act, the Commission's regulations and its jurisdictional contracts. Additionally, the Commission's uniform regulation of the termination of contracts stemming from the circumstances surrounding the Enron bankruptcy is necessary for the maintenance of a reliable stable power market. Finally, the Commission's assertion of jurisdiction in this proceeding is important to the Commission's regulatory responsibility to ensure just and reasonable rates and practices and is fundamental to the delicate balances underlying the Commission's market-based rate regime. *See* Section IV.E.2.(c), *infra*.

14. City seeks relief from the unjust and unreasonable charges EPMI claims based on its purported exercise of termination rights, in violation of the Master Agreement and the long-term confirmations. EPMI ignored the specific terms of the Master Agreement and long-term confirmations, in violation of its jurisdictional contracts to unreasonably pursue its goal of converting its agreements into claims for immediate cash through unlawful contract cancellations. In particular, City establishes that, despite the fact that buyer's non-payment of a disputed amount is not an "Event of Default," under the Master Agreement, and, in direct contravention of City's right under the Master

⁵ *See, e.g., Enron Power Marketing, Inc. et al.*, (Docket No. EL02-113); *Portland General Electric Co. et al.*, (Docket No. EL02-114); *Avista Corp. et al.*, (Docket No. EL02-115); *American Electric Power Corp., et al.*, (Docket Nos. EL03-137 thru 179); *Enron Power Marketing, Inc. et al.*, (Docket Nos. EL03-180 thru EL03-203).

Agreement to net or recoup amounts owed under all transactions between the parties, EPMI improperly sought to terminate the contracts based on City's dispute regarding payment of EPMI's invoice for November 2001 deliveries. As demonstrated herein and made clear to EPMI in December 2001, an appropriate netting or recoupment of all outstanding contractual obligations between City and EPMI as of December 4, 2001, would have resulted in a net payment owed by EPMI to City. Accordingly, City provided EPMI notice that no amount was due to EPMI and invoked a good faith dispute regarding the invoice EPMI subsequently mailed to City. EPMI's invoice sought payment for November 2001 deliveries without taking into account City's notice of its dispute regarding calculations of amounts due based on its rights under the Master Agreement. The Master Agreement, uniquely drafted by EPMI, provides a broad right to recoup payments, and also provides that no Event of Default can result from failure to pay when the payment is disputed in good faith. Consequently, City's good faith dispute of the amount City was obligated to pay under the unique terms of the Master Agreement precluded City's failure to pay from being an Event of Default. Thus, EPMI did not have a legitimate basis under the Master Agreement or the long-term confirmations to establish an Early Termination Date or to seek an Early Termination Payment from City.

15. In addition, City seeks relief from EPMI's invalid attempt to cancel its contracts with City without complying with Section 205(d) of the Federal Power Act. EPMI failed to comply with the requirement under Section 205 to provide notice of cancellation of jurisdictional, long-term, market-based rate power sales agreements with City. EPMI's failure to provide such notice interfered with the Commission's ability to review the lawfulness of the cancellation and prevent an unjust

cancellation based on a dispute or an inadvertent error. Since EPMI failed to file the prerequisite notice, the Commission should determine that EPMI's January 2002 cancellation is void, and of no effect. Accordingly, City requests an order declaring that EPMI's cancellation is void *ab initio*, and that if City was incorrect in its dispute, no cancellation can occur until after expiration of the contractual ten-day cure period following resolution of City's dispute, and shall not become effective until after EPMI complies with Section 205(d). *See* Section V.C., *infra*.

16. City alternatively requests that the Commission preclude EPMI from using its market-based rates in computing any Early Termination Payment that may be due for unconsummated transactions. City also requests the Commission to revoke EPMI's market-based rate authority retroactive to the date EPMI violated the terms or requirements of that authority. In prior proceedings, the Commission detailed numerous bad acts undertaken by EPMI in violation of its market-based rate authority. The Commission, in those proceedings, recognized EPMI's failure to notify the Commission of changes in EPMI's market power, and EPMI's egregious acts and the impact of such acts in undermining the wholesale power market. In response, the Commission revoked EPMI's market-based rate authority prospectively, and immediately terminated EPMI's electric market-based rate Tariff. However, despite its violations of its market-based rate authority, EPMI continues to seek profits from its market-based rate contracts through unlawful claims for alleged termination damages for transactions that were not completed, including transactions that never commenced and would not be completed until after the effective date of the revocation of EPMI's market-based rate authority. Under the totality of the circumstances, EPMI must be prevented from unlawfully using

market-based rates to calculate profits, which, due to its violations, EPMI was not entitled. Under these unique circumstances, any charges allowed for EPMI's uncompleted transactions, including Early Termination Payments, should be based on a traditional cost-of-service basis. *See* Section V.D., *infra*.

17. The Commission's investigation of Enron's trading practices, and the resulting record in Docket Nos. PA02-2, EL02-113 and EL03-77, are replete with examples of EPMI's bad acts occurring as early as May 25, 1999. That record conclusively demonstrated that EPMI misled the Commission regarding the scope of EPMI's activities under its market-based rate authority, and throughout the year 2000, violated the Federal Power Act and its market-based rate authority.⁶ The record before the Commission in those proceedings demonstrates that EPMI's continued use of market-based rates after January 2000 was based on EPMI's market-based Tariff violations and failure to notify the Commission of changes in EPMI's circumstances and market power. The record also shows EPMI's violations were occurring prior to, and through, the time when City entered into the two long-term contracts.⁷

18. Finally, City asks the Commission to clarify that, based on its revocation of EPMI's market-based rate authority, the collection of any charges by EPMI, including any Early Termination Payment costs authorized by the Commission, are to be calculated solely on the basis of costs incurred. Such an order will protect City

⁶ *See Enron Power Marketing, Inc. and Enron Energy Servs. Inc., et al.*, 103 FERC ¶ 61,346 (2003); *American Electric Power Service Corp., et al.*, 103 FERC ¶ 61,345 (2003); *El Paso Electric Co., et al.*, 100 FERC ¶ 61,188 (2002); *Portland General Electric Co., et al.*, 100 FERC ¶ 61,186 (2002); *Avista Corp., et al.*, 100 FERC ¶ 61,187 (2002).

⁷ *See El Paso Electric Co., et al.*, 100 FERC ¶ 61,188 at 61,667.

from excessive Early Termination Payment charges in the event that the Commission determines EPMI's jurisdictional contract authorized EPMI to assert a claim for any such charges under the facts presented. Accordingly, City requests, as alternative relief, that EPMI's market-based rate authority be revoked as of the date of its initial bad acts, and any lawful charges after that revocation date be recalculated on a traditional cost-of-service basis. Such relief is consistent with the Commission's repeated notices of its intent to revoke the market-based rate authority of any public utility that violated the Federal Power Act and the Commission's orders or regulations. Moreover, the Commission possesses the authority necessary to order revocation of market-based rate authority retroactive to the date of the initial violations. Under Sections 206 and 309 of the Federal Power Act, as well as the Commission's precedent, including the precedent permitting utilities to only charge the filed rate, the Commission possesses the authority to remedy Enron's violation of the filed rate doctrine through the retroactive relief requested. Only such relief will ensure that market participants, such as City, are restored to the *status quo ante*. Accordingly, in the alternative, City seeks an order revoking EPMI's market-based rate authority effective as of January 2000. To the extent the Commission or a court ultimately determines that EPMI is entitled to any Early Termination Payment from City, EPMI must be required to calculate any such charges under the Master Agreement and the long-term confirmations solely on the basis of EPMI's actual cost.

III. COMMUNICATIONS AND DESCRIPTION OF PARTIES

A. City of Santa Clara, California

19. Santa Clara is a city, duly chartered under the laws of the State of California, which owns and operates a municipal electric utility system, doing business as Silicon Valley Power. City is engaged in the generation, transmission, distribution, purchase and sale of electric power and energy at wholesale within the western United States, and the distribution and sale of electricity at retail within its service territory, which is coextensive with the area of the City of Santa Clara. To meet the needs of the citizens of Santa Clara, City generates electricity and purchases and sells power and energy in the western United States wholesale markets.

20. The persons to whom correspondence, pleadings, and other papers in relation to this proceeding should be addressed and the persons whose names are to be placed on the Commission's official service list are designated as follows pursuant to Rule 203, 18 C.F.R. § 385.203 (2003):

Junona A. Jonas
 Director of Electric Utility
 City of Santa Clara
 1500 Warburton Avenue
 Santa Clara, CA 95050
 (408) 261-5490

James D. Pembroke, Esq. jdp@dwgp.com
 Peter J. Scanlon, Esq. pjs@dwgp.com
 Duncan, Weinberg, Genzer & Pembroke, P.C.
 1615 M Street, N.W.
 Suite 800
 Washington, DC 20036
 (202) 467-6370
 (202) 467-6379 (fax)

It is requested that a copy of all pleadings, correspondence and testimony be sent to the following:

Judith Propp, Esq.
Assistant City Attorney
City of Santa Clara
1500 Warburton Avenue
Santa Clara, CA 95050
(408) 615-2230

B. Respondent

21. EPMI is an affiliate of an investor-owned utility. EPMI purchased and sold electric power at wholesale throughout the western United States, including in California. EPMI is a public utility, as defined in Section 201 of the Federal Power Act⁸ and is subject to the jurisdiction of the Commission. EPMI was authorized to transact at market-based rates,⁹ however, EPMI's authority to transact at market-based rates has now been revoked.¹⁰

IV. BACKGROUND

22. This proceeding involves three agreements for the purchase and sale of power at wholesale between City and EPMI. On September 10, 1999, City and EPMI entered into a Master Energy Purchase and Sale Agreement ("Master

⁸ 16 U.S.C. § 824.

⁹ See *Enron Power Marketing, Inc.*, 65 FERC ¶ 61,305 (1993) (granting EPMI's request for authorization to sell power at market based rates). The order granting authority and the authority granted were clarified at 66 FERC ¶ 61,244 (1994) (rejecting EPMI's attempts to limit the information it was required to report to the Commission). The authority was subsequently revised to reflect a code of conduct for trades with EPMI's affiliate, Portland General Electric Co. *Enron Power Marketing, Inc.*, 85 FERC ¶ 61,447 (1998).

¹⁰ See *Enron Power Marketing, Inc.*, 103 FERC ¶ 61,343 (2003) ("Revocation Order").

Agreement”),¹¹ a unique agreement drafted by EPMI.¹² The Parties engaged in short-term purchase and sale transaction thereunder, and eventually, as a result of EPMI’s response to City’s requests for proposals (“RFPs”) for long-term power, City and EPMI executed two long-term firm power transactions pursuant to confirmations under the Master Agreement.

23. For mutual service rendered in November and December 2001, City notified EPMI that City disputed that any payment was owed to EPMI based on City’s rights, as provided in the Master Agreement, to net, recoup or set off amounts mutually owed by EPMI and City. As described in greater detail below, EPMI ignored City’s dispute, claimed an Event of Default based on the disputed net amounts owed, and purported to terminate the arrangements with City based solely on the unpaid, disputed amounts. In bankruptcy court filings, EPMI has sought an Early Termination Payment in the amount of \$147 million from City.¹³ EPMI seeks to calculate the Early Termination Payment pursuant to the market-based rates reflected in the various arrangements with City. As discussed in detail herein, EPMI’s bankruptcy filings belatedly assert two additional, equally unlawful grounds for canceling the agreements.

¹¹ See Exhibit 2 (Master Agreement). In accordance with Rule 206(b)(8), the documents attached as exhibits to this Complaint are summarized in Appendix A, attached hereto. For clarity, a chronological list of the Exhibits is included as Appendix B.

¹² As discussed herein, EPMI’s unique Master Agreement was materially different from standard, multi-laterally negotiated contract forms such as the Commission approved Western Systems Power Pool (“WSPP”) Agreement.

¹³ See Exhibit 6.

24. Section 205 of the Federal Power Act requires public utilities, including marketers, to file their rates, terms and conditions with the Commission.¹⁴ The Commission order authorizing EPMI to sell power at market-based rates obligated EPMI to comply with the Federal Power Act Section 205(c) filing requirement without physically filing its contracts, but allowing after-the-fact compliance with respect to such contracts by making quarterly informational filings regarding its contracts and sales.¹⁵ Thus, the Commission deemed the contracts between EPMI and City to be filed in accordance with Federal Power Act Section 205(c) when EPMI made its notice filings through its quarterly reports.¹⁶ Because the contracts were deemed by the Commission to be filed after the fact and through a notice filing, the specific terms and conditions of EPMI's unique Master Agreement have not previously been submitted for review by the Commission. EPMI remains subject to the notice of cancellation requirements because the order granting EPMI market-based rate authority expressly denied EPMI's request for waiver of the Commission regulations incorporating the Federal Power Act Section 205(d) requirement of filing notice with the Commission before cancellation of contracts.¹⁷

25. The Commission revoked EPMI's authority to sell power at market-based rates because EPMI violated its tariff and the Federal Power Act and

¹⁴ See 65 FERC at 62,406.

¹⁵ See *id.*

¹⁶ See Exhibit 7.

¹⁷ See 65 FERC at 62,406-407. Unlike the WSPP Agreement, EPMI's unique contract form did not include a waiver of the notice of termination obligations.

thereby disrupted the energy markets.¹⁸ Due to its undisclosed acquisition of control over generation, its violation of jurisdictional contracts and its violation of Commission regulations, EPMI violated the conditions under which the Commission granted EPMI authority to transact under market-based rates.¹⁹

26. The facts set forth herein below describe the agreements between EPMI and City, including the provisions respecting cancellation/termination of the agreements. The facts summarized also explain the timing and mechanism of EPMI's alleged cancellation of the agreements involving EPMI's defaults under the agreements, City's actions to protect itself, EPMI's alleged basis for the cancellation, and a summary of the related proceeding pending before the Bankruptcy Court for the Southern District of New York.

A. The Master Agreement and Transaction Confirmations

27. **Master Agreement.** EPMI and City entered into the Master Agreement on September 10, 1999.²⁰ EPMI notified the Commission that the Master Agreement had been executed when EPMI filed with the Commission on January 31, 2000, its informational filing for the fourth quarter of 1999.²¹

28. The Master Agreement is a unique contract, drafted by EPMI.²² The Master Agreement is expressly governed by California law²³ and is subject to the

¹⁸ See Revocation Order at PP 14-17, 51-56.

¹⁹ See *id.* at P 99, n. 30.

²⁰ See Exhibit 2.

²¹ Exhibit 7, excerpt from EPMI's quarterly report dated January 31, 2000.

²² See Exhibit 1 at P 7.

Uniform Commercial Code.²⁴ The Master Agreement governs individual transactions for the purchase or sale of electricity that may thereafter be entered into by the parties.²⁵

Under the Master Agreement, each party was able to sell to the other, and City and EPMI entered into numerous short-term transactions as both buyer and seller under the Master Agreement. These “short-term” transactions were generally for terms of three months or less.

29. **Long-Term Transactions.** Although the Master Agreement was created to address short-term (less than one year) transactions, the Master Agreement was modified by two long-term transaction confirmations, one executed on August 29, 2000,²⁶ and the other on April 17, 2001.²⁷ Both of the long-term confirmations explained

(Footnote con't....)

²³ See Exhibit 2 at § 8.5. This complaint seeks Commission review of the reasonableness of EPMI’s rates, terms and conditions, and practices under the Federal Power Act. While the facts involved also give rise to numerous state law contract defenses, which City has asserted as defenses in response to EPMI’s Complaint in Bankruptcy Court, City understands that the Commission does not typically address state contract law defenses, and City does not seek the Commission’s action on any such defenses in this proceeding. See *American Electric Power Service Corp., et al.*, 106 FERC ¶ 61,020 at 61,051 n.28 (2004). Rather City seeks relief from the Commission on the issues within the Commission’s exclusive and primary jurisdiction (i.e., just and reasonable rates). Indeed, in its answer in the adversary proceeding, City expressly asserted that the Commission has primary jurisdiction of its Federal Power Act defenses, including that: (i) EPMI failed to provide the Commission with 60-days prior notice of its intent to terminate the parties’ agreements; (ii) EPMI’s purported termination was not just and reasonable and was contrary to the public interest and; (iii) the Early Termination Payment claimed by EPMI was not just and reasonable and was contrary to the public interest.

²⁴ See Exhibit 2 at § 5.3.

²⁵ See Exhibit 2 at § 1.1.

²⁶ Exhibit 3.

²⁷ Exhibit 4.

that they resulted from EPMI's response to City's RFPs for long-term energy.²⁸ In entering into the long-term transactions, City relied on the alleged financial strength of EPMI's corporate parent, Enron Corp., and City required Enron Corp. to guarantee EPMI's obligations.

30. At EPMI's insistence, EPMI's unique Master Agreement was used as the basic framework to document the two long-term transactions and the terms of the Master Agreement were incorporated in those two long-term agreements.

31. The provisions of the EPMI-drafted Master Agreement include a right to withhold payments when the Buyer disputes a payment obligation, with no obligation to pay unless and until ten (10) days after the dispute is resolved against the Buyer. Section 6.1 of the Master Agreement provides:

If Buyer, in good faith, disputes a statement, Buyer shall provide a written explanation of the basis of the dispute and pay the portion of such statement conceded to be correct no later than the due date. If any amount disputed by the Buyer is determined to be due to Seller, it shall be paid within ten days of such determination, along with interest accrued at the Interest Rate until the date paid.²⁹

The protection from termination in the case of a payment dispute is repeated in Section 4.1(a), describing payment failures as an Event of Default, which concludes: "provided the payment is not the subject of a good faith dispute as described in Section 6."

Therefore, City's dispute of the net amount due under EPMI's invoice relieved the City of any obligation to pay the disputed invoice and did not constitute an Event of Default, nor could it become an Event of Default unless the amount remained unpaid ten days

²⁸ See Exhibits 3 and 4, Agreement Provision No. 2.

²⁹ Exhibit 2 at § 6.1. Compare with Section 9.3 of the WSPP Agreement, which requires payment of amounts in dispute.

after the resolution of the payment dispute.³⁰ Such a resolution has not occurred (although subsequent correspondence from EPMI demonstrates that City was correct that no amounts would be due after set off or recoupment).

32. The Master Agreement included provisions requiring netting of payments for transactions within the same month. The EPMI drafted Master Agreement also contained an uncommon broader, general right to set off or recoup outstanding transactions, without regard to whether they involved payments due in the same month. It was this additional right to recoup or set off, on which City relied in December 2001 after EPMI notified City that EPMI would not be able to perform its delivery obligations, had failed to provide Performance Assurances properly requested by City, and appeared to be going out of business. The provision states:

If Buyer and Seller are each required to pay an amount in the same month, then such amounts with respect to each Party shall be aggregated and the Parties shall discharge their obligations to pay through netting, in which case the Party, if any, owing the greater aggregate amount shall pay to the other Party the difference between the amounts owed. Each Party reserves to itself all rights, set offs, counterclaims and other remedies and defenses consistent with Section 5 (to the extent not expressly herein waived or denied) which such Party has or may be entitled to arising from or out of this Agreement. All outstanding Transactions and the obligations to make payment in connection therewith or under this Agreement or any other agreement between the Parties may be offset against each other, set off or recouped therefrom.³¹

³⁰ EPMI's invoice is attached as Exhibit 9.

³¹ Exhibit 2 at § 6.2 (emphasis supplied). The first two sentences in Section 6.2 are nearly identical to § 28.1 of the WSP Agreement. The third, operative sentence, is unique to EPMI's Master Agreement contract.

33. **Long-Term Transactions.** The City sought price stability and a reliable source of power to protect its customers from the extreme volatility of the dysfunctional spot markets. Consistent with the Commission's encouragement of long-term transactions to avoid over reliance on spot markets, the City requested proposals for long-term power contracts. Given its obligation to serve, it was critical that the City find a reliable long-term source of power. The City's internal risk management guidelines prohibited it from entering into contracts with non-investment grade counterparties.³² EPMI, at the time, held its parent out as an investment grade corporation and offered both its parent's financials and its parent's guaranty to the City. In reliance on these financial statements, representations and guaranties, the City contracted to buy "firm power" from EPMI at fixed prices covering extended periods of time under the long-term confirmations.³³ The City's expectation was that it was contracting with a financially stable entity, and would continue to receive good faith performance delivering reliable firm power in exchange for a fixed price.³⁴

34. **August 2000 Long-Term Confirmation – Nine-Year Transactions.** Under the August 29, 2000 long-term confirmation, City agreed to purchase 75 megawatts of firm energy from EPMI, 24 hours a day, seven days a week, from January 1, 2001, through December 31, 2009. The 75 megawatts consisted of three blocks of 25 megawatts each. Two blocks of the power were to be delivered to City at the California-Oregon border and were priced at \$47.15 per megawatt hour. The other

³² Exhibit 1 at P 15.

³³ See Exhibits 3 and 4.

³⁴ Exhibit 1 (Hatcher Affidavit) at P 15.

25-megawatt block, priced at \$43.95 per megawatt hour, was to be delivered at a point in Arizona identified as "Palo Verde."³⁵

35. **April 2001 Long-Term Confirmation – Five-Year Transaction.**

Under the April 17, 2001 long-term confirmation, City agreed to purchase 50 megawatts of firm energy from EPMI, 24 hours a day, seven days a week, from January 1, 2002, through December 31, 2006. The 50 megawatts, priced at \$64.00 per megawatt hour, were to be delivered to City at a point within California identified as "NP-15".³⁶ EPMI did not deliver any energy under this transaction, nor did it fulfill the condition precedent to deliver a \$350 million guarantee from Enron Corp. to support the transaction.

36. **Open Short-Term Transactions.** At the time that EPMI and Enron Corp. filed for bankruptcy on December 2, 2001, there were approximately 60 open short-term transactions under which EPMI agreed to buy energy from City, with the latest delivery date being March 31, 2002. As of December 20, 2001, the date on which EPMI claims City defaulted under the agreements by not paying the amount demanded by EPMI in its November invoice, EPMI actually owed City a net sum in excess of \$1 million. EPMI simply ignored City's correspondence disputing the net amounts owed under the short and long-term transactions in order to manufacture a claim for an Early Termination Payment.

³⁵ See Exhibit 3.

³⁶ See Exhibit 4. Notably, on February 11, 2003, the California Independent System Operator suspended EPMI's trading and market participation rights, after which EPMI would have been unable to deliver energy to City at NP-15.

B. EPMI's Purported Cancellation of Long-Term Transactions

37. On December 11, 2001, City sent EPMI a letter addressing calculations of amounts due and City's contractual right to recoup or set off payments owed to it for actual power deliveries and retain any remaining amount as security for City's continuing deliveries, because EPMI had failed to respond to City's demand for \$31,750,000 of Performance Assurance.³⁷ City also informed EPMI that it would elect to set off or recoup payments through December 4, 2001, when City would suspend deliveries to EPMI,³⁸ pending EPMI's delivery of Performance Assurance.

38. EPMI failed to respond to or acknowledge City's prior demand for Performance Assurance and City's dispute based on City's calculations and its rights to set off or recoup amounts owed by EPMI to City.³⁹

39. On December 21, 2001, the day after the November invoice would have been due if it were not subject to the City's written dispute, EPMI sent City a letter claiming payment was due in the amount of \$1,010,439.50. EPMI's letter neither acknowledged nor disputed City's right to Performance Assurance nor did it address

³⁷ See Exhibit 8. As discussed herein, City's request for Performance Assurance was authorized by Enron Corp.'s credit downgrade to below investment grade. It was also justified by EPMI's failure to deliver its required parental guaranty, its corporate parent's restatement of earnings, dating back before the contract was executed and impacting the financial statements relied on by City when executing the contracts, EPMI and EPMI's corporate parent's credit downgrade and subsequent bankruptcy, and by EPMI's November 29, 2001 notification to City that EPMI would not be able to meet its delivery obligations.

³⁸ See *id.*

³⁹ See Exhibit 9.

City's dispute of any payment obligation, as described in City's December 11, 2001 notice to EPMI.

40. On December 21, 2001, City responded that it "has not failed to make a payment which has become due."⁴⁰ City also reiterated its position based on its contractual right to set off or recoup that no amounts were owed by EPMI.⁴¹ City reiterated its intent to hold outstanding amounts, due to City's doubt as to EPMI's ability to perform, as security for payment for services City provided to EPMI from December 1 through December 4, 2001.

41. EPMI again ignored City's dispute and sent a letter dated December 28, 2001, claiming a right to cancel the contracts as of January 2, 2002.⁴² City responded by letter on January 10, 2002, again explaining the set off of amounts due.⁴³ Despite the contract language requiring that payment disputes be resolved before payments become due, much less before an Event of Default can be asserted, EPMI never made any effort to respond to the merits of City's dispute. Instead of addressing City's exercise of its rights under EPMI's jurisdictional contract, EPMI, in keeping with its unreasonable and disruptive strategy of terminating contracts to obtain cash, misused City's good faith dispute and declared City's non-payment an Event of Default. By ignoring the good faith dispute of the invoice based on the City's contractual rights, EPMI unlawfully avoided performance of the contract, and manufactured a claim to

⁴⁰ See Exhibit 10.

⁴¹ See Exhibit 11.

⁴² See Exhibit 12.

⁴³ See Exhibit 13.

“monetize” the purported “value” of the long-term contract created when short-term prices dropped below the long-term contract price.

42. Five months later, on May 30, 2002, EPMI sent City a letter claiming it had a right to an Early Termination Payment in the amount of \$147 million.⁴⁴ EPMI proceeded to file its adversary proceeding in the Bankruptcy Court without having resolved the payment dispute, and without seeking mediation as required by Section 8.6 of the Master Agreement.

43. In addition to EPMI’s unlawful cancellation based on an unresolved dispute, EPMI’s May 30, 2002 letter and its complaint against the City filed in Bankruptcy Court claimed two additional, equally invalid, and never before asserted grounds for canceling the agreements: (1) EPMI alleged City defaulted by suspending deliveries; and (2) EPMI alleged City defaulted by not paying EPMI’s (improper) demand for cash “margin,” dated November 27, 2001.⁴⁵ As explained herein, there was no contractual right to cancel the contracts based on City’s suspension of deliveries. Likewise, EPMI’s “margin call” was improperly made, materially defective, promptly disputed by City, abandoned by EPMI and was not a valid grounds for cancellation.

44. EPMI neither notified the Commission of the purported cancellation of its agreements with City nor sought approval of such cancellation as required by Section 205(d) of the Federal Power Act.

⁴⁴ See Exhibit 6.

⁴⁵ Exhibit 14.

C. EPMI's Deteriorating Financial Condition Warranted City's Demand for Security

45. City bargained for a stable, long-term source of fixed price power with a counterparty, EPMI, that backed the transactions with guarantees from its corporate parent, Enron Corp., whose financial statements created the façade of an investment grade financial counterparty. That bargain, in truth, was an illusion.

46. In the fall of 2001, Enron Corp.'s financial house of cards was crumbling, resulting in a chaotic sequence of events and disputes under the agreements briefly summarized as follows:

- a. In October 2001, Enron Corp. took a \$1 billion charge due to write-downs of investments, disclosed its equity shrank by \$1.2 billion, and became the subject of an SEC investigation.⁴⁶
- b. On November 8, 2001, Enron Corp. restated its earnings for 1997 through 2000, and stated that "the financial statements for these periods and the audit reports relating to the year-end financial statements for 1997 through 2000 should not be relied upon."⁴⁷

⁴⁶ See Exhibit 16.

⁴⁷ Exhibit 5. Notably, City required EPMI to deliver to City copies of Enron Corp.'s financial statement for 1999 before City would execute the long-term confirmations with EPMI. The Bankruptcy Examiner determined that Enron Corp. purposefully misrepresented its financial condition to enable EPMI to enter into energy transactions without having to post collateral. See Exhibit 26 (Second Interim Report of Neal Batson, Court-Appointed Examiner, dated January 21, 2003) at pp. 9, 15, 18-30, App. Q.

- c. Enron Corp. tried to resolve its liquidity problems by extending its debt payments, obtaining additional lines of credit, and agreeing to merge with Dynegy.⁴⁸
- d. On November 27, 2001, EPMI sent City an unwarranted and materially defective “margin call” demanding payment of \$79,250,000 in cash by the close of business on November 28, 2001.⁴⁹ EPMI’s “margin call” was not in accordance with the contract terms and violated the California Uniform Commercial Code.⁵⁰ By letter dated November 28, 2001, City disputed the obligation to pay the “margin call”.⁵¹ EPMI never responded and abandoned its demand for margin. EPMI did not rely upon the “margin call” as a ground for cancellation. EPMI did not discuss the “margin call” again until several months later in EPMI’s letter of April 4, 2002.
- e. On November 28, 2001, the credit rating of Enron Corp. and EPMI was downgraded to “junk” status (specifically, B-) by Standard and Poor’s, and Enron’s merger with Dynegy fell apart.⁵²
- f. On November 29, 2001, EPMI approached City regarding an assignment of the agreements by EPMI, and City consented to an assignment to PG&E Energy Trading. This assignment was on the verge of being consummated when Enron and EPMI filed for bankruptcy protection on December 2, 2001.

⁴⁸ See Exhibit 16.

⁴⁹ See Exhibit 14 (November 27, 2001 letter).

⁵⁰ See CAL. COM. CODE §§ 2101 *et al.* (West 2002).

⁵¹ See Exhibit 15.

⁵² See Exhibit 16.

EPMI refused to consummate the assignment following Enron's bankruptcy filing and left City with no assurance of performance.⁵³

- g. On November 29, 2001, EPMI notified City that EPMI would fail to deliver the agreed upon energy under the long-term confirmations. EPMI subsequently failed to deliver the full amount of agreed upon power on 22 days in December 2001.

47. As of December 1, 2001, EPMI had ceased to fully perform under its agreements with City. EPMI was not responding to requests from City for Performance Assurances and was scheduling energy deliveries in a sporadic and disruptive manner.⁵⁴

48. At the same time that it failed to fully perform under the agreements with City, it appears that EPMI did perform under certain agreements with other counterparties (*e.g.*, Nevada Power Company).⁵⁵

49. Although EPMI was declining or unable to perform its obligations to City, City fully performed by continuing to deliver energy to EPMI under the short-term transactions. On November 29, 2001, to ensure payment for City's deliveries to

⁵³ A subsequent attempt at a business resolution of EPMI's inability to perform was likewise abandoned by EPMI. In April of 2002, over three months after EPMI's purported termination, EPMI contacted City and renewed the attempts at assignment. City again agreed to work with EPMI to achieve such an assignment, but EPMI ultimately abandoned the concept in June of 2002, in favor of pursuing an Early Termination Payment through litigation. EPMI personnel informed City that EPMI decided it had a chance of getting more money from litigation, and even if litigation failed, EPMI would be able to restart deliveries at that point and earn profits from sales to City. *See* Exhibit 1 (Hatcher Affidavit), at P 23.

⁵⁴ *See id.* at P 21 (Hatcher Affidavit).

⁵⁵ *See Nevada Power Company and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al.*, 105 FERC ¶ 61,185 (2003).

EPMI in light of Enron Corp. and EPMI's downgrading, which constituted a Material Adverse Change under the agreements with City, City properly requested Performance Assurance in the amount of \$31.75 million.⁵⁶ Due to EPMI's notice of inability to perform, and EPMI's Material Adverse Change, City had indisputable grounds for requesting security regarding EPMI's ability to perform. EPMI neither paid nor made the requested Performance Assurances, nor did EPMI object to the request for Performance Assurances. On December 3, 2001, City notified EPMI that City was intending to suspend deliveries until EPMI provided its Performance Assurance.⁵⁷ Because City had previously scheduled its deliveries to EPMI, City was not able to suspend until after deliveries concluded on December 4, 2001.

50. It is now apparent that EPMI used the confusion and disputes resulting from its financial collapse to manufacture a termination claim against the City. In order to generate immediate cash, EPMI undertook a strategy of forcing the termination of contracts, including contracts with City, in order to "drag money in" through Early Termination Payments.⁵⁸ Enron's actions designed to terminate contracts were performed in bad faith, frustrated City's intent of securing reliable energy at stable prices, aggravated the market disruptions caused by EPMI, and cannot be considered just and reasonable practices under the Federal Power Act.

⁵⁶ See Exhibit 17.

⁵⁷ See Exhibit 18.

⁵⁸ See Exhibit 19 (Enron e-mail dated November 30, 2001) and Exhibit 20 (Choi Deposition transcript).

D. Existing Proceedings

51. In accordance with Rule 206(b)(6), 18 C.F.R. § 385.206(b)(6) (2003), City states that EPMI filed a complaint with the United States Bankruptcy Court for the Southern District of New York, alleging a right to an Early Termination Payment. EPMI claims the Master Agreement and long-term confirmations provide for an Early Termination Payment amount in “excess of \$100 million.” EPMI’s Bankruptcy Court Early Termination Payment complaint against City requires the resolution of several issues within the Commission’s primary jurisdiction.

52. EPMI’s Bankruptcy Court claim for Early Termination Payment implicates the following issues within the Commission’s primary jurisdiction: (1) determination of violations of tariffs, including violation of market-based rate authorities and relief therefrom; (2) determination of violations of the Federal Power Act and relief therefrom; (3) determination of the lawfulness of contract terminations under Sections 205, 206 and 309 of the Federal Power Act; and (4) determinations of whether termination charges must be based on market or cost-of-service, and the just and reasonable level of such charges, if any.

53. In October 2002, City filed various motions with the United States District Court for the Southern District of New York, seeking, *inter alia*, referral to the Commission of the issues arising under the Federal Power Act in relation to EPMI’s purported termination and claim for an Early Termination Payment. Because it did not take jurisdiction over the case on bankruptcy law grounds, the District Court declined to reach the question of referral of the Federal Power Act defenses to the Commission, and returned the proceeding to the Bankruptcy Court.

E. Commission Jurisdiction

1. The Authority to Determine Whether EPMI’s Contract Cancellation Involves Just and Reasonable Rates, Charges, Terms, Conditions and Practices Rests Exclusively with the Commission

54. The Federal Power Act⁵⁹ vests authority in the Commission to determine whether rates, charges or practices for any jurisdictional sales of electric energy at wholesale are “just and reasonable,” and to determine a “just and reasonable” rate or practice if it determines that a rate or practice affecting a rate is “unjust, unreasonable, unduly discriminatory or preferential.”⁶⁰ This authority to determine whether a rate or practice is just and reasonable rests exclusively with the Commission.⁶¹ As the Commission has recognized:

Electricity is not just any commercial good or service. Rather, Congress in the Federal Power Act has charged [the Commission] with ensuring that sales for resale or transmission in interstate commerce by public utilities take place under terms and conditions that are just and reasonable.⁶²

55. The Commission’s jurisdiction over tariffs and contracts governing the sale of electric energy at wholesale extends to any modification or change to a tariff or contract including the termination of the tariff or contract.⁶³ The Commission’s

⁵⁹ 16 U.S.C. §§ 824 *et seq.*

⁶⁰ *See* 16 U.S.C. §§ 824d(a), 824e(a).

⁶¹ *See* 16 U.S.C. § 824(b); *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 371 (1988) (“FERC has exclusive authority to determine the reasonableness of wholesale [electricity] rates.”).

⁶² *Promoting Wholesale Competition Through Open Access*, FERC Stat. and Regs. ¶ 31,048 at 30,306 (1997) (“Order No. 888-A”).

⁶³ *See, e.g.*, Order No. 888-A at 30,305-306 (“a termination of service is clearly a change in service”); *Kansas Gas & Electric Co.*, 24 FERC ¶ 61,377 at 61,787

(Footnote con’t...)

jurisdiction is thus exclusive as “no change may be made . . . in any . . . rates, charges classifications or service” absent Commission approval.⁶⁴

56. City has answered EPMI’s bankruptcy complaint, in part, by asserting the various Federal Power Act issues raised herein as defenses in its answer to the Bankruptcy Complaint. The Bankruptcy Court has jurisdiction over the Bankruptcy Complaint and, therefore, over the City’s defenses.⁶⁵ However, as stated in City’s answer in the adversary proceeding, the Federal Power Act defenses raised herein can only be decided by the Commission.⁶⁶ The propriety of the termination of agreements subject to Commission jurisdiction falls exclusively within the purview of the Commission’s jurisdiction. In *NRG Energy, Inc. v. Blumenthal et al.* (“NRG”),⁶⁷ the United States District Court for the Southern District of New York, considering a request to cease performance under an agreement, addressed a motion for injunctive relief concerning the interrelationship of bankruptcy and federal energy regulatory laws and whether the proper authority to address the issue raised was a federal district court or the Commission.⁶⁸ The Court concluded that since the agreement was a wholesale power

(Footnote con’t....)

n.10 (1983) (stating that proposed “cancellation of rate schedule is a change in service under Section 205(d) of the Federal Power Act”); *Louisiana Power & Light Co.*, 17 FERC ¶ 61,230 at 61,442 (1981) (establishing that under 18 C.F.R. §§ 35.15 and 2.4 and *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 313, 423-424 (1952), the Commission must approve termination of service).

⁶⁴ See 16 U.S.C. § 824(d).

⁶⁵ See *Reiter v. Cooper*, 507 U.S. 258, 268-69 (1993).

⁶⁶ See *id.* at 265.

⁶⁷ See *NRG Energy, Inc. v. Blumenthal, et al.*, 2003 U.S. Dist. LEXIS 11111 (S.D.N.Y. 2003) (“NRG”).

⁶⁸ See *id.*

contract, the agreement fell within the Federal Power Act's purview and the Commission's exclusive jurisdiction. The Court in *NRG* also concluded that "the [Federal Power Act] has vested [the Commission] as the authority that may alter the terms of the Agreement."⁶⁹ The Court explained:

Here, the Agreement between [the parties] is a wholesale power contract. The Agreement therefore falls within the [Federal Power Act's] purview, and hence, [the Commission's] exclusive jurisdiction. Accordingly, the [Federal Power Act] has vested [the Commission] as the authority that may alter the terms of the agreement. [Debtor] may believe that it is entitled to cease performance under the Agreement . . . because the Bankruptcy Court allowed [debtor] to reject the Agreement. However, [the Commission] acted within its legal authority, delegated to it under the [Federal Power Act], when it ordered [Debtor] to continue to comply with its obligations under the Agreement.⁷⁰

The Court in *NRG* also clarified that where the issues affect the Commission's regulatory authority, as they clearly do herein, the Commission must address the issues, not the Court.⁷¹ Accordingly, the determination of whether it is just, reasonable or otherwise lawful for a utility to alter or cease performance of a jurisdictional contract rests with the Commission. So the reasonableness of EPMI's purported termination of its jurisdictional contract and the determination of all relevant termination fees and penalties, based upon a just and reasonable rate, fall within the Commission's jurisdiction.

57. As Congress granted the Commission exclusive jurisdiction to make determinations regarding termination of service under the Federal Power Act, only

⁶⁹ *Id.* at *8.

⁷⁰ *Id.* at *8, *11.

⁷¹ *See id.* at *11; *see also id.* at *9-*10 ("If the decision is regulatory, it may not be altered or impeded by any court lacking jurisdiction to review it.").

the Commission has the jurisdiction and expertise necessary to consider the standards of the Federal Power Act and to determine whether such standards have been met.⁷² In fact, the Commission recognized terminations must be addressed by the Commission, and not by a bankruptcy or federal district court as the terms and conditions of power sales agreements are within the exclusive jurisdiction of the Commission and as attempts to terminate such agreements go to the heart of the Commission's regulatory responsibilities.⁷³ Given the clear Congressional intent that the Commission decide such matters, and the importance of protecting customers, which is the primary goal of the Federal Power Act, Commission consideration regarding the termination of service is necessary and appropriate.

58. The Federal Power Act establishes with the Commission "exclusive authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce."⁷⁴ Included within this establishment of authority is the "exclusive authority to determine the reasonableness of wholesale rates."⁷⁵ Such authority extends to the determination of just reasonable terms, conditions and practices.⁷⁶ To this effect, the Commission specifically recognized that it has been

⁷² See *id.* at *7-*11.

⁷³ See *Blumenthal v. NRG Power Marketing, Inc.*, 103 FERC ¶ 61,344 at P 46 (2003) (Order Addressing Amended Complaint) ("*NRG I*"); *Blumenthal v. NRG Power Marketing, Inc.*, 104 FERC ¶ 61,211 at PP 18-19 (2003) (Order Denying Rehearing) ("*NRG II*"). See generally *Blumenthal v. NRG Power Marketing, Inc.*, 103 FERC ¶ 61,188 (2003) (Order Requiring Compliance with Contract) ("*NRG P*") (providing brief background of the *NRG* proceedings).

⁷⁴ See *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982). See also *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 956, 966 (1986).

⁷⁵ See *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 371 (1988).

⁷⁶ See Order No. 888-A at 30,306.

charged by Congress, in the Federal Power Act, with the responsibility to ensure “that sales for resale or transmission in interstate commerce by public utilities take place under terms and conditions that are just and reasonable.”⁷⁷

59. With respect to the determination of just and reasonable rates, terms, and conditions, the Supreme Court clarified that the right to a reasonable rate is “the right to the rate which [the Commission] files or fixes, and that, except for review of the Commission’s orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one.”⁷⁸

60. Additionally, and most significantly, the Supreme Court noted that “to reduce the abstract concept of reasonableness to concrete expression in dollars and cents is the function of the Commission.”⁷⁹ Moreover, “no court may substitute its own judgment on reasonableness for the judgment of [the Commission].”⁸⁰

61. Accordingly, the determination of just and reasonable practices and termination charges lies solely within the jurisdiction of the Commission. This determination of reasonableness of Commission-regulated rates and agreements may not be collaterally attacked in state or federal courts and “[t]he only appropriate forum for such a challenge is before the Commission or a court reviewing the Commission’s order.”⁸¹

⁷⁷ *Id.*

⁷⁸ *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-52, (1951).

⁷⁹ *Id.*

⁸⁰ *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981).

⁸¹ *Mississippi Power & Light Co.*, 487 U.S. at 375.

62. This significant longstanding precedent was recently applied, in a more limited nature, in a proceeding addressing the Commission's jurisdiction over the termination of Commission jurisdictional contracts in a bankruptcy context.⁸² In *Mirant*, the Court denied debtor's motion to reject a Commission jurisdictional agreement between the debtor corporation and a creditor electric power supply company, holding that it was prohibited from entertaining debtor's collateral attack on the filed rates and concluding that while it had exclusive jurisdiction over the debtor's property, that jurisdiction did not give the Court the power to disregard the Congressional mandate that the Commission had exclusive jurisdiction over the sales of electric energy at wholesale in interstate commerce.⁸³ The *Mirant* Court recognized that there can be no divided authority over interstate commerce.⁸⁴ The *Mirant* Court also emphasized that a court may not substitute its judgment on reasonableness for the Commission's judgment, as Congress granted exclusive authority over rate regulation to the Commission.⁸⁵ Finally, the *Mirant* Court stressed that the reasonableness of rates and agreements regulated by the Commission may not be collaterally attacked in state or federal courts as the only appropriate forum for such challenge is before the Commission or a court reviewing the Commission's order.⁸⁶

63. Pursuant to the Federal Power Act, the Commission oversees its market-based rate regime and has the authority and the duty to regulate the rates for

⁸² See *In re Mirant Corp.*, 2003 U.S. Dist. LEXIS 23600 (N.D. Tex 2003).

⁸³ See *id.* at *23.

⁸⁴ See *id.* at *22.

⁸⁵ See *id.* at *22-*23.

⁸⁶ See *id.*

wholesale electric power and to prohibit utilities from charging unreasonable rates.⁸⁷

Additionally, under the Federal Power Act, where the Commission finds a rate unreasonable, it “must order imposition of a just and reasonable rate” and may, where it finds violations of the filed tariff or contract, “perform any and all acts . . . it may find necessary or appropriate” to carry out its regulatory responsibilities.⁸⁸ It is thus evident that the Commission was given the sole responsibility for reviewing the lawfulness of contracts governing the wholesale sale of energy in interstate commerce, to review changes thereto, to determine just and reasonable rates, and to remedy any unlawful conduct associated with the sales.⁸⁹

2. The Commission Should Exercise Its Jurisdiction Because It Possesses Special Expertise with Regard to the Matter at Hand, Because Uniformity of Interpretation Is Required in Resolving the Matter at Hand, and Because the Matter at Hand is Important to the Commission’s Regulatory Responsibilities

64. Although EPMI filed a complaint seeking to collect its unlawful termination charge with the Bankruptcy Court, certain defenses raised by City unquestionably fall within the Commission’s jurisdiction. The Commission has developed a three-part test for determining when it should exercise its primary jurisdiction.⁹⁰ This three-part test is applied when there is a question as to whether the Commission or an equally competent court should hear a dispute. The Commission

⁸⁷ See *Consolidated Edison Co. of New York v. FERC*, 347 F.3d 964 at 967 (D.C. Cir. 2003).

⁸⁸ *Id.* (citing 16 U.S.C. § 825(h)); *Towns of Concord, Norwood, & Wellesley, Mass. v. FERC*, 955 F.2d 67, 73 (D.C. Cir. 1992)).

⁸⁹ See *In Re Mirant Corp.*, 2003 U.S. Dist. LEXIS 23600 (N.D. Tex. 2003); see also *United Gas Pipe Line Co. v. Mobile Gas Corp.*, 350 U.S. 332, 341-43 (1956).

⁹⁰ See, e.g., *PPL Electric Utilities Corp.*, 101 FERC ¶ 61,370 at 62,546 (2002).

generally elects to exercise its primary jurisdiction based upon three factors: (1) whether the Commission possesses some special expertise which makes the case particularly appropriate for the Commission to decide; (2) whether there is a need for uniformity of interpretation of the type of issue presented; and (3) whether the case is important in relation to the regulatory responsibility of the Commission.⁹¹

65. In the present case, the Commission must exercise its jurisdiction because the core of the Commission's regulatory obligations are impacted by EPMI's actions, and the provision of relief from such actions is a fundamental assumption on which market-based regulation is based. In addition, due to the numerous investigations into the western markets generally, and EPMI's actions in particular, the Commission has a unique and special expertise to review the EPMI actions.

a) The Commission Possesses Special Expertise that Makes this Case Appropriate for Commission Decision

66. As noted above, the Supreme Court has repeatedly held that issues involving justness and reasonableness under the Federal Power Act must be decided by the Commission, because such standards have no meaning beyond that given by the Commission. In addition, the Commission possesses substantial expertise, which makes this case particularly appropriate for the Commission to decide. EPMI's misdeeds under its market-based rates have been the subject of no fewer than six Commission

⁹¹ See *id.*; see also *Arkansas Louisiana Gas Co. v. Hall*, 7 FERC ¶ 61,175 at 61,322, *reh'g denied* 8 FERC ¶ 61,031 (1979). Accord *Southern California Edison Co.*, 85 FERC ¶ 61,023 at 61,069 (1998); *Portland General Electric Co.*, 72 FERC ¶ 61,009 at 61,021-22 (1995).

investigation proceedings,⁹² creating a body of regulatory knowledge that provides the Commission with a special expertise to understand the circumstances leading to Enron's purported contract cancellation for profit scheme. Those on-going⁹³ proceedings address EPMI's failure to notify the Commission of its change in market power, its accumulation of control over generation through unfiled contracts, its accumulation of control over generation by violating its affiliate standards rules, its use of sleeving to avoid Commission scrutiny of its affiliate transactions, and its gaming strategies to manipulate

⁹² See e.g., *Enron Power Marketing, Inc. et al.*, (Docket No. EL02-113); *Portland General Electric Co., et al.*, (Docket No. EL02-114); *Avista Corp., et al.*, (Docket No. EL02-115); *Enron Power Marketing, Inc. et al.* (Docket No. EL03-77); *American Electric Power Corp., et al.* (Docket Nos. EL03-137 to 179); *Enron Power Marketing, Inc., et al.* (Docket Nos. EL03-180 to EL03-203).

⁹³ The Commission's June 17, 2004 News Release discusses continuing activities in the investigations, stating, in part:

COMMISSION DIRECTS STAFF TO REVIEW ENRON MATERIALS,
RECOMMEND PROCEDURAL STEPS IN PENDING ENRON
PROCEEDINGS

* * *

"As our 2002-2003 staff investigation showed, the corporate culture at Enron 'fostered a disregard for the American energy customer,'" said FERC Chairman Pat Wood, III. "These taped conversations indicate that this corrosive attitude seeped down from the corporate offices to the employees at the front line."

The material was filed with the Commission in the Enron gaming proceeding (EL03-180). The pending staff review will determine whether the material should also apply in other proceedings stemming from Enron's activities during the Western energy crisis. Other proceedings involving Enron include the overall refund proceeding (EL00-95), the Enron-El Paso Electric Co., proceeding (EL02-113), the Enron-Portland General Electric Co. proceeding (EL02-114), and an ongoing investigation into the bidding practices of Enron and other participants in the California spot markets.

and exploit the California Independent System Operator Corporation (“ISO”) and California Power Exchange Corporation (“PX”) markets.

67. Additionally, the Commission has developed vast expertise in addressing EPMI’s market-based rates. The Commission revoked EPMI’s authority to sell power at market-based rates because EPMI violated its Tariff and the Federal Power Act and disrupted the energy markets.⁹⁴ The Commission determined that EPMI violated its market-based rate Tariff by: (1) disregarding its corporate form and violating its affiliate transaction rules; (2) acquiring control over generation assets without notifying the Commission; (3) failing to file a tariff schedule notifying the Commission of certain services; and (4) failing to notify the Commission of its change in market power and other circumstances.⁹⁵ These conclusions, as well as the Commission’s recognition that fraud, deception, and misrepresentation are violations of market-based rate authorizations,⁹⁶ create a regulatory body of knowledge that only the Commission can utilize to determine just and reasonable cancellation terms, conditions, charges and practices. The Commission’s indisputable expertise in the circumstances surrounding the termination of the contracts in dispute herein, as well as the activities which brought about EPMI’s default, make necessary the Commission’s assertion of jurisdiction over the determination of just and reasonable cancellation rates, charges and practices.

⁹⁴ Revocation Order at PP 14-17, 51-56.

⁹⁵ *Id.*

⁹⁶ *Enron Power Marketing, Inc., et al.*, 102 FERC ¶ 61,316 at P 8 (2003) (Order Proposing Revocation of Market-Based Rate Authority).

b) Uniformity of Interpretation of the Questions Raised in This Dispute Is Necessary

68. Only the Commission can provide uniform application of the standards of justness and reasonableness under the Federal Power Act. The Commission's uniform review of the reasonableness of the termination of contracts stemming from the Enron bankruptcy is necessary for the maintenance of a reliable and stable power market. EPMI's practices prior to and surrounding its bankruptcy forced the cancellation of numerous jurisdictional contracts. Uniform review is necessary for the Commission to ensure that bankrupt utilities do not upend the stability and the reliability of the power market through unlawful attempts to generate cash.

69. The certainty, stability and reliability that stems from contract performance is essential to the power market. EPMI's practices destroyed the stability and reliability of its contracts and such practices threaten consumers with degradation of firm service. The bargain the City believed it struck – an agreement for long-term firm power at a fixed price from an investment grade, financially solid counterparty – was converted into an illusory trap by EPMI's unlawful misuse of its jurisdictional contract provisions. The need for contract stability to foster markets has been raised by sellers in recent cases. Sellers have argued that the Commission must make the market safe for sellers by ensuring stability of contracts. It is equally true that buyers must be protected. There must be both willing buyers and sellers if markets are to develop, work efficiently and encourage infrastructure investment. Buyers will not participate in markets where the scales are tipped in favor of sellers to the extent sellers can, on a whim, choose to replace performance and energy deliveries with bad faith cancellation demands in the

pursuit of short-term cash flow, and abuse the filed rate doctrine as a shield exempting such wrongful actions from well-established contract defenses. The Federal Power Act was created for the public's benefit, not to make it easy and convenient for sellers to engage in misrepresentations and collect unjust profits. Accordingly, the Commission must assert its jurisdiction granted by the Federal Power Act, to ensure uniform determinations of the reasonableness of EPMI's termination terms, practices and charges in order to maintain reliable, stable, power markets.

c) This Case Is Important to the Commission's Regulatory Responsibilities

70. The Commission's assertion of jurisdiction in this proceeding is important to the performance of the Commission's regulatory responsibilities. The Commission has recently stated that its responsibility to review attempts to cancel power sales agreements, and to assure that power sales are performed and terminated only in accordance with the Federal Power Act and the Commission's regulations, goes to the heart of the Commission's regulatory responsibilities.⁹⁷ The issues presented in this proceeding are also fundamental to the Commission's market-based rate regime. Under the Commission's market-based rate system, the Commission relies on a utility's lack of market power, depends on the utility to inform it of any change in its circumstances or

⁹⁷ See *NRG II*, 103 FERC at 61,318; *NRG III*, 104 FERC at 61,736 (stating that terms and conditions of power sales agreements are within the exclusive jurisdiction of the Commission, attempts to terminate such agreements go to the heart of the Commission's regulatory responsibilities and such matters must be addressed by the Commission, and not by a bankruptcy or district court).

market power, and presumes a lack of deceit, misrepresentation, and fraud.⁹⁸ Based on those presumptions, the Commission relies on a functioning market to regulate the utilities, and deduces that market-based rates, terms, conditions and practices are just and reasonable.⁹⁹ The ability to bring a complaint before the Commission if any of the presumptions becomes untrue is a fundamental pillar of the market-based rate regime.¹⁰⁰ Allowing a utility to unilaterally and wrongfully terminate energy sales contracts or to default due to its own market power abuse, without the approval and involvement of the Commission, would render meaningless the Commission's strict requirements and enforcement with regard to market-based rates. Allowing a utility to circumvent the Commission's determination of just and reasonable terms for the cancellation of such service is inapposite to the Commission's most basic regulatory responsibilities. Accordingly, the Commission should assert its jurisdiction over this dispute in order to confirm and emphasize the Commission's authority over market-based rates.

71. Allowing EPMI to profit from its unreasonable and unlawful conduct will create an open season for tariff violations, sharp practices, unreasonable conduct and market instability. The Commission's prior proceedings demonstrate that all of the presumptions underlying market-based rates were laid to waste by EPMI. The Commission has determined that EPMI hid its market power from the Commission and

⁹⁸ See Order Proposing Revocation of Market-Based Rate Authority, 102 FERC at P 8; see also *California ex rel. Lockyer v. British Columbia Power Exchange Corp., et al.*, 99 FERC ¶ 61,247 at 62,062 (2002) ("*Lockyer*").

⁹⁹ See *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc. et al.*, 105 FERC ¶ 61,185 at 61,982 (2003).

¹⁰⁰ See *Lockyer*, 99 FERC at 62,064; *Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364, 370-71 (D.C. Cir. 1998).

used its market power to manipulate market prices and terms of service, and caused disruptions throughout the Western markets. Allowing EPMI to unreasonably forsake stability to gain short-term profits will discourage parties from entering into long-term contracts, resulting in further market instability. In order to ensure just and reasonable rates and confidence in markets through the maintenance of stable markets, the Commission must assert its jurisdiction over EPMI's rates, terms and conditions, and practices, and the justness and reasonableness of the termination penalties resulting from EPMI's purported termination of the contracts in dispute herein.

F. The Enron Bankruptcy Proceeding Neither Hinders Nor Diminishes the Commission's Authority in this Proceeding

72. While the filing of a petition for bankruptcy normally stays certain actions against the debtor, the Commission has repeatedly recognized that the Section 362(b)(4) of the Bankruptcy Code provides an exception from the automatic stay provisions of the Bankruptcy Code for "an action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment" and that "actions taken under the authority granted [the Commission] by the Federal Power Act and the controlling regulations fit within this exception, and, therefore, are exempt from the automatic stay provision."¹⁰¹ This exception clearly applies to the instant Complaint

¹⁰¹ *Pacific Gas and Electric Co.*, 106 FERC ¶ 61,058 at 61,188 (2004) (citing in support 11 U.S.C. § 362(b)(4) (1994 & Supp. 2000); *Virginia Electric and Power Co.*, 84 FERC ¶ 61,254 (1998); *Century Power Corp.*, 56 FERC ¶ 61,087 (1991)); *Pacific Gas and Electric Co.*, 106 FERC ¶ 61,054 at 61,183 (2004) (same); *Pacific Gas and Electric Co.*, 106 FERC ¶ 61,036 at 61,131 (2004) (same); *California Independent System Operator Corp.*, 106 FERC ¶ 61,032 at 61,108-9 (2004) (same); *Pacific Gas and Electric Co.*, 100 FERC ¶ 61,233 at 61,827 (2002) (same); *Pacific Gas and Electric Co.*, 98 FERC ¶ 61,281 at 62,214 (2002) (Footnote con't...)

as it seeks to invoke the Commission's exercise of its regulatory power under the Federal Power Act in a determination of just and reasonable rates, terms, conditions, and practices related to contract terminations.

73. The Commission has already concluded that this exception applies to its dealings with Enron, Enron's market-based rates, and the fall-out from Enron's market manipulation and Tariff violations. In its order revoking Enron's market-based rate authority, the Commission unequivocally held that "[t]he Bankruptcy Code is not, as Enron would have it, a shield to protect market manipulation, unjust and unreasonable rates, and continued failure to comply with Commission orders."¹⁰² Recognizing the application of this exemption to the automatic stay provisions of the Bankruptcy Code

(Footnote con't...)

(same); *Pacific Gas and Electric Co.*, 98 FERC ¶ 61,089 at 61,267-68 (2002) (same); *San Diego Gas & Electric Co. v. Sellers of Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 96 FERC ¶ 61,120 at 61,516 (2001) (same); *Pacific Gas and Electric Co.*, 95 FERC ¶ 61,273 at 61,966 (2001) (same); *Pacific Gas and Electric Co.*, 95 FERC ¶ 61,247 at 61,863 (2001) (same); *California Independent System Operator Corp.*, 95 FERC ¶ 61,024 at 61,075 (2001) (same); *San Diego Gas & Electric Co. v. Sellers of Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 95 FERC ¶ 61,021 at 61,051 (2001) (same); *Pacific Gas and Electric Co.*, 95 FERC ¶ 61,020 at 61,046 (2001) (same). *Accord Pacific Gas and Electric Co.*, 95 FERC ¶ 61,118 at 61,372 n.1 (2001) (concluding that the Commission's actions fall under the exception to the automatic stay provision because the Commission is exercising its regulatory power as a governmental unit and because its actions do not trigger any monetary obligations); *Southern Company Energy Marketing, L.P.*, 84 FERC ¶ 61,199 at 61,986 n.4 (1998) (noting that Commission's action does not violate automatic stay provisions because Commission action is pursuant to the Commission's regulations and an exercise of regulatory power exempt from such automatic stay provisions).

¹⁰²

Revocation Order at P 83.

and stating that it need not seek relief from the stay before taking action,¹⁰³ the Commission emphasized that, in addressing Enron's market-based rates, the Commission is exercising its "undoubted police or regulatory authority . . . to ensure that rates are just and reasonable – as the [Federal Power Act] and [Natural Gas Act] require[]." ¹⁰⁴ The Commission further emphasized that its actions, in revoking Enron's market-based rate authority, "ensure that rates charged by Enron, including its affiliates and subsidiaries, are just and reasonable under both the [Federal Power Act] and the [Natural Gas Act]." ¹⁰⁵ Additionally, the Commission clarified that, especially given Enron's bad acts and the Commission's response thereto, it "do[es] not believe that the automatic stay provision of the Bankruptcy Code bars [the Commission] from ensuring that rates and charges under the [Federal Power Act] and the [Natural Gas Act] are just and reasonable." ¹⁰⁶ Similarly, this well-recognized exception from the bankruptcy stay applies to the instant Complaint.

74. The Commission further explained the application of the exception from the stay provision of the Bankruptcy Code in the *NRG* proceedings.¹⁰⁷ The Commission stated that "the Bankruptcy Code *clearly* signals that regulatory agencies, such as the Commission, *retain their full rights to review matters within their regulatory ambit* during bankruptcy."¹⁰⁸ Additionally, reiterating that the exception

¹⁰³ See *id.* at P 84.

¹⁰⁴ *Id.* at P 81.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at P 83.

¹⁰⁷ See *NRG II*, 103 FERC ¶ 61,344 (2003); *NRG III*, 104 FERC ¶ 61,21 (2003).

¹⁰⁸ *NRG II*, 103 FERC at 62,318 (emphasis added). Accord *NRG III*, 104 FERC at 61,735 (reiterating that "the Bankruptcy Code clearly signals that regulatory agencies, such as the Commission, retain their full rights to review matters within
(Footnote con't...)

prevents a bankruptcy court from interfering with governmental regulatory actions, the Commission highlighted that “this section of the Bankruptcy Code indicates that an agency retains its traditional control over rates throughout a bankruptcy.”¹⁰⁹ Moreover, the Commission stated that, even if the Commission’s action conflicts with a course taken by a bankruptcy court, the Commission may take regulatory action that it deems appropriate under the Federal Power Act if such action serves a regulatory purpose.¹¹⁰ In such cases, the Commission explained, the bankruptcy stay is excepted where the action is not “‘designed to advance the government’s pecuniary interest,’ as where the agency is a creditor of the bankrupt entity,”¹¹¹ and where the agency action “is ‘aimed at effectuating public policy’ consistent with an agency’s statutory responsibilities.”¹¹²

75. Applying the two factors laid out in *NRG II*, it is clear that the bankruptcy stay has no effect on, and the Commission can exercise, its regulatory authority in addressing the instant Complaint. In addressing the issues contained herein,

(Footnote con't....)

their police or regulatory power during bankruptcy” and that “Section 362 generally prevents bankruptcy courts from interfering with governmental regulatory actions by providing that the stay of proceedings upon the filing of a bankruptcy petition does not apply to a proceeding by a governmental unit to enforce its regulatory powers”).

¹⁰⁹ *NRG II*, 103 FERC at 62,318. See also *NRG III*, 104 FERC 61,735-36.

¹¹⁰ See *NRG II*, 103 FERC at 62,318-19.

¹¹¹ *Id.* at 61,318 (citing *Eddleman v. Dept. of Labor*, 923 F.2d 782, 791 (10th Cir. 1991), overruled in part on other grounds by *Temex Energy v. Underwood, Wilson, Berry, Stein & Johnson*, 968 F.2d 1003, 1005 n.3 (10th Cir. 1992) (indicating that most courts agree that “the Section 362(b)(4) exception can apply to agency actions, even though such actions may affect debtor assets”).

¹¹² *Id.* at 61, 319 (citing as example *In re Cajun Electric Power Coop., Inc.*, 185 F.3d 446, 453 (5th Cir. 1999) (upholding a state commission’s reduction of debtor’s rates during the pendency of a bankruptcy proceeding)).

the Commission is not advancing its pecuniary interest. Rather, fulfilling the second prong of the test laid out in *NRG II*, Commission action addressing this Complaint would be squarely aimed at effectuating public policy consistent with the Commission's statutory responsibilities, as it would ensure that EPMI does not charge rates and undertake practices that are unjust and unreasonable and in contravention of the Federal Power Act.

G. Alternative Dispute Resolution

76. Pursuant to Rule 206(b)(9), 18 C.F.R. § 385.206(b)(9) (2003), City states that it has not used the Commission's Enforcement Hotline or other alternative dispute resolution mechanisms. At the time Enron filed for bankruptcy protection, City and EPMI were on the verge of effecting an assignment of EPMI's rights and obligations to a creditworthy third party, which effort was abandoned by EPMI, as was a subsequent attempt to complete an assignment. City also notes that EPMI initiated an adversary proceeding in the Bankruptcy Court without submitting the dispute to contractually required mediation, which is a prerequisite to filing any action based on the contract.¹¹³ Finally, the parties have been participating in a mediation process established by the Bankruptcy Court.

H. The Commission's Determination of City's Complaint is Pursuant to the Just and Reasonable Standard

77. City requests a Commission determination of rates, terms and conditions of service with EPMI under the Master Agreement and long-term confirmations thereunder. The Master Agreement does not specify a standard of review

¹¹³ See Exhibit 2 at § 8.6 (including the requirement that "mediation under this paragraph is a condition precedent to filing an action in any court.").

for the determination of rates, terms and conditions of service.¹¹⁴ The Commission's review of the rates, terms and conditions of service pursuant to the Master Agreement is pursuant to the just and reasonable standard of review.¹¹⁵

78. The long-term confirmations state that the "rates for service" will not be changed pursuant to Sections 205 or 206 of the Federal Power Act.¹¹⁶ However, City's Complaint does not seek to change the rate for energy sold under the long-term confirmations. Rather, City seeks a determination of the justness and reasonableness of EPMI's actions under the Master Agreement and long-term confirmations to declare an Event of Default, establish an Early Termination Date and to recover an Early Termination Payment. These issues do not implicate the "rates for service" as specified in the long-term confirmations.

79. City's alternative request for relief, that the Commission prohibit EPMI from using its revoked market-based rates for computing the Early Termination

¹¹⁴ See *Kansas Cities v. FERC*, 723 F.2d 82, 87-88 (D.C. Cir. 1983); *Pennsylvania Power & Light Co.*, 74 FERC ¶ 61,314 at 61,994 (1996) ("contracts that do not expressly specify what showing is required for a change in rates, consistent with precedent, we find such a just and reasonable standard (as opposed to a public interest standard) applicable."); *Northeast Utilities Service Co.*, 66 FERC ¶ 61,332 at 62,085 (1994) (explaining public interest standard of review applies in cases where the issue is "whether or not a rate increase or other contract modification unilaterally requested by a utility is precluded by a fixed-rate contract already on file with and accepted by the Commission."). See generally *Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities*, 67 Fed. Reg. 51,516 at 32,272 (Aug. 8, 2002), *FERC Statutes and Regulations* ¶ 32,275 (2002) ("Proposed Policy Statement").

¹¹⁵ See 16 U.S.C. §§ 824d(a), § 824e(a). See also *FPC v. Texaco, Inc.*, 417 U.S. 380, 386-87 (1974); *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414, 422 (1954); *Gulf States Utilities Co. v. Alabama Power Co.*, 824 F.2d 1465, 149-70 (5th Cir. 1987).

¹¹⁶ Exhibit 3 at Attachment A and Exhibit 4 at Attachment A.

Payment, and/or that the Commission revoke EPMI's market-based rate authority to at least January 2000, does not implicate the provisions of the long-term confirmations regarding the price per megawatt hour of energy sold. Thus, City does not seek a change in the rates for electricity actually sold by EPMI to City. The relief City seeks is from EPMI's Tariff violations, unjust and unreasonable practices, and excessive and unjustified termination charges, under EPMI's jurisdictional contracts.

V. COMPLAINT

80. City seeks relief from unjust and unreasonable charges EPMI claims City owes in direct violation of EPMI's jurisdictional contracts and unjust and unreasonable practices in connection with the Master Agreement and long-term confirmations. City also seeks Commission remedies under the Federal Power Act for EPMI's unprecedented and unlawful misuse and abuse of the jurisdictional contracts. Finally, City seeks remedies under the Federal Power Act for EPMI's attempt to use its market-based rate authority to obtain future profits that are based on the market distortions EPMI helped precipitate by its unlawful acts as determined by the Commission.

81. In reviewing this Complaint, the totality of circumstances surrounding EPMI's purported cancellation should control. The relevant circumstances can be summarized as follows:

- a hair-trigger cancellation by EPMI, an insolvent utility, intended to frustrate the business purpose of the transaction and manufacture a claim for an unjust and unreasonable Early Termination Payment;

- EPMI was failing to fully perform deliveries of the “firm power” transactions to City prior to its purported cancellation, failed to deliver Performance Assurance, and in fact owed City on a net basis at the time EPMI purported to terminate the contracts for non-payment;
- the asserted reason for cancellation is a disputed payment obligation, with the dispute clearly being raised by City before EPMI’s purported cancellation;
- EPMI drafted the unique contractual recoupment provision on which City’s disputed payment calculation was based;
- City made all undisputed payments due under the contract, City did not terminate the agreement, and EPMI faced no increased credit risk;
- EPMI ignored City’s dispute and disregarded past practices for resolving disputed payments to jump to a bad faith termination;
- mandatory contractual dispute resolution procedures were evaded and EPMI never responded to City’s correspondence disputing the payment, based on EPMI’s unique contract language;
- the transactions were entered into, in part, as a consequence of short-term market manipulation by EPMI;
- all delivery points under the transactions are within the western markets, which Commission Staff has found were manipulated;
- the contract (written by EPMI) was unfairly negotiated, with City relying on false Enron Corp. financial data provided by EPMI;

- the revelation of EPMI's true financial circumstances transformed the bargained for secure, long-term source of power, into a bad faith contract termination claim by EPMI;
- EPMI violated its market-based rate authority by, *inter alia*, concealing its true market power, particularly with regard to its control over generation (and therefore prices) involving substantial generation facilities where at least one of the contractual delivery points was located;
- the purported cancellation was part of a concerted effort by EPMI to "drag money in" by forcing termination of its power contracts to make claims for early termination payments;
- both prior to and after EPMI's purported termination, City agreed to allow EPMI to assign the contracts to a credit-worthy counterparty; and
- EPMI's Tariff under which it seeks to collect unearned profits for unconsummated transactions has been revoked.

82. The proposed cancellation is plainly unlawful since EPMI seeks to cancel without a contractual right to do so, without resolution of the underlying disputes, and without prior Commission approval.

A. EPMI Violated the Master Agreement and Long-Term Confirmations by Purporting to Exercise Termination Rights Based on Pending Good Faith Dispute

83. EPMI violated its jurisdictional contracts and otherwise acted unlawfully by attempting to collect a charge based on a purported contract termination that was not permitted under the Master Agreement and long-term confirmations or authorized by the Commission. By ignoring the specific terms of the Master Agreement

and long-term confirmations and unreasonably pursuing its goal of converting its agreements into claims for immediate cash through unlawful contract cancellations, EPMI seeks, by its actions, to unilaterally modify the contract, and thereby collect an unlawful charge. City seeks a determination that EPMI is precluded from terminating its agreements with City and seeking an Early Termination Payment based on an invoice that was subject to a good faith dispute.

84. The Master Agreement¹¹⁷ permits early termination only in limited circumstances. Section 4.2 of the Master Agreement provides a right for a Non-Defaulting Party to cancel the contract if a specified Event of Default occurred. Section 4.2 describes the terms for cancellation, as follows:

If an Event of Default occurs with respect to a Defaulting Party at any time during the term of this [Master] Agreement, the Non-Defaulting Party may, in its sole discretion, for so long as the Event of Default is continuing, (a) by no more than 20 days notice to the Defaulting Party, designate a day no earlier than the day such notice is effective as an early termination date (“Early Termination Date”)¹¹⁸

85. Events of Default are specified and defined in Section 4.1 of the Master Agreement. Failure to make a required payment, unless such payment is subject of a good faith dispute, constitutes an Event of Default. Section 4.1 describes an Event of Default in relevant part, as follows:

An “Event of Default” shall mean with respect to a Party (“Defaulting Party”): (a) the failure by the Defaulting Party to make, when due, any payment required pursuant to this Agreement if such failure is not remedied within three (3) Business Days after written notice of such failure is given

¹¹⁷ Exhibit 2.

¹¹⁸ Exhibit 2 at § 4.2.

to the Defaulting Party by the other party (“Non-Defaulting Party”) and provided the payment is not the subject of a good faith dispute as described in Section 6; or . . . (d) the Defaulting Party shall be subject to a Bankruptcy Proceeding¹¹⁹

86. The Master Agreement expressly excludes from Events of Default the failure to make a required payment that is the subject of a good faith dispute. Section 6.1 of the Master Agreement establishes the mechanism for initiating and implementing a good faith dispute:

If Buyer, in good faith, disputes a statement, Buyer shall provide a written explanation of the basis for the dispute and pay the portion of such statement conceded to be correct no later than the due date.¹²⁰

87. On December 11, 2001, City informed EPMI by letter that, by City’s calculation, no amount would be due to EPMI for November and December 2001 “pursuant to **Section 6.2 Netting/Setoff**”¹²¹ Netting/set-off allows one party to subtract amounts owed by the other party from the amount otherwise owed. Section 6.2 of the Master Agreement provides the parties with extensive rights to offset, net, set off and recoup payments. It provides as follows:

If Buyer and Seller are each required to pay an amount in the same month, then such amounts with respect to each Party shall be aggregated and the Parties shall pay to the other Party the difference between the amounts owed. Each Party reserves to itself all rights, set offs, counterclaims and other remedies and defenses consistent with Section 5 (to the extent not expressly herein waived or denied) which such Party has or may be entitled to arising from or out of this Agreement. **All outstanding**

¹¹⁹ *Id.* at § 4.1 (emphasis supplied).

¹²⁰ *Id.* at § 6.1.

¹²¹ *See* Exhibit 8 (emphasis in original).

Transactions and the obligations to make payment in connection therewith or under this Agreement or any other agreement between the Parties may be offset against each other, set off or recouped therefrom.¹²²

88. The three components of the set-off/recoupment rights defined in Section 6.2, namely, netting of amounts owed within one month, the reservation of other remedies and defenses, and the right to offset, recoup or set off the obligations under all outstanding transactions, provided City with comprehensive rights to offset, set off or recoup all amounts and contractual obligations with EPMI. The first sentence of Section 6.2 requires netting of amounts owed within the same month. The second sentence reserves to each party “other remedies and defenses” consistent with Section 5 of the Master Agreement.

89. The third sentence of Section 6.2, which is unique to the EPMI Master Agreement, allows a party to offset, set off or recoup the “obligations to make payment . . . under this Agreement or any other agreement.” This transaction-based permissive right to net or recoup is not temporally limited, unlike the obligation defined in the first sentence of Section 6.2, which requires the parties to net all obligations arising during the same month. The third sentence of 6.2 relates to all outstanding “Transactions,” a defined term in the Master Agreement, to which time periods do not relate.¹²³ This provision of Section 6.2 is in addition to the temporally limited netting rights created in the first sentence because it addresses “all outstanding Transactions” and addresses that term without regard to time periods or time limitations. This third

¹²² Exhibit 2 at § 6.2 (emphasis supplied).

¹²³ Exhibit 2 at Appendix 1 – Definitions to the Master Agreement (defining “Transaction” to mean “a particular transaction agreed to by the Parties relating to the purchase and sale of Energy pursuant to this Master Agreement.”).

sentence of Section 6.2 granted City the right to net or recoup a payment owed for service in November against transactions and obligations for service under the same Agreement, whenever provided or due.

90. City provided timely written notice to EPMI, in accordance with the requirements of Section 6.1, explaining that City disputed the amounts due for November 2001, based on City's rights under EPMI's jurisdictional contracts to set off or recoup all transactions for November and December 2001, and City also reserved any remainder as security for its unfulfilled demand for Performance Assurance.¹²⁴ City was delivering energy to EPMI under short-term transactions. By December 4, 2001, EPMI owed City \$1,306,370 for City's services to EPMI during the first four days of December after which City suspended its deliveries to EPMI. The \$1,306,370 EPMI owed City was more than the \$1,010,439 amount for November, leaving a payment due from EPMI to the City of nearly \$300,000 after the first four days of December. City also claimed liquidated damages that it would calculate at a later date.¹²⁵

91. EPMI's multiple defaults in November and December 2001 caused City to take actions to protect itself, as authorized by the Master Agreement. On December 11, 2001, City notified EPMI in writing that, based on City's calculations under the Master Agreement, EPMI owed City a net amount for energy sales that had been fully performed through December 4, 2001.¹²⁶ City's letter provided notice of dispute with the requisite explanation of the basis thereof, with regard to EPMI's

¹²⁴ Exhibit 1 at P 25 (Hatcher Affidavit).

¹²⁵ *Id.*

¹²⁶ *See* Exhibit 8.

November 2001 invoice. On that date, the energy deliveries by City to EPMI had been completed, pending EPMI's resolution of its default, as City suspended its deliveries after December 4, 2001. The "Transactions" City identified had already occurred and the obligation to make payment attached by the time City notified EPMI of its dispute. The terms of Section 6.2 expressly allowed this form of netting or recoupment, and EPMI never disputed or responded to City's letter.

92. City's actions fully comported with the rights and obligations detailed in Master Agreement Sections 6.1 and 6.2. City acted properly, within the terms of the Master Agreement and in full satisfaction of all obligations to EPMI, by notifying EPMI that City disputed any obligation to pay EPMI's November invoice based on City's rights of netting and recoupment and for security for EPMI's obligations. City's payment dispute was in good faith and eminently reasonable in light of EPMI's failure to provide Performance Assurance, its bankruptcy and its notification that it would be unable to perform its obligations to deliver energy to City. After ignoring City's dispute, EPMI cannot now argue that City's interpretation of EPMI's contract language was in error and created a right to terminate. EPMI's purported termination in disregard of City's dispute was in bad faith, violated the protections built into the Master Agreement, and violated the assumption underlying Federal Power Act Section 205(d) that terminations due to inadvertent errors are contrary to the public interest.¹²⁷

93. EPMI did not dispute, and failed to meet its obligation to provide, the \$31.75 million of Performance Assurance in response to City's November 29, 2001

¹²⁷ See *Central Illinois Pub. Serv. Co.*, 17 FERC ¶ 61,270 at 61,534 (1981) (Federal Power Act Section 205(d) avoids cancellation due to customer oversight or omission).

demand.¹²⁸ EPMI's obligations to City for Performance Assurance and for service received from December 1 to 4, 2001, were properly subject to recoupment or netting against City's obligations due by December 21, 2001 to EPMI. City and EPMI's obligations both arose from transactions between the parties and involved obligations to make payments in connection with agreements between the parties. Accordingly, City's dispute based on its right to recoup the amounts EPMI owed City under the transactions against amounts it owed to EPMI for November deliveries was asserted in good faith.

94. On December 11, 2001, City notified EPMI that City disputed its payment obligations for November based on Sections 6.1 and 6.2 of the Master Agreement. EPMI never responded to City's December 11, 2001 notice. As will be discussed later, it is apparent that EPMI did not respond because its goal was to manufacture claims for termination payments, without regard for its obligation of good faith and just and reasonable practices effecting its jurisdictional agreements.

95. City acted under the reasonable belief, formed on the basis of a careful review of the Master Agreement, drafted by EPMI, that it could set off/recoup amounts from different periods and that EPMI's financial condition was such that recoupment and set-off would become necessary to protect the City's interests. The totality of the circumstances, as described hereinabove, and the construction of the Master Agreement, reasonably led City to dispute payment based on the Master Agreement rights to seek set-off, and recoupment for the November-December 2001 period. The unique language of Section 6.2 of the EPMI drafted agreement provided for the set-off or recoupment without temporal boundaries. If EPMI disagreed with City's

¹²⁸ Exhibit 17.

interpretation of language EPMI drafted, EPMI was obligated to address City's interpretation in good faith; and attempt to resolve the dispute in accordance with the Master Agreement. EPMI cannot use the City's good faith defensive actions as a pretext to terminate the Master Agreement to claim an Early Termination Payment, without making any effort to resolve the dispute. EPMI's conduct is patently unjust and unreasonable under the Federal Power Act and in bad faith under the California Uniform Commercial Code.

96. EPMI's unjust and unreasonable actions unilaterally violated the Master Agreement by ignoring City's good faith dispute. EPMI asserted a purported right to terminate based on City's failure to pay for EPMI's November deliveries notwithstanding City's dispute of EPMI's calculations under the Master Agreement, and City's determination that EPMI owed City an indisputably larger amount for Performance Assurance and December deliveries to EPMI that were at risk of never being paid. The Master Agreement does not permit EPMI to unilaterally judge City's interpretation of unique contractual provisions EPMI drafted in its jurisdictional contract, silently determine that City's interpretation was incorrect and pass judgment on City's dispute, and use that unilateral judgment to declare an early termination without mediation, good faith debate or notice to City of EPMI's position on the dispute, in violation of the terms of the agreements.

97. However, by letter dated December 21, 2001,¹²⁹ EPMI did just that, providing written notice to City of the purported failure to make a required payment.

¹²⁹ See Exhibit 10. Although EPMI's only ground for claiming a right to cancel the contracts is the disputed invoice, when EPMI filed its complaint in Bankruptcy Court it claimed two additional, equally improper grounds for canceling the
(Footnote con't...)

EPMI stated that a payment of \$1,010,439.50 was due, *i.e.*, EPMI was seeking the November payment without reflecting City's rights under Sections 6.1 and 6.2 of EPMI's Master Agreement. The amount EPMI claimed was outstanding ignored the calculations in City's December 11, 2001 letter. EPMI plainly chose to ignore City's good faith dispute and proceeded with its invoice and December 21, 2001 letter to fabricate a claim for early termination.

98. By letter dated December 21, 2001, City promptly reiterated the reason it was not obligated to pay the invoice in question. In response to EPMI's December 21, 2001 letter purporting to establish that City failed to make a required payment, City expressly disputed EPMI's assertion that City "**failed to make a payment which has become due.**"¹³⁰ A copy of City's previously ignored December 11, 2001 letter notifying EPMI of City's dispute was enclosed with its December 21, 2001 letter.

99. Accordingly, City once again properly provided EPMI with notice that no amount was due to EPMI on the day EPMI purported to provide notice that City failed to make a required payment. City's response to EPMI and explanation of the reason that the amount billed was not properly due and owing constituted written explanation of the basis for the dispute as required by Section 6.1 of the Master

(Footnote con't....)

contracts: (1) City did not pay EPMI's improper "margin call"; and (2) because City protected itself by suspending its energy deliveries under the short-term transactions. As to the first, EPMI's margin call was improper, and was immediately objected to by City. EPMI did not dispute City's objections and never mentioned the margin call again until by letter five months after EPMI purported to cancel the contracts. As to the second, City was justified in suspending its deliveries, and in any event, delivery failures are not grounds for cancellation under the Master Agreement. *See* Section V.B., *infra*.

¹³⁰ Exhibit 11 (emphasis in original).

Agreement. By providing that explanation, City invoked a good faith dispute regarding the amounts mutually owed based on its rights under Sections 6.1 and 6.2 of the Master Agreement - the jurisdictional contract drafted by EPMI.

100. EPMI was obligated to attempt to resolve the good faith dispute not ignore it. First, EPMI never disputed the existence of a good faith dispute – it simply ignored City’s invocation of the relevant contract provision. Second, City’s dispute was reasonable, made in good faith by City, and for a legitimate purpose. Finally, the EPMI-drafted Master Agreement language regarding set-off/recoupment is sufficiently broad, containing no temporal limitation, thereby justifying City’s payment dispute based on those contractual rights. The instant case presents an appropriate circumstance for use of the broad netting recoupment provision, as a demand for payment was made by a non-performing EPMI which had filed for bankruptcy. Moreover, the broad provision is unique to the EPMI-drafted Master Agreement. EPMI cannot be permitted to cancel a contract because it disagreed with a customer’s interpretation of EPMI’s uniquely drafted contract, especially without, at a minimum, first notifying the customer of the basis for EPMI’s disagreement with the customer’s interpretation.

101. Although EPMI was obligated to engage in dispute resolution if it disagreed with City’s dispute, EPMI simply ignored City’s position under the jurisdictional contract so that EPMI could manufacture a termination. By letter dated December 28, 2001, EPMI sought to establish an Early Termination Date of January 2, 2002, based solely on the manufactured payment failure. EPMI wrote, in relevant part, as follows:

i) an Event of Default has occurred; (ii) [City] is the Defaulting Party; and (iii) Enron hereby declares

Wednesday, January 2, 2002 as the Early Termination
Date.¹³¹

102. It is apparent that EPMI's notice, which disregarded City's dispute, was part of EPMI's unjust and unreasonable practice of forcing cancellations regardless of contractual rights. As will be discussed in greater detail in Section V. B.1, below, EPMI's internal e-mails demonstrate that EPMI's strategy was to attempt to resolve its liquidity problems by misusing credit, collateral and termination provisions in its jurisdictional contracts. The following is one example of EPMI's communications demonstrating its unjust and unreasonable practice of forcing terminations of its jurisdictional contracts:

"Hey Guys, here are the legal arguments for trying to get reluctant counterparties to settle with us pre-bankruptcy:

After Bankruptcy we have a number of options that all favor us and all potentially hurt them:

- 1. Option to keep performing and collecting money. (they can't lock in term replacement power)***
- 2. The trustees can elect to terminate and enforce the two way payments (predominant view of hordes of Houston and New York lawyers).***
- 3. The Trustee can assign the contract (to the worst floating credit counterparty we can find if you don't settle now).***
- 4. If the market changes and the contract is out of the money to us, the Trustee can terminate it and, you will get a penny on the dollar for your in the money two way payment.***

¹³¹ Exhibit 12.

When confronted with these reasons, the vast majority of counterparties always elect to terminate before bankruptcy. Let's gear up our efforts and try to drag money in. – cgy.”¹³²

EPMI used this wrongful strategy to attempt to “drag money in” from City. EPMI notified City that it would be unable to perform, and ignored the City’s demand for Performance Assurance. City did not take the bait, and suspended rather than cancel the contracts. EPMI requested City’s consent to an assignment, which City agreed to provide and negotiated documents to consummate the assignment, which EPMI abandoned. Because those two attempts of creating a termination failed, EPMI latched onto the next opportunity – City’s good faith dispute of a payment obligation. However, this third attempt at manufacturing a termination based on the disputed payment cannot stand because it violates the EPMI jurisdictional contract.

103. EPMI’s purported invocation of an Early Termination Date violated Sections 4.2 and 6.2 of its jurisdictional contract. There was no Event of Default that would permit EPMI to establish an Early Termination Date. City’s good faith dispute based on the rights created by the Master Agreement to recoup or set off amounts owed by each party, precluded EPMI from using City’s purported failure to pay \$1,010,439.50 as an Event of Default to justify its purported cancellation of a \$300,000,000.00 contract.

104. The absence of an Event of Default voids EPMI’s attempt to establish an Early Termination Date and renders EPMI’s termination based on an otherwise non-existent right an impermissible unilateral modification of the Master

¹³² Exhibit 19. (November 30, 2001 Enron e-mail from Christian Yoder to Paul Choi, et al.)

Agreement. EPMI contended that City's failure to pay the net amount owed for November was an Event of Default. The Commission need not decide who was correct in this dispute. It need only determine that City's good faith dispute of the November invoice under Sections 6.1 and 6.2, precluded EPMI from treating City's non-payment of the November invoice as an Event of Default. Accordingly, EPMI did not have a legitimate basis under the Master Agreement to establish an Early Termination Date or to seek an Early Termination Payment from City.

105. EPMI's attempt to collect an Early Termination Payment violates the terms of the Master Agreement and the long-term confirmations thereunder. EPMI's attempted cancellation is an unreasonable practice since EPMI does so by denying City its rights under Sections 6.1 and 6.2 of the Master Agreement. EPMI cannot be permitted to unilaterally revise its Tariff to eliminate protections from cancellation. The resulting Early Termination Payment is an unjust and unreasonable charge and violates the Federal Power Act.

106. The Commission has rejected similar attempts to terminate a jurisdictional contract based on a pending good faith dispute. The Commission held in *NRG II*, that a jurisdictional contract with dispute language similar to EPMI's, could not be cancelled while a party exercised its contractual right to dispute a charge.¹³³ As was

¹³³ *NRG II*, 103 FERC at 62,320 (Determining that a contractual right to cancel was not effective until after a dispute was resolved, and the attempted cancellation could not occur unless and until NRG demonstrated that it was in the public interest to modify the contract to create an earlier right to cancel where Seller claimed the Buyer was in default for failing to pay amounts due for energy but Buyer explained that it was withholding the amounts based on a dispute regarding congestion charges).

the case in *NRG II*, EPMI's Master Agreement expressly provided that good faith payment disputes are not Events of Default.

107. The applicable dispute and default sections of the contract at issue in *NRG* stated as follows:

5.4 If the Buyer disputes the amount of any bill, it shall so notify the Seller in writing. The Buyer shall pay to the Seller any undisputed amount of the bill when due. The disputed amount may, at the discretion of the Buyer, be held by the Buyer until the dispute has been resolved; provided that the Buyer shall be responsible to pay interest on any withheld amounts that are determined to have been properly billed, which shall be calculated in the same manner as interest on late payments under Section 5.3.

* * *

5.5. In the event that Buyer fails to pay the amount due by the due date, the Seller may notify the Buyer that, unless payment is received, it will be in default of its obligations under this Agreement. The Buyer shall have thirty (30) days from the date of receipt of such notification from the Seller to cure its default. In the event that the default is not cured within such 30 day period, the Seller, in addition to any other legal or equitable remedies it may have, shall have the right to terminate this Agreement upon five (5) days written notice to the Buyer.¹³⁴

108. The Commission determined that *NRG* could not terminate the contract, without notice to and approval by the Commission, unless and until the payment dispute was resolved. The *NRG II* Order follows the Commission's consistent practice of reviewing jurisdictional contracts to determine if they allow cancellation for non-

¹³⁴ Complaint and Emergency Request for Order Staying Contested Termination of Wholesale Power Contract, Attachment B, Docket No. EL03-123-000.

payment.¹³⁵ If the contracts do not provide such cancellation rights, the Commission rejects the cancellation outright.¹³⁶ If the contracts contain a cancellation right that is contingent on the resolution of a dispute, the Commission either suspends or rejects the cancellation, making it ineffective until after the dispute is resolved by a court or by the Commission.¹³⁷

109. Therefore, even if EPMI were correct about the underlying payment dispute, which it is not, EPMI had, and has, no currently effective right to terminate the Master Agreement. As the Commission has held, EPMI cannot cancel the contract until the dispute regarding payments is resolved or unless and until it seeks and obtains Commission approval to modify the contract terms, as appropriate.¹³⁸

¹³⁵ See *Trigen-Syracuse Energy Corp.*, 95 FERC ¶ 61,326 (2001). (Explaining that if the parties dispute the existence of a contractual right to cancel the contract, the Commission reviews the contract terms and conditions at the outset to determine if the contract includes a unilateral right to cancel upon various occurrences.) See also *Sierra Pacific Power Co. v. Utah Power & Light Co.*, 12 FERC ¶ 61,020 (1980) (determining power contract did not provide a right to terminate); *Cinergy Services*, *supra* at 62,058 (interpreting contract to allow cancellation under some circumstances); *PPL Electric Utilities Corp.*, 92 FERC ¶ 61,057 at 61,144 (2000) (interpreting contract as providing a right to early cancellation in event of material change); *PPL Montana, LLC*, 96 FERC ¶ 61,313 at 62,206 (2001) (interpreting contract to allow an early cancellation for breach); *Portland General Electric Co.*, 72 FERC ¶ 61,009 at 61,021 (1995) (interpreting contract to allow early cancellation after an event of default).

¹³⁶ See *Sierra Pacific Power Co. v. Utah Power & Light Co.*, *supra*; *NRG I and II*, *supra*.

¹³⁷ See, e.g., *PPL Electric Utilities Corp.*, 92 FERC at 61,144.

¹³⁸ See *supra* discussion and accompanying notes, Section III.E.1. See generally, *NRG I*, 103 FERC ¶ 61,188; *NRG II*, 103 FERC ¶ 61,344; *NRG III*, 104 FERC ¶ 61,211; *Sierra Pacific Power Co.*, 39 FERC ¶ 61,176 (1987) (requiring a utility to file notice with the Commission and obtain Commission approval before cancellation).

B. EPMI's Post Hoc Arguments for Cancellation Are Invalid and Based on Unreasonable Practices

110. EPMI's termination letter of December 28, 2001,¹³⁹ stated a single basis for its termination - the disputed payment obligation discussed above. EPMI's complaint filed with the Bankruptcy Court, however, belatedly asserts two additional Events of Default to support the purported termination: (a) the City's failure to provide EPMI with \$79 million in cash, in response to a bad faith, materially defective "margin call" demanded by a crumbling EPMI; and (b) the City's suspension of its power deliveries to EPMI under certain short-term transactions. These two newly claimed bases for cancellation do not provide valid grounds for cancellation of the agreements. EPMI's failure to initially specify these two occurrences as grounds for termination indicates its awareness that the occurrences did not warrant termination. If they did, EPMI's failure to specify them as grounds deprived City of the opportunity to address the belatedly purported grounds before termination.

1. EPMI's "Margin Call" Does Not Provide Grounds for Cancellation

111. On November 27, 2001, as Enron's merger with Dynegy was breaking down, and five days before Enron filed for bankruptcy, EPMI sent City a hastily drafted and materially deficient letter asserting a right to a "margin call," demanding that the City deliver \$79 million in cash to EPMI the very next day.¹⁴⁰ The demand was

¹³⁹ Exhibit 12.

¹⁴⁰ Exhibit 14. At the same time, EPMI made improper margin demands on numerous other counterparties. The "call for margin" described by EPMI is a term that is not used in the Master Agreement or long-term confirmations. Paragraphs 4.1 and 4.8 of the Master Agreement discuss "Performance Assurance" and "Collateral." The improper nomenclature is significant because EPMI was

(Footnote con't...)

improper for several reasons. First, a request for margin or a right to a “margin call” was not provided for under the Master Agreement. The Master Agreement addresses Performance Assurance (§ 4.1(e)) and collateral (§ 4.8), but does not address “margin.” Second, there was no “Event of Default” on City’s part under Section 4.1 of the Master Agreement, including 4.1(e) relating to a Material Adverse Change.¹⁴¹ To the extent EPMI intended to invoke Section 4.1 of the Master Agreement, that section is expressly limited to a party’s Material Adverse Change; the provision was inapplicable to City, given that City was in the same position on November 27, 2001, in terms of its credit rating, as it was the date the Master Agreement was signed. Because no Material Adverse Change had occurred with respect to the City, EPMI’s demand was not justified as Performance Assurance under Section 4.1, nor was it permissible as a request for collateral under Section 4.8 based on controlling California law.¹⁴² Third, because EPMI

(Footnote con’t....)

apparently using terms from other agreements, with other counterparties, as it was pursuing “Margin Calls” with multiple counterparties in an effort to obtain cash and create termination rights. *See* Exhibit 23.

¹⁴¹ The definition of “Material Adverse Change” in the Master Agreement relates to the party’s underlying credit rating. As evidenced in the Affidavit of Ann Hatcher at Exhibit 1 at P 17, the City’s credit rating had not declined and the City had not failed to perform any of its obligations.

¹⁴² Section 8.5 of the Master Agreement (Exhibit 2) establishes California Law as governing interpretation of the contract, and Section 5.3 of the Master Agreement provides for the Uniform Commercial Code to govern the contract. Because Section 4.8, governing “Performance Assurance,” is not automatic, and is “at will,” the demand must be in good faith. The California U.C.C. supports the premise that Enron had a duty of good faith in making its demand for performance assurance. CAL. COM. CODE § 1208 (Based on U.C.C. § 1-208) states:

A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral ‘at will’ or ‘when he

(Footnote con’t....)

itself had failed to provide the security (increased parent guaranty) required from EPMI by the April 2001 confirmation, under California law, EPMI lacked any right to demand security from City for performance of that transaction.¹⁴³ Fourth, the demand was based on materially incorrect calculations and City promptly disputed the “margin demand” by letter dated November 28, 2001.¹⁴⁴ EPMI did not respond to the City’s letter disputing the “margin call,” did not identify the City’s failure to provide margin as a basis for terminating the Master Agreement in its December 28, 2001 letter, and did not make any reference to its demand for margin until more than six months later. EPMI abandoned its improper demand for margin, but later chose to resurrect it to justify its invalid contract termination.

(Footnote con’t....)

deemed himself insecure’ or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised. ‘Good faith’ is defined in section 1201(19) as ‘honesty in fact in the conduct of the transaction concerned.’

These provisions have been interpreted to limit a party’s ability to exercise a right to demand performance assurance to circumstances where the party has reason to believe the other party will be unable to perform. See *United States v. Grayson*, 879 F.2d 620, 623 (9th Cir. 1989).

¹⁴³ Under California law, an obligation to produce promised security or a promised guaranty is a condition precedent to the contract, and a failure to produce required security prevents a party from seeking to enforce its rights under the contract. See, e.g., *Weisz Trucking Co. v. Wohl Construction*, 13 App. 3d 256, 91 Cal. Rptr. 489 (Cal. Ct. App. 1970). EPMI had failed to provide the Enron guaranty that was a condition precedent to enforcing the April 2001 confirmation and did not make any deliveries under that confirmation and, therefore could not demand Performance Assurance related to that transaction.

¹⁴⁴ Exhibit 15 (City’s November 28, 2001 response letter).

112. Furthermore, EPMI's demand was invalid as it violated several specific requirements of the provision in the Master Agreement relating to Performance Assurance. EPMI demanded cash payment of "margin" within one day, while the Master Agreement provisions allowed Performance Assurance to be by letter of credit, to be provided within two-business days.¹⁴⁵ The demand was not sent to the attention of the contractually specified individual at the City.¹⁴⁶ Instead, the demand letter began "Dear Mr. White," an individual who did not work at City, who likely worked at one of the other trading parties that received a demand from EPMI that day. The fax number on the letter was not the City's fax number; the fax number on the letter is for a department at Snohomish Public Utility District.¹⁴⁷ In addition, the demand claimed it was "Pursuant to Annex A to the Master Agreement," and there is no "Annex A" to the Master Agreement, so EPMI was trying to enforce a contract right against City that was not part of the EPMI Master Agreement. Thus, EPMI's demand was not only substantively improper, but also materially defective.

113. Finally, EPMI's demand for \$79 million in cash "margin" was pursued for improper reasons, and was an unjust and unreasonable practice. EPMI was pursuing a strategy of seeking cash "margin" from as many counterparties as possible, not to provide assurance of performance by its counterparties, but to obtain immediate cash flow either: (1) through the "margin" payments (hence the demand for cash as

¹⁴⁵ See Exhibit 14 (EPMI's Nov. 27, 2001 letter) and Exhibit 2 (Master Agreement § 4.8).

¹⁴⁶ See Exhibit 2 at Exhibit A (establishing City's risk manager as the person to whom notices are to be sent); *see also* Exhibit 14.

¹⁴⁷ Exhibit 1 (Hatcher Affidavit) at P 16.

opposed to collateral); or (2) if the counterparty failed to comply with the demand for cash, EPMI intended to declare a termination and seek immediate cash payments in the form of early termination payments. EPMI's strategy of forcing counterparties to terminate jurisdictional contracts to "drag money in" was discussed above, in Section V. A. EPMI's strategy involving abuse of collateral terms and conditions to "drag money in" is evident from e-mail correspondence retrieved from the Commission's website database, discussed herein.

114. A review of EPMI's e-mails from November of 2001 demonstrates that Performance Assurance was becoming a central issue to EPMI as Enron's inflated finances collapsed. The Examiner appointed by the Bankruptcy Court determined that Enron Corp.'s financial fraud was intended, in part, to avoid collateral requirements being imposed on its subsidiaries.¹⁴⁸ When its parent guarantees became worthless, parties began demanding collateral from EPMI, and cash-strapped EPMI apparently decided to turn the tables and began using demands for collateral to create defaults, to obtain cash.

¹⁴⁸ See Exhibit 26 (Second Interim Report of Neal Batson, Court-Appointed Examiner, dated January 21, 2003, "Batson II") at pp. 9, 15, 18-30, App. Q (Enron Schedules). Over a period of at least four years, EPMI's parent had engaged in illegal accounting schemes designed to conceal billions of dollars of debt, disguise loan proceeds as revenue to fraudulently bolster its net worth, and recognize income that did not exist. *Id.* As identified by the Examiner, one specific motivation for this financial fraud was to enable EPMI to use its parent's fraudulent financial statements to entice counterparties and obtain favorable contract terms that would otherwise not have been available to it in trading transactions. *Id.* By trading without the normal market credit restrictions, EPMI was acting outside the "regulatory" restraints imposed by the market, on which its authority to trade was based. EPMI was able to increase the volume of its trading, and could thereby influence the markets.

- E-mails from early November 2001, around the time Enron restated its earnings, demonstrate that numerous parties, which had previously relied on the false strength of Enron Corp., were now demanding Performance Assurance, and were threatening to terminate their contracts if EPMI did not deliver Performance Assurance.¹⁴⁹
- On November 28, 2001, Timothy Belden sent an e-mail to his staff noting that Enron's downgrade was:

“very bad news for Enron’s future prospects ... many of our contracts have provisions that allow our customers to stop performing on their contracts with us if Enron’s credit rating falls below investment grade and if we are unable to post sufficient collateral.”¹⁵⁰

- An e-mail from November 28, 2001, indicates that EPMI was demanding margin with the hope that the parties would default. The e-mail requests copies of eleven contracts, including City’s Master Agreement:

“so that [EPMI] can send out default notices to counterparties that have failed to post margin. Margin letters were sent out on November 27 and margin is due by the end of today... each contract needs to be checked to see if the due date for posting was today and to see what rights we have to declare an event of default.”¹⁵¹

- A subsequent e-mail from the same author confirms EPMI’s desire to use margin provisions to create defaults and early terminations. It discusses letters of credit and states, in part:

¹⁴⁹ See Exhibit 22.

¹⁵⁰ Exhibit 21.

¹⁵¹ Exhibit 23.

“If they do not renew I’m hoping that we can declare an Event of Default, terminate, request payment of a termination payment and if they don’t pay draw.”¹⁵²

- A December 27, 2001 e-mail demonstrates the trap EPMI set with its unreasonable demand for margin. When counterparties tried to gain a release of collateral, they were told to get in line with a claim in Bankruptcy Court.¹⁵³ Those who did not comply were told they were in default.

115. The e-mails demonstrate that on November 27, 2001, when EPMI sent its demand for “margin” to City, it did so in bad faith, apparently without having reviewed the Master Agreement to determine if EPMI had a right to demand cash margin, and without regard for City’s financial condition. Because EPMI did not bother to read the contract before making its demand, EPMI’s demand unlawfully called for cash “margin” on one day’s notice when the Master Agreement allowed a minimum of two days to provide collateral. EPMI’s demand was, therefore invalid, and, that is why EPMI did not pursue “margin” from City after receipt of City’s letter disputing EPMI’s “margin call,” and did not rely on its “margin call” as a reason to terminate the conditions until six months later, when EPMI was looking for post hoc support for its unlawful termination.

116. EPMI’s e-mails also demonstrate that the purpose of EPMI’s November 27, 2001 “margin” demand to City was not made to obtain assurance of the City’s performance, or address any concerns about City’s ability to perform. City had fully performed its obligations and its financial condition had not changed. The purpose

¹⁵² Exhibit 24.

¹⁵³ See Exhibit 25.

demonstrated by EPMI's e-mails was solely to set a trap to attempt to create defaults to collect termination payments. Such misuse of collateral provisions is invalid under applicable California law, is detrimental to the interests protected by the Federal Power Act, and disrupts the operation of the energy markets regulated thereunder.

117. In sum, EPMI's margin demand does not provide grounds for canceling the agreements because: the demand was not allowed under the Master Agreement's terms and applicable California law; it contained numerous material defects, requesting margin under terms the Master Agreement did not allow; it was made for improper purposes as part of an unreasonable practice; it was disputed by City without response from EPMI; and it was not contemporaneously pursued or identified as a grounds for termination by EPMI.

2. The City's Suspension of Deliveries Does Not Provide Grounds for Termination

118. The City's suspension of deliveries similarly provides no basis for EPMI's purported termination. As discussed previously, City properly suspended its deliveries of energy to EPMI on December 4, 2001, due to EPMI's Defaults. Assuming, *arguendo*, the suspension was not justified, the suspension of deliveries does not provide grounds for termination. First, Section 4.1(c) of the Master Agreement, quoted below, expressly provides that a delivery failure is not an Event of Default. With respect to this issue, the language of the Master Agreement could not be clearer. The sole remedy under the Master Agreement for a delivery failure, found at Section 3.5, is to cover and assert a claim. Sections 4.1 (a) through (g) define "Events of Default." None of the subsections identifies a suspension of performance or failure to deliver energy as an Event of Default.

In fact, Section 4.1(c) expressly excludes such occurrences from Events of Default, stating:

[T]he failure by the Defaulting Party to perform any covenant set forth in this Agreement (other than the events that are otherwise specifically covered in this Section 4.1 as a separate Event of Default or its obligations to deliver or receive Energy a remedy for which is provided in Section 3), and such failure is not excused by Force Majeure or cured within five Business Days after written notice thereof to the Defaulting Party; . . .¹⁵⁴

119. Section 3 provides a remedy of cover damages for failures to deliver. Therefore, even if City's suspension of deliveries was improper (which it was not), City's suspension at most created a right to cover; City's suspension of deliveries did not and could not create a right to terminate. Section 4.5 of the Master Agreement provided the City with the express right to suspend deliveries. Moreover, the City's suspension was a reasonable response to EPMI's numerous material breaches, including the anticipatory repudiation of its obligation to deliver energy and failure to provide the \$31.75 million Performance Assurance properly demanded by the City as a result of the Material Adverse Change (credit downgrade) in EPMI's parent's financial condition.¹⁵⁵ EPMI's correspondence recognized City's right to suspend the deliveries; Timothy Belden's November 28, 2001 e-mail recognized that counterparties had a right to suspend performance if EPMI could not produce collateral after its corporate parent was downgraded to junk status.¹⁵⁶

¹⁵⁴ Exhibit 2, § 4.1(c) (emphasis supplied and added).

¹⁵⁵ See Exhibit 2, § 4.1(e).

¹⁵⁶ See Exhibit 21.

120. Finally, even if a delivery failure could be deemed an Event of Default, before that could occur, EPMI would have been required under Section 4.1(c) of the Master Agreement to provide the City with five days' written notice. EPMI never gave such notice. Clearly, City's suspension of deliveries was not a lawful basis for EPMI to terminate the Master Agreement.

C. EPMI's Purported Cancellation Is Void for Failure to Provide Notice in Compliance with Section 205(d) of the Federal Power Act

121. EPMI failed to comply with the requirement under Section 205 of the Federal Power Act, and the Commission's regulations thereunder, to provide prior notice of cancellation of its jurisdictional, long-term, market-based rate power sales agreements with City.¹⁵⁷ EPMI's failure interfered with the Commission's ability to meet its responsibility for reviewing the lawfulness of the cancellation and the charges EPMI seeks as a result of the purported cancellation. The Commission has recently stated that its responsibility to review attempts to cancel power sales agreements, and to assure that power sales are performed and discontinued only in accordance with the Federal Power Act, goes to the heart of the Commission's regulatory responsibilities.¹⁵⁸ The public interests served by the prior notice requirement include allowing the Commission an opportunity to evaluate a proposed cancellation to determine whether the cancellation is justified under the public interest test, protecting customers from cancellations due to

¹⁵⁷ Note that EPMI's unique Master Agreement does not contain a waiver of Notice of Termination, as is the case with the industry standard WSPP Agreement.

¹⁵⁸ See *NRG II*, 103 FERC at 61,318 P 46; *NRG III*, 104 FERC at 61,736 PP 18-19 (stating that terms and conditions of power sales agreements are within the exclusive jurisdiction of the Commission, attempts to terminate such agreements go to the heart of the Commission's regulatory responsibilities and such matters must be addressed by the Commission, and not by a bankruptcy or district court).

oversight, and determining if the cancellation involves an exercise of market power.¹⁵⁹ In *Cinergy*, the Commission explained its role in evaluating a notice of cancellation as follows:

Before it can approve a notice of termination, the Commission must, under Section 205 of the [Federal Power Act], determine that the proposed termination is not unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. We need to examine what the proposed termination does, and what harm, if any, it causes.¹⁶⁰

122. Because the contracts at issue were long-term (greater than one year) market-based rate contracts, EPMI was obligated to file a notice with the Commission at least 60 days before cancellation can be effective. EPMI's failure to provide any 60-day prior notice of cancellation to the Commission voids such action.¹⁶¹

¹⁵⁹ *Central Illinois Pub. Serv. Co.*, 17 FERC ¶ 61,270 at 61,534 (1981) (stating that Section 205(d) “provides the Commission with an opportunity to evaluate” a proposed cancellation and avoids cancellation due to customer oversight or omission); *Southern Co. II*, 86 FERC at 61,458 (explaining that the rule protects against the exercise of market power); *NRG II*, 103 FERC at 62,318 P 46 (explaining that the responsibility to assure that cancellation is in accordance with the Federal Power Act); *Cinergy Services, Inc.*, 93 FERC ¶ 61,308 at 62,058 (2000) (finding that the threshold issue for the Commission to review is whether or not the contract grants a unilateral right to cancel).

¹⁶⁰ *Cinergy Servs, Inc.*, 93 FERC at 62,059 (footnotes omitted).

¹⁶¹ Under *NRG II and III*, notice must be given if there is no contractual right to cancel. Under *Southern Co.*, the notice obligation does not apply to contracts for short-term transactions where default is not disputed. See *Southern Co. Energy Marketing, L.P.*, 84 FERC ¶ 61,199 (1998) (“*Southern I*”), *reh’g denied*, 86 FERC ¶ 61,131 (1999) (“*Southern II*”), *aff’d sub nom. Power Co. of American v. FERC*, 245 F.3d 839 (D.C. Cir. 2001) (“*PCA*”) (collectively “*Southern Co.*”). *Southern Co.*, however, must be limited to its facts, e.g., short-term transactions.

1. The Federal Power Act Requires Notice Prior to Cancellation of a Contract

123. Section 205(c) of the Federal Power Act requires utilities to file with the Commission schedules and contracts affecting rates and charges for power sales governed by the Commission.¹⁶² Section 205(d) of the Federal Power Act provides that public utilities shall not change rates for sales subject to the jurisdiction of the Commission, or contracts relating thereto, “except after sixty days’ notice to the Commission.”¹⁶³ Cancellation is a change in rate that is subject to the Federal Power Act 60-day prior notice requirement.¹⁶⁴ Therefore EPMI was obligated to provide notice before cancellation.

a) The Commission’s Regulations under Section 205(d) Require Prior Notice

124. Procedures for complying with the Section 205(d) notice of cancellation requirement are set forth in the Commission’s regulations.¹⁶⁵ The Commission’s regulations require the filing with the Commission of a notice of cancellation or termination of a contract at least 60 days in advance of effectiveness: “When a rate schedule **or part thereof** required to be on file with the Commission is

¹⁶² 16 U.S.C. § 824e(c).

¹⁶³ 16 U.S.C. § 824e(d).

¹⁶⁴ See *Nevada Power Co.*, 1 FERC ¶63,004 at 65,030-31 (1976) (quoting *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414, 422-24 (1952) (stating that if company wants to discontinue service it must file a notice under Section 205(d)); *Portland General Electric Co.*, 77 FERC ¶ 61,171 at 61,639 (1996) (stating that the Commission has consistently held that a utility may cancel service only by first making an appropriate filing of a change in service pursuant to Section 205 of the Federal Power Act); *NRG II*, 103 FERC at 62,320 P 58 and *NRG III*, 104 FERC at 61,740 P 39 (requiring notice before a contract is modified, cancelled or abrogated)).

¹⁶⁵ 18 C.F.R. § 35.15 (2003).

proposed to be cancelled or is to terminate by its own terms and no new rate schedule or part thereof is to be filed in its place”¹⁶⁶

125. The requirement of prior notice of cancellation under 18 C.F.R. § 35.15 (2003) applies to the “rate schedules,” or parts thereof, that are required to be filed under 18 C.F.R. § 35.1(a) (2003), and which are the enforceable “rate schedules” under Section 35.1(e). These “rate schedules” include all “contracts, which in any manner affect or relate to the aforementioned service, rates, and charges.”¹⁶⁷ The Commission requires all contracts relating to a rate schedule to be filed as part of the rate schedule.¹⁶⁸

126. The regulation provides for only one exception to this prior filing requirement. For power sale contracts executed on or after July 9, 1996, no notice is required where the contract is subject to “termination by its own terms.”¹⁶⁹ This exception has no application to the present case, because the contracts at issue here did not terminate by their own terms, but were purportedly cancelled by EPMI for an alleged breach by City which was disputed and remains disputed -- a situation held by the Commission to not be covered by this exception. The long-term contracts would not “terminate by their own terms” until December 31, 2006, and December 31, 2009, respectively, and EPMI lacked grounds for exercising an earlier termination. Notice is

¹⁶⁶ 18 C.F.R. § 35.15(a) (2003) (emphasis added).

¹⁶⁷ 18 C.F.R. §35.2(b) (2003).

¹⁶⁸ See *NRG II*, 103 FERC at 62,318 P 46. See also; *Pacific Gas and Electric Co.*, 5 FERC ¶ 61,305 at 61,655 (1978); *Transmission Agency of Northern California v. Pacific Gas and Electric Co.*, 55 FERC ¶ 61,417 at 62,251 (1991) (interpreting 18 C.F.R. §§ 35.1 and 35.2(b)). See generally *NRG*, 2003 U.S. Dist LEXIS at *8-9 (market-based sales agreements, along with the sellers’ tariff authority, are part of the “rates, terms and conditions” subject to 205 of the Federal Power Act).

¹⁶⁹ 18 C.F.R. §35.15(b)(2) (2003).

required because EPMI seeks to terminate the contracts based on a good-faith dispute, which is not grounds for termination under EPMI's jurisdictional contract, the Master Agreement.

127. The prescribed forms for notice apply to power sales agreements that expire other than by their own terms¹⁷⁰ (e.g., cancellation due to breach), regardless of when the contract was executed.¹⁷¹ While the regulations allow contracts entered into after Order No. 888 (July 9, 1996) to expire without notice to the Commission only at the end of their intended term, the notice requirement remains applicable to cancellations prior to the end of the term, such as early cancellation for a disputed breach.

b) The Notice Requirement Applies to Long-Term Market-Based Rate Contracts

128. For market-based rate contracts, the Commission deems contracts to be filed in accordance with the requirements of Section 205(c) when the utilities file

¹⁷⁰ Notably, the EPMI Master Agreement did not automatically terminate on the occurrence of any Events of Default, and is, therefore, distinguishable from the contract in *Vermont Public Power Supply Authority*, 104 FERC ¶ 61,185 (2003), where no notice was required due to the automatic termination of the contract upon the occurrence of bankruptcy.

¹⁷¹ See 18 C.F.R. § 35.15(b)(2) (2003); *Portland General Electric Co.*, 75 FERC ¶ 61,310 at 62,002 (1996) (indicating that Order No. 888 specifically retained the notice requirement for cancellations of power sales contracts cancelled due to an event of default); *NRG II*, 103 FERC at 62,321 P 59, *NRG III*, 104 FERC at 61,741 P 43 (notice requirement applied to the NRG contract even though it was entered into after July 9, 1996, since the agreement was not terminating by its own terms). City notes that the United States District Court for the Southern District of New York, in connection with a motion to withdraw the reference from the Bankruptcy Court, interpreted this regulation as having no application to contracts executed after July 9, 1996. *Enron Power Marketing, Inc. v. City of Santa Clara*, 2003 WL 68,036 at * 5 (S.D.N.Y. 2003). That interpretation is in direct conflict with the Commission's rulings cited in this footnote.

transaction reports with the Commission.¹⁷² Power sales at market-based rates have been held to be within the Commission's jurisdiction over interstate sales in wholesale markets.¹⁷³ Because the rates and contracts must be filed under Section 205(c), notice is required under Section 205(d) before those contracts can be cancelled. The fact that the contracts are not physically filed, or that the Commission deems the contracts to be filed through summary reports rather than through physical filings with the Commission, does not exempt the agreements from the Section 205(c) filing requirement, nor does it excuse the contracts from the corresponding statutory requirement that changes in the filed rates, terms or conditions can only occur after notice to, and review and acceptance by, the Commission.

129. The Commission has routinely rejected requests for waivers of the notice of cancellation requirements by parties seeking market-based rates authority, including a waiver request made by EPMI.¹⁷⁴ The Commission explained that the notice requirement is not burdensome and provides necessary information to the Commission and the public.¹⁷⁵

¹⁷² See *San Diego Gas & Electric Co. v. Sellers of Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 96 FERC ¶ 61,120 at 61,505-506 (2001); *State of California v. British Columbia Power Exchange Corp., et al.*, 99 FERC ¶ 61,247 at 62,061-65 (2002); *NRG II*, 103 FERC at 61,320 P 58.

¹⁷³ See, e.g., *San Diego Gas & Electric Co.*, 96 FERC at 61,505-506; *Public Utility District No. 1 v. Dynegy Power Marketing, Inc. (In re: California Wholesale Electric Antitrust Litigation)*, 244 F. Supp. 2d 1072 at 1076 (S.D. Cal. 2003). See also *NRG II*, 103 FERC at 62,313 and 62,319.

¹⁷⁴ See, e.g., *Enron Power Marketing, Inc.*, 65 FERC at 62,406 (refusing EPMI's request for waiver of notice of cancellation requirements).

¹⁷⁵ *Id.*

130. The Commission has applied, and continues to apply, the prior notice requirement to contracts for sales at market-based rates,¹⁷⁶ which, along with the seller's market-based rate authority, are part of the rates, terms and conditions that are subject to Sections 205 and 206 of the Federal Power Act.¹⁷⁷ The Commission has recently confirmed that “[I]f a seller seeks to modify or abrogate a jurisdictional contract, the seller must make appropriate filings under Sections 205 and 206 of the Federal Power Act to change the contract, whether or not the contract has been physically filed.”¹⁷⁸ For cancellations or other modifications, the filings required under Section 205 are notice filings with the Commission 60 days before the proposed cancellation is to become effective.¹⁷⁹ Thus, *NRG II* confirms that notice of cancellation under Section 205 continues to apply to market-based rate contracts.¹⁸⁰

¹⁷⁶ See *NRG II*, 103 FERC at 61,320, *NRG III*, 104 FERC at 61,740; *Portland General Electric Co.*, 75 FERC ¶ 61,310 at 62,002-03 (1996); *Trigen-Syracuse Energy Corp.*, 95 FERC ¶ 61,326 (2001); *PPL Montana LLC*, 96 FERC ¶ 61,313 (2001); *Cheyenne Light, Fuel and Power Co. v. PacifiCorp*, 94 FERC ¶ 61,163 (2001).

¹⁷⁷ *NRG II*, 103 FERC at 61,318.

¹⁷⁸ *Id.* at P 58.

¹⁷⁹ 16 U.S.C. § 824d(d).

¹⁸⁰ The Commission's confirmation of the notice requirement in *NRG* proceedings is consistent with its ruling in Order No. 2001. See Revised Public Utility Filing Requirements, Docket No. RM01-8, FERC Statutes and Regulations ¶ 32,554 at 34,063 (2001); FERC Statutes and Regulations ¶ 31,127 (2002) (amending filing requirements for short-term and long-term power sales agreements) (“Order No. 2001”). Order No. 2001 revised the filing and notice of cancellation requirements for both market-based and cost-based contracts. See *Southern Co. Servs., Inc.*, 99 FERC ¶ 61,103 at 61,424 (2002). The Commission's rulemaking placed generators and marketers under the same electronic contract filing system, thereby eliminating the need for the Commission's prior order requiring marketers to physically file their long-term contracts. *Id.* The rulemaking revised the information required to be included in market-based utilities' quarterly transactions reports, and created a mechanism for electronic filings of market-

(Footnote con't...)

131. In *NRG II*,¹⁸¹ the Commission clarified that its prior decision in *Southern Co.*¹⁸² does not excuse parties from seeking Commission approval before cancellation of a contract when the cancellation is disputed. The *Southern Co.* case is often read too broadly in arguments raised by sellers. In *Southern Co.* 25 marketers, including EPMI, filed termination notices regarding numerous short-term transaction agreements with a bankrupt marketer, Power Company of America (“PCA”). As the Commission and the reviewing court emphasized, the contracts at issue in *Southern Co.* were short-term (less than one year) transactions that could involve transactions as short as one hour, so requiring 60 days notice was impractical, if not impossible.¹⁸³ As EPMI noted in its extensive comments accompanying its notice of termination, there was no dispute with PCA regarding the amount of payments due, nor was there a dispute with PCA regarding the occurrence of an event of default.¹⁸⁴ The *Southern Co.* case involved a bankrupt buyer that clearly had failed to pay for energy delivered, and was not able to pay going forward. *Southern Co.* simply does not support termination without notice in

(Footnote con’t....)

based and cost-based energy sales agreements. With regard to cancellations, the Commission noted: “The Commission will eliminate the cancellation of contract data element. When an agreement expires, the actual termination date will be entered into the contract data. Therefore, the cancellation of contract data element provides redundant data. Signatories to an agreement will receive notice pursuant to the terms of the agreement, and **cancellations without the other parties’ consent must be individually filed with the Commission for approval.**” Order No. 2001 at P 321 (emphasis added).

¹⁸¹ See *NRG II*, 103 FERC at 62,321.

¹⁸² See *Southern I*, 84 FERC ¶ 61,199; *Southern II*, 86 FERC ¶ 61,131.

¹⁸³ See *id.*

¹⁸⁴ See *Enron Power Marketing, Inc.*, Notice of Termination Under Section 35.15(c) and Alternative Request for Waiver at pp. 20-21, Docket Nos. ER98-3966-000 and ER94-24-025 (filed July 29, 1998).

this case where long-term contracts were cancelled due to a good faith payment dispute, and where the buyer had not failed to pay any undisputed amounts, was owed money, was financially stable, and the terminating seller was insolvent and incapable of delivering energy.

132. The *Southern Co.* ruling creates a limited exception to the Federal Power Act Section 205(d) statutory requirement that notice of a change in a contract, *e.g.*, a cancellation, be filed at least 60 days before it occurs. Because it creates an exception to a remedial statute, the ruling must be narrowly construed.¹⁸⁵ As such, it must be limited to its facts, clear undisputed failures to pay under short-term transactions¹⁸⁶ where there is no dispute regarding the right to terminate.

133. Under the facts presented by this case, notice is required under any reading of *Southern Co.* and *NRG* because EPMI cannot terminate the contracts under their terms. As discussed in Section V. A, above, EPMI seeks to terminate the contract based on a payment that is the subject of a good faith dispute, and therefore is not an Event of Default under EPMI's jurisdictional contract, the Master Agreement.

¹⁸⁵ See, *e.g.*, *Spokane & Inland Engine R.R. v. United States*, 241 U.S. 344, 350 (1916) (providing that exceptions from a general policy which a law embodies should be strictly construed).

¹⁸⁶ There are two apparent reasons why the Commission and the court decided to waive the notice requirement for short-term transactions, but not for long-term transactions. First, the court states that, with the short-term transactions, the transaction could end before the notice period expired. *PCA*, 245 F.3d at 844-45. Second, the Commission and the court realized that the waiver was based on the practical difficulty of filing and reviewing cancellation notices for a great number of short-term transactions. *Id.* The Commission has indicated there are far fewer long-term transactions than short-term transactions. *Southern Co. Servs., Inc.*, 87 FERC ¶ 61,214 at 61,848 (1999) (creating but suspending a requirement that long-term contracts be physically filed instead of filed via quarterly reports). The filing requirements were later modified by the Commission's ruling in Order No. 2001 discussed above at note [183].

134. Notably, the basis for EPMI's arguments for the exception in *Southern Co.* have not withstood the test of time, and are, in fact, refuted by EPMI's own actions. EPMI argued that notice of termination must not be required of marketers because: (1) they lack market power; (2) they do not have any control over generation, and therefore cannot withhold energy from the markets, and therefore the terminations cannot involve an exercise of market power; and (3) aggrieved counterparties can always file a complaint with the Commission.¹⁸⁷ As the Commission has learned, EPMI concealed its market power and controlled generation through undisclosed marketing agreements. Therefore, the premise upon which *Southern Co.* was decided is inapplicable to EPMI's terminations. Contrary to its argument in *Southern Co.*, EPMI has recently argued that a complaint cannot provide relief to a party aggrieved by a cancellation because Section 206 can only be applied prospectively, which precludes relief from a utility that exercised a right to cancel the contract.¹⁸⁸ EPMI cannot have it both ways. If EPMI does not have to give notice prior to termination and City cannot challenge EPMI's termination after the fact, the Commission's regulatory regime would unlawfully fail to provide parties with remedies for unlawful terminations and tariff violations.

135. EPMI's own argument establishes City's entitlement to relief in this case. EPMI argued in *Southern Co.* that parties aggrieved by a cancellation do not need prior notice since they can file Section 206 complaints after the fact. EPMI's

¹⁸⁷ See *Enron Power Marketing, Inc.*, Notice of Termination Under Section 35.15(c) and Alternative Request for Waiver at pp. 8-19, Docket Nos. ER98-3966-000 and ER94-24-025 (filed July 29, 1998).

¹⁸⁸ See Answer of Enron Power Marketing, Inc. to Complainant's Arguments on the Merits, at pp. 20-22, Docket No. EL04-1-000, filed October 27, 2003.

inconsistent arguments on this point reflect the problems with Section 206 relief and market-based rates foreshadowed by the court in *Louisiana Power*.¹⁸⁹ The statutory prior notice of cancellation requirement avoids any retroactivity concerns by providing an opportunity for Commission review of cancellations before they are effective. The Commission should find that EPMI's failure to provide such notice rendered its purported cancellation void and/or that its termination was void due to its unjust and unreasonable practices.

2. EPMI Failed to File Notice

136. EPMI's attempted cancellation is an unlawful practice since EPMI acted without providing notice to the Commission required by the Federal Power Act and the Commission's regulations, discussed above.

137. EPMI's contracts with City were deemed filed by the Commission in accordance with Section 205(c) of the Federal Power Act. Under the Commission's market-based rate regulatory regime, the Commission deemed the contracts filed when EPMI submitted its quarterly reports summarizing the energy sold during the prior quarter.¹⁹⁰ EPMI notified the Commission that it entered into the contract with City in EPMI's January 2000 quarterly report.¹⁹¹

¹⁸⁹ See *Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364 at 370-371 (1998) (indicating that Section 206 relief may be insufficient when the Commission's market-based rate presumptions that utilities lack market power turn out to be false).

¹⁹⁰ See *Lockyer*, 99 FERC at 62,062.

¹⁹¹ See Exhibit 7.

138. The Commission's order authorizing EPMI to transact pursuant to market-based rates expressly required EPMI to file notice of termination.¹⁹² EPMI's failure to provide the required notice violated that authorization.

3. EPMI's Failure to Provide Notice Negates Cancellation

139. Commission precedent clearly provides that a contract cancellation cannot occur until notice has been filed with, and approved by, the Commission.¹⁹³ Since EPMI failed to file the prerequisite notice, its January 2002 purported cancellation is void, and of no effect. The cancellation cannot be given effect until after EPMI submits the required notice, even if the cancellation were just, reasonable, and otherwise lawful, which it is not.

140. City requests an order declaring that EPMI's cancellation is void *ab initio*, and that any cancellation shall not become effective until, at the earliest, 60 days from the date on which EPMI complies with Section 205(d) of the Federal Power Act.

D. EPMI Must be Prohibited From Applying Market-Based Rates to Calculate an Early Termination Payment

141. As discussed above, EPMI's purported termination violated EPMI's jurisdictional contract, was an unjust and unreasonable practice, and is void due to EPMI's failure to comply with the Federal Power Act notice requirements. Assuming, *arguendo*, EPMI's purported contract termination was proper, it would still be the case that EPMI cannot and should not be permitted to compute the Early Termination

¹⁹² See *Enron Power Marketing, Inc.*, 65 FERC ¶ 61,305 (1993).

¹⁹³ See *Sierra Pacific Power Co.*, 39 FERC ¶ 61,176 at 61,660 (1987) (mandating that a utility must file a notice of cancellation before cancellation can occur). See also *Indiana & Michigan Electric Co.*, 12 FERC ¶ 61,007 at 61,016 (1980).

Payment it claims based on its revoked market-based rates. As alternative forms of relief, City seeks an order prohibiting EPMI from using market-based rates to calculate an Early Termination Payment. The purpose of such an order is to ensure that EPMI does not benefit from its adjudicated bad acts under rates, terms and conditions that are presently in dispute between the parties. City alternatively seeks an order revoking EPMI's market-based rates as of January 2000. The two forms of alternative relief would ensure that, to the extent EPMI is found to be entitled to recover any additional charges from City for early termination, EPMI would only recover cost-based charges. City vigorously disputes EPMI's right to an Early Termination Payment, as described in detail above, but seeks relief in the alternative, to the extent the Commission or a court determines that City is liable for any charge for early termination.

142. Limiting EPMI to cost-based rate recovery for its unperformed energy delivery obligations is appropriate and reasonable under the circumstances. When it entered into the two long-term confirmations, City bargained for stability in the form of long-term, reliable "firm" energy deliveries at fixed prices from a financially solid (then largest available) counterparty. The stability of long-term transactions was recognized by the Commission as a means to mitigate the California market dysfunctions.¹⁹⁴ City bargained for stable performance guaranteed by an investment grade corporation (Enron Corp.). It is now apparent that the stability City thought it had bargained for was an illusion. In the wake of Enron Corp.'s financial disclosures, EPMI notified City that EPMI would begin interrupting service in December 2001, and EPMI attempted to cancel

¹⁹⁴ See e.g., *San Diego Gas Elec. Co. v. Sellers of Energy*, 95 FERC ¶ 61,418 at 62,549 (2001).

the contracts by January 2002. Instead of receiving stable, long-term power for six and nine year terms, City received one year of deliveries under the August 2000 contract, and received no energy deliveries under the April 2001 contract. As discussed in detail in Sections V. A and V. B, above, EPMI developed an unjust and unreasonable practice of collecting cash by misusing its market-based rate contract collateral, dispute resolution, and termination provisions. Cost-of-service recovery is appropriate under the totality of the circumstances; it will limit EPMI to profits it would have recovered through just and reasonable practices and actual energy deliveries. If EPMI intended to reliably meet its firm long-term delivery obligations, EPMI would have acquired matching energy supply contracts, and those contracts would demonstrate EPMI's cost of service for the unperformed energy delivery obligations. Limiting EPMI to recovering its costs will prevent EPMI from recovering a windfall, it will mitigate the impact of short-term market manipulations on the long-term cancellation charges, and will mitigate the unjust and unreasonable penalty EPMI seeks to impose on City and its ratepayers, which adds salt to City's wound opened by the loss of the stable energy contract it sought.

143. In its Order Revoking Market-Based Rate Authorities and in its Order Denying Rehearing, the Commission detailed the numerous bad acts undertaken by EPMI in violation of its market-based rate authority.¹⁹⁵ Among other things, the Commission recognizes that EPMI management "invented numerous manipulation schemes," "routinely disregarded the corporate separation of various Enron affiliates, and used one or another to facilitate misconduct." Enron affiliates also "routinely failed to

¹⁹⁵ See Order Revoking Market-Based Rate Authorities, 103 FERC at 62,297; Order Denying Rehearing, 106 FERC ¶ 61,024 at P 24-32.

respect the corporate boundaries of its various subsidiaries and affiliates.”¹⁹⁶ The Commission further recognized that “the behavior of Enron Power Marketers constitutes market manipulation and results in unjust and unreasonable rates.”¹⁹⁷ The Commission stated that EPMI “exercised unmitigated market power in the form of gaming through multiple inappropriate trading strategies”¹⁹⁸ and that by “engaging in inappropriate trading strategies” and by “filing false schedules in the California markets that misrepresented the nature of electricity to be supplied and the intended load to be served” Enron was able to “erect and control barriers to market entry.”¹⁹⁹ Additionally, in its Order Denying Rehearing, the Commission affirmed its revocation of Enron’s market-based rate authority “in light of the overwhelming evidence the Enron Power Marketers exercised and engaged in market manipulation” and stated:

In any event, we also find that Enron Power Marketers engaged in unjust and unreasonable practices. Trading strategies such as Circular Scheduling (*i.e.*, Death Star), where Enron Power Marketers scheduled energy in the opposite direction of congestion (counter flow), but no energy was actually put onto the grid or taken off the grid, were designed to generate payments for receiving transmission congestion by “fooling” the California Independent System Operator’s computerized congestion management program with imaginary transactions. **Such practices undermine the functioning of the wholesale power market and our reliance on that market to carry out the mandate of the [Federal Power Act].**²⁰⁰

¹⁹⁶ Revocation Order at 62,297.

¹⁹⁷ Order Denying Rehearing, 106 FERC at 61,093.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 61,094 (emphasis added).

The Commission thus recognized EPMI's egregious acts had undermined the markets whose forces the Commission was relying on to regulate EPMI's conduct. As a result, the Commission revoked EPMI's market-based rate authorities, and immediately terminated its electric market-based rate tariffs removing EPMI's authority to close out existing wholesale electric contracts, such as those with the City.²⁰¹

144. Relying on its strict requirements for granting market-based rate authority and EPMI's failure to meet the most basic requirements for maintaining such authority, the Commission emphasized that:

[I]mplicit in the Commission order granting market-based rates is a presumption that a company's behavior will not involve fraud, deception or misrepresentation. Companies failing to adhere to such standards were and are subject to revocation of their market-based rate authority. In addition, the Enron Power Marketers were expressly directed, when they were granted market-based rate authority, to inform the Commission promptly of changes in status (which would include changes in their generation market shares) that reflect a departure from the characteristics (such as generation market share) that the Commission relied upon (indeed, expressly considered and relied upon) in granting market-based rate authority.²⁰²

The Commission thus specifically acknowledges EPMI's failure to meet the requirements for maintaining market-based rate authorization occurred when EPMI first failed to notify

²⁰¹ See *id.*

²⁰² Order Denying Rehearing, 106 FERC at 61,092 (citing *Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 99 FERC ¶ 61,272 at 62,153-54 (2002). *Accord Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 97 FERC ¶ 61,220 at 61,975-77 (2001); *GWF Energy, LLC, et al.*, 98 FERC ¶ 61,330 at 62,390 (2002); *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 at 61,798-800 (2000), *order on reh'g*, 97 FERC ¶ 61,155 (2001); *Washington Water Power Co.*, 83 FERC ¶ 61,097 at 61,462-64, *order in response to show cause presentation*, 82 FERC ¶ 61,282 (1998); *Kansas City Power & Light Co.*, 74 FERC ¶ 61,066 at 61,175, *order on reh'g*, 75 FERC ¶ 61,244 (1996)).

the Commission of changes in status. Additionally, stressing the significance of EPMI's violations and the flagrant nature of EPMI's violations, the Commission noted:

If the Enron Entities are arguing that they reasonably thought that, under the [Federal Power Act] and [the Commission's] regulations, precedent and policies, their fraudulent, deceptive and misrepresentative practices were permitted as just and reasonable practices affecting jurisdictional rates, that argument is hardly credible.²⁰³

145. Despite its glaring violations of its market-based rate authority, EPMI continues to seek profits from its market-based rate contracts with City through unlawful claims for termination damages computed based on EPMI's tainted market-based contract rates.²⁰⁴ EPMI's continuing actions demonstrate that the relief the Commission granted thus far for EPMI's violation of its market-based rate authority is inadequate and incomplete. In determining the remedy for EPMI's violations of the Federal Power Act and the Commission's orders and regulations, the Commission did not state that it considered, and apparently did not consider, the need for a remedy for EPMI's long-term contracts with City entered into under EPMI's market-based rate authority.²⁰⁵

146. The Commission has not considered and has not crafted a remedy that responds to the continuing and future harm EPMI's revoked market-based rate authority inflicts on City. EPMI calculates its claim for Early Termination Payment of \$147 million using market-based rates, which contravenes and evades the Commission's clear intent in revoking that authority effective June 25, 2003. Therefore, City requests

²⁰³ Order Denying Rehearing, 106 FERC at 61,092 n.34.

²⁰⁴ See Order Revoking Market-Based Rate Authorities, 103 FERC at 62,299-302.

²⁰⁵ See *id.* at 62,308.

the Commission's protection from EPMI's continued reliance on its market-based rates, to profit from its bad acts by extracting unjust and unreasonable charges from City either by: (1) clarifying or modifying its orders revoking EPMI's market-based rates by holding that EPMI cannot collect market-based rates through Early Termination Payments for undelivered energy for contracts with terms extending beyond the June 25, 2003, Revocation Order; or (2) by revoking EPMI's market-based rate authority retroactive to at least January 2000, or such earlier date as the Commission deems necessary and appropriate to protect City. Such order would ensure that any payment City owes EPMI for early termination costs, which City contends is zero, would be calculated on a traditional cost-of-service basis, and would prevent EPMI from collecting market-based rates for unperformed contracts.

1. EPMI's Use of Market-Based Rates after January 2000 was Based on False Information Provided to the Commission

147. In granting EPMI market-based rate authority in 1993, the Commission relied upon its conclusion that EPMI did not possess generation market power.²⁰⁶ At that time, the Commission also directed EPMI:

[T]o inform the Commission promptly of any change in status that would reflect a departure from the characteristics the Commission has relied upon in approving market-based pricing. These include but are not limited to: (1) ownership of generation or transmission facilities or inputs to electric power production other than fuel supplies; (2) affiliation with any entity that owns generation or transmission facilities or inputs to electric power production, or affiliation with any entity that has a franchised service area; or (3) business and financial arrangements involving Enron or any entity affiliated with Enron and the entities that buy

²⁰⁶ See *Enron Power Marketing, Inc.*, 65 FERC ¶ 61,305 at 62,404-405 (1993).

from or sell power to Enron.²⁰⁷

148. As early as January 2000, EPMI violated these clearly defined conditions to the maintenance of the Commission's market-based rate authority. While EPMI was required to notify the Commission of its change in control of generation, its required market analysis, submitted in January 2000, failed to reflect generation under EPMI's control which would directly impact the Commission's assessment, in granting and maintaining market-based rate authority, of generation market power.

149. On January 14, 2000, EPMI submitted to the Commission an updated market analysis.²⁰⁸ This analysis, submitted as part of the "Affidavit of William H. Hieronymous,"²⁰⁹ states that "Enron Corp. subsidiaries have contracts to purchase 867 MW in the Pacific Northwest and California."²¹⁰ EPMI recently relied on the representations made in this analysis in its response to the Commission in the Show Cause Proceeding.²¹¹ EPMI stated that:

Enron did inform the Commission about its power purchases, as required by the EPMI Market Order. It did so in a market power study submitted on January 14, 2000, in Enron's market-based rate docket. That study consists of an Affidavit of William H. Hieronymous, detailing Enron's ownership interests in generating facilities for the purpose of fulfilling the precise notice requirements at issue here.²¹²

²⁰⁷ *Id.*

²⁰⁸ Exh. SNO-24; Docket Nos. EL03-180, *et al.*

²⁰⁹ *Id.*

²¹⁰ *Id.* at P.9.

²¹¹ Docket Nos. EL03-137, *et al.*

²¹² Response of Enron Power Marketing, Inc. and Enron Energy Services, Inc. to Order to Show Cause Concerning Gaming and/or Anomalous Market Behavior Through the use of Partnerships, Alliances or Other Arrangements and Directing Submission of Information at P.38; Docket Nos. EL03-137, *et al.*

150. However, at the time it submitted this market analysis, Enron controlled resources well beyond 867 MW of purchased power. Administrative Law Judge Cintron's Initial Decision in Docket No. EL02-113 concluded that the record evidence demonstrates that "Enron's dealings with El Paso violated Enron's market-based rate authority" as "Enron never informed the Commission of changed circumstances" resulting from those dealings.²¹³

151. In Docket No. EL02-113, Commission Staff demonstrated, and EPMI and Enron Capital and Trade Resources Corporation (collectively "Enron") admitted, that due to the Power Consulting Services Agreement ("PCSA") between EPMI and Enron Capital and Trade Resources Corporation and El Paso Electric Company, Enron "touched/managed 3,500 MW a day with no risk."²¹⁴ The Initial Decision clearly states that, due to this relationship, Enron's circumstances changed in at least four different ways: (1) Enron's market share of generation increased; (2) the PCSA created an affiliation with El Paso; (3) the PCSA created an opportunity for self-dealing; and (4) the PCSA provided Enron with sensitive, competitive market information which gave it an advantage in the market place.²¹⁵ More specifically, the PCSA created an affiliation between Enron and El Paso wherein they shared a common source of control.²¹⁶ Under this arrangement, Enron exercised decision-making authority over the economics of El

²¹³ See *Enron Power Marketing, Inc. and Enron Capital and Trade Resources Corporation*, 104 FERC ¶ 63,010 at 65,025-26 (2003) ("Initial Decision").

²¹⁴ See *id.* at 65,029. See also Final Report at P. VI-41 (citing August 22, 2000 West Mid-Market Quarterly Business Review).

²¹⁵ See *id.* at 65,026.

²¹⁶ See *id.*

Paso's power scheduling activities and the related jurisdictional assets. Enron operated the El Paso trading desk and exercised control over the sale of power.²¹⁷ In assessing whether such shared control constitutes a change in status, the Initial Decision indicates that "Commission decisions support the finding that by virtue of such control, Enron 'operated' El Paso's facilities for the purposes of the Federal Power Act and Commission rules. Thus, Enron and El Paso were affiliates within the purview of the Commission's rules."²¹⁸

152. The Initial Decision is replete with examples of changed circumstances, which run counter to those principles, and characteristics relied upon in the granting of market-based rate authority and which necessitate notification to the Commission. The Initial Decision points out that "evidence shows that Enron admitted it gained control of El Paso and this was part of a larger strategy to gain control of many resources in the West."²¹⁹ In concluding that "Enron changed its competitive position in the generation market, and **should have disclosed this fact to the Commission**", the Initial Decision notes that El Paso admitted that Enron benefit[ed] from the relationship by virtue of the information available to it regarding generation resources."²²⁰ Furthermore, the Initial Decision concludes that "the PCSA resulted in Enron engaging in self-dealing, **and this warranted Commission notification due to a change in Enron's status reflecting a departure from the characteristics the Commission relied upon in**

²¹⁷ *See id.*

²¹⁸ *Id.*

²¹⁹ Initial Decision, 104 FERC at 65,027.

²²⁰ *Id.* (emphasis added).

approving its market-based rate authority.”²²¹ The Initial Decision explains that “EPMI actually executed wholesale electricity transactions (both buying and selling) with itself on El Paso’s behalf” and that “the type of self-dealing in this case is more blatant than affiliate abuse between two subsidiaries sharing the same parent.”²²² Similarly, the Initial Decision notes that “the PCSA provided Enron with access to sensitive, competitive information which under normal circumstances El Paso would not have wanted its competitors to have” and that such access constituted a changed circumstance warranting Commission notification.²²³

153. However, despite these numerous changed circumstances, Enron’s triennial market analysis, submitted on January 14, 2000, did not notify the Commission of any increased generation market power. This direct violation of the Commission’s requirements for the establishment and maintenance of market-based rate authority warrants revocation, suspension, or an order prohibiting EPMI’s continued use of such authority after the date of that fraudulent report. Enron’s January 2000 market analysis misrepresented Enron’s control over generation in the West. Because EPMI’s continued use of market-based rates after January 2000 was based on false information, the Commission should revoke, suspend, or prohibit EPMI’s continued use of its market-based rate authority after January 2000. Such relief would ensure that EPMI is not unjustly enriched and does not inappropriately benefit from a market-based rate authority, which was inappropriately maintained through reliance on EPMI’s misrepresentations.

²²¹ *Id.* (emphasis added).

²²² *Id.* at 65,028.

²²³ *See id.*

2. The Commission's Western Market Investigation Revealed and Documented Enron's Violation of Its Market-Based Rate Authority as of January 2000 or Earlier

154. In its February 13, 2002 Order issued in Docket No. PA02-2,²²⁴ the Commission directed its Staff to undertake a thorough examination of Enron's trading practices. As a result of that investigation Commission Staff found that various Enron subsidiaries, including EPMI, violated Commission-approved tariffs, regulations, orders and the Federal Power Act. Based in large part on the Commission Staff report, the Commission revoked the market-based rate authority it had granted various Enron subsidiaries, including EPMI.

155. Commission Staff's *Final Report on Price Manipulation in Western Markets* ("Final Report"), issued on March 26, 2003, demonstrates that various Enron subsidiaries, including EPMI, engaged in behavior that constituted gaming, market manipulation, failure to disclose changes in market share or other anomalous market behavior in violation of the Federal Power Act, Commission's orders and regulations and the ISO and/or PX Tariffs during the period the Commission authorized Enron to sell power at market-based rates.²²⁵ The Final Report demonstrates that, while EPMI engaged in numerous bad acts in violation of the Federal Power Act and the market-based rate authority during the year 2000, EPMI engaged in such behavior as early as May 25, 1999.²²⁶

²²⁴ *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 FERC ¶ 61,165 (2002).

²²⁵ See *Final Report on Price Manipulation in Western Markets* at pp. VI-1 to VI-59; Docket No. PA02-2-000 ("Final Report"). See also Enron's Market-Based Rate Authority Orders in Docket No. EL03-77-000.

²²⁶ See Final Report at p. VI-26.

156. The Commission Staff's Final Report details the various EPMI trading strategies and anomalous activities in violation of the Federal Power Act and EPMI's market-based rate authority. In discussing transmission congestion strategies, the Final Report examines, *inter alia*, three Enron trading strategies known as "non-firm exports," "death star," and "wheel-out," along with similar variations.²²⁷ These strategies, the Final Report explains, were designed to generate payments for relieving transmission congestion by "fooling" the ISO's computerized congestion management program.²²⁸ The Final Report indicates that the first instance of these trading strategies occurred on May 25, 1999.²²⁹ The Final Report details that, on that day, Enron scheduled an infeasible transaction in the PX market across an intertie between Southern California and Nevada calling for 2,900 megawatts to go across a line with only 15 megawatts of available capacity and triggering the ISO's congestion management procedures.²³⁰ Additionally, with respect to these strategies, the Final Report references an Enron e-mail dated February 17, 2000, indicating the clear participation of Enron and others in such congestion relief schemes.²³¹

157. The Final Report also indicates that in December 2000, an Enron subsidiary, Enron Energy Services, Inc., participated in the trading strategy known as "ricochet" or "megawatt laundering."²³² This strategy involved one entity buying energy

²²⁷ *See id.*

²²⁸ *See id.*

²²⁹ *See id.*

²³⁰ *See id.*

²³¹ *See id.* at p. VI-30.

²³² *See id.* at pp. VI-17 to VI-19.

from the PX in the day-ahead market and exporting it to a second entity, which received a fee from the first company. The energy was later sold to the ISO in the real-time market (or as an out-of-market sale).²³³ Staff concluded that this strategy “is an example of anomalous market behavior – that is ‘behavior that departs significantly from the normal behavior in competitive markets that do not require continuing regulation or behavior leading to unusual or unexplained market outcomes.’”²³⁴

158. The Final Report indicates that while the “get shorty” trading strategy may have occurred as early as January 11, 2000, it provided significant revenue to Enron prior to June 5, 2000.²³⁵ The Final Report explains that the “get shorty” trading strategy involves “paper trading” of ancillary services.²³⁶ That is, Enron would sell ancillary services without actually having those services on standby, requiring submittal of false information to the ISO.²³⁷ In demonstrating Enron’s use of this strategy, the Final Report cites to an Enron e-mail dated January 11, 2000, explaining how Enron will take a more aggressive strategy to bid into the day-ahead ancillary services market without the necessary resources.²³⁸ Additionally, the Final Report cites to a June 5, 2000 Enron e-mail describing the results of such efforts and detailing the money earned on ancillary services for May 2000.²³⁹

²³³ See *id.* at VI-17.

²³⁴ *Id.* at VI-18.

²³⁵ See *id.* at VI-31 to VI-32.

²³⁶ See *id.* at VI-31.

²³⁷ See *id.*

²³⁸ See *id.* at VI-31 to VI-32.

²³⁹ See *id.* at VI-32.

159. The Final Report also addresses “wash trading” on EnronOnline (“EOL”).²⁴⁰ The Final Report explains that a “wash trade” is generally defined as a prearranged pair of trades of the same goods between the same parties, involving no economic risk and no net change in beneficial ownership and serving no legitimate business purpose.²⁴¹ The Final Report further explains that wash trades might be used to create the illusion that a market is liquid and active, to increase reported trading revenue figures, or to affect the average or index price reported for a market.²⁴² Wash trades are damaging to the integrity of a market and have the potential of misleading a host of market stakeholders through other forms of manipulation.²⁴³ With respect to Enron’s activities, the Final Report concludes, “wash trading was commonplace on the EOL trading platform between January 2000 and November 2001.”²⁴⁴

160. The Commission found “Enron management invented numerous market manipulation schemes . . . and used various Enron companies to execute these schemes.”²⁴⁵ According to the Commission, these strategies constituted an exercise of unmitigated market power.²⁴⁶ Enron’s market manipulation also resulted in unjust and unreasonable rates in violation of the Federal Power Act.²⁴⁷ The Commission also found “Enron routinely disregarded the corporate separation of the various Enron affiliates, and

²⁴⁰ See *id.* at VII-1 to VII-16.

²⁴¹ See *id.* at VII-1.

²⁴² See *id.*

²⁴³ See *id.*

²⁴⁴ See *id.* at VII-14.

²⁴⁵ Order Revoking Market-Based Rate Authorities, 103 FERC at 62,297.

²⁴⁶ See Order Denying Rehearing, 106 FERC at 61,093.

²⁴⁷ See Order Revoking Market-Based Rate Authorities, 106 FERC at 62,302.

used one or another to facilitate misconduct”²⁴⁸ in violation of Commission orders and regulations.

161. The above demonstrates that the Commission’s records and conclusions in Docket Nos. PA02-2 and EL03-77 are replete with examples of bad acts through which EPMI violated the Federal Power Act and its market-based rate authority on or before January 2000, the effective date of City’s requested alternative relief.

3. EPMI Had Sufficient Notice of the Potential for the Relief Demanded Based on its Violations

162. EPMI cannot complain of lack of notice of the potential for the alternative relief City requests. The Commission has provided repeated notices of its intent to immediately revoke market-based rate authority from any public utility that violated the Federal Power Act and the Commission’s orders or regulations.²⁴⁹ The Commission initiated the proceedings in Docket No. EL00-95 to investigate the justness and reasonableness of the rates and charges of public utilities that sell energy and ancillary services in the ISO and PX markets. In its December 2000 Order, the Commission provided notice that the opportunity for sellers to exert market power existed, and that it would, in lieu of rejecting market-based rates at that time, condition

²⁴⁸ See *id.* at 62,297.

²⁴⁹ See November 2000 Order at 61,376; *San Diego Gas & Electric Co. v. Sellers of Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 93 FERC ¶ 61,294 at 62,011 (2000) (Order Directing Remedies for California Wholesale Electric Markets) (“December 2000 Order”); *San Diego Gas & Electric Co.*, 95 FERC ¶ 61,115 at 61,360 (2001) (Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets) (“April 2001 Order”); *San Diego Gas & Electric Co.*, 95 FERC ¶ 61,418 at 62,565 (2001) (Order on Rehearing of Monitoring and Mitigation Plan) (“June 2001 Order”); July 2001 Order at 61,508.

the market-based rates of sellers to address the market dysfunction.²⁵⁰ Accordingly, the December 2000 Order put EPMI on notice that its market-based rate authority was subject to revocation, and that violations would be remedied.

163. In its April 2001 Order, the Commission provided additional notice of its intent to remedy illegal acts, undertaken by entities with market-based rate authority, in stating that it would:

[condition] public utility sellers' market-based rates to ensure that they do not engage in certain anticompetitive bidding behavior. **Suppliers violating these conditions would have their rates subject to refund as well as the imposition of other conditions on their market-based rate authority.**²⁵¹

The Commission bolstered this notice in its June 2001 Order that stated “public utility sellers’ market-based rate authority will be subject to potential revocation if they are found to have engaged in inappropriate behavior.”²⁵² The Commission’s April 2001 and June 2001 Orders again alerted EPMI that the Commission could order refunds and/or revocation of EPMI’s market-based rate authority.

164. Furthermore, the Commission’s June 4, 2002 Order in Docket No. PA02-2 likewise notified market participants that “companies failing to adhere to the proper standards are subject to immediate revocation of their market-based rate authority.”²⁵³ In sum, all jurisdictional sellers, including EPMI, were on notice, at least as early as December 2000, of the Commission’s intent to impose remedies including

²⁵⁰ See December 2000 Order, 93 FERC at 62,011.

²⁵¹ April 2001 Order, 95 FERC at 61,360 (emphasis supplied).

²⁵² June 2001 Order, 95 FERC at 62,565.

²⁵³ *Fact Finding Investigation on Potential Manipulation of Electric and Gas Prices*, 99 FERC ¶ 61,272 at 62,154 (2002).

revocation of a seller's market-based rate authority if the Commission found a violation of the Federal Power Act or the Commission's regulations or orders.

165. Further, the Commission, in both the Gaming Order and Partnership Order, recognized that market participants were on notice as early as 1998. In the Gaming Order, the Commission stated that the ISO and PX Tariffs have included "provisions that identify and prohibit 'gaming' and 'anomalous market behavior' in the sale of electric power," as part of the Market Monitoring and Information Protocol.²⁵⁴ The Commission established the period for evaluating gaming and/or anomalous market behavior as having occurred during the period between January 1, 2000 to June 20, 2001. The Commission further recognized that the notice that market participants were under was sufficient to initiate the proceedings in the Gaming Order and Partnership Order.²⁵⁵

166. The notice relied upon in the Gaming Order and Partnership Order is sufficient for use in this proceeding. Notice is sufficient if it informs the party of "the matters of fact and law asserted" by the Commission.²⁵⁶ The function of notice is to advise the party of the "things claimed to be wrong so that the [party] may be put upon his defense."²⁵⁷ Courts, in comparing this requirement to Constitutional requirements, have stated that "[t]he purpose of notice under the Due Process Clause is to apprise the affected individual of, and permit adequate preparation for, an impending 'hearing.'"²⁵⁸

²⁵⁴ *American Electric Power Serv. Corp., et al*, 103 FERC ¶ 61,345 at 62,330 (2003) ("Gaming Order"); *Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,346 at 62,350 (2003) ("Partnership Order").

²⁵⁵ See Gaming Order, 103 FERC at 62,333; Partnership Order, 103 FERC at 62,354.

²⁵⁶ Administrative Procedure Act ("APA"), 5 U.S.C. § 554(b)(3) (2002).

²⁵⁷ *FTC v. Gratz*, 253 U.S. 421, 430 (1920) (Brandeis, J., dissenting).

²⁵⁸ *Memphis Light, Gas and Water Div. v. Craft*, 436 U.S. 1, 14 (1978).

Notice is legally sufficient when it informs the party of the conduct at issue and affords a fair opportunity to prepare and present a defense.²⁵⁹ Where a party understands an issue, and has been or will be afforded a full opportunity to justify its conduct, the APA notice requirement is considered satisfied.²⁶⁰ The Commission has stated that notice is sufficient when it is “reasonably calculated, under all the circumstances, ‘to apprise interested parties of the pendency of the action.’”²⁶¹ The January 2000 date on which the Commission began the period under review in the Gaming and Partnership Orders is the appropriate effective date for the relief requested by the City.

167. Additionally, the Commission has previously entered other show cause orders regarding violations of market-based rate authority²⁶² in which the Commission suspended the market-based rate authority but ordered retroactive relief.²⁶³

²⁵⁹ See *Soule Glass and Glazing Co. v. NLRB*, 652 F.2d 1055, 1074 (1st Cir. 1981).

²⁶⁰ See *Southwest Sunsites, Inc. v. FTC*, 785 F.2d 1431, 1435 (9th Cir. 1986) (finding notice requirement of the APA satisfied and due process not violated where the party proceeded against understands the issue and has been given an opportunity to provide a defense).

²⁶¹ *Pacific Gas and Electric Co.*, 25 FERC ¶ 61,010 at 61,055 (1983) (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (“An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.”)).

²⁶² See, e.g., *Washington Water Power Co.*, 83 FERC ¶ 61,097 (1998).

²⁶³ See *Washington Water Power Company*, 83 FERC ¶ 61,282 (1998). The market-based rate authority in *Washington Water Power* was suspended on a prospective basis. However, the utility involved there, unlike Enron, is a functioning utility. Thus, the prospective relief ordered in *Washington Water Power* actually punished the utility, whereas prospective relief with respect to Enron will not. Additionally, the disgorgement of profits on a retroactive basis effectively revoked on a retroactive basis the market-based rate authority as to the transactions under review.

168. A Commission order precluding EPMI's use of its market-based rates to compute termination damages for energy it chose not to deliver during periods after the date of its first violation would come neither as a surprise, nor without adequate notice, to EPMI. Moreover, applying the foregoing law to this proceeding, EPMI's customers are clearly entitled to the remedy of precluding EPMI from collecting charges based on EPMI's market-based rates for energy that was not delivered, for periods after EPMI's January 2000 false triennial report.

4. The Commission Possesses the Authority Necessary to Order This Alternative

169. The Commission has found that retroactive relief may be necessary where a party has acted inconsistently with its filed rate.²⁶⁴ In addition, where a party demonstrates a violation of Commission regulations or a seller's market-based rate authority, the Commission may order retroactive relief.²⁶⁵

170. The Commission has independent, alternative authority to order retroactive revocation of EPMI's market-based rate authority based upon Section 309 of the Federal Power Act. Section 309 states that the Commission has the power to "perform any and all acts, and to prescribe, issue, make, amend, and *rescind* such orders, rules and regulations as it may find *necessary or appropriate . . .*"²⁶⁶ Accordingly, the Commission should, relying upon such authority, ensure an adequate remedy for Enron's

²⁶⁴ See *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,121 at 61,376 (2000) (reviewing the Commission's analysis of its retroactive refund authority under the Federal Power Act, concluding that under such limited circumstances the Commission can order retroactive rate changes).

²⁶⁵ See *San Diego Gas & Electric Co.*, 96 FERC 61,120 at 61,507-61,508 (2001).

²⁶⁶ 16 U.S.C. 825h (emphasis added).

bad acts either by prohibiting EPMI's continued use of market-based rate authority to compute damages on unconsummated transactions, or by making its Revocation Order effective as of the date of EPMI's January 2000 false triennial report filing.

171. Market-based rate authority is granted by the Commission only after a showing that a seller does not have market power or has sufficiently mitigated market power.²⁶⁷ Commission Staff's analysis, as presented in the Commission Staff's Final Report, demonstrates that EPMI engaged in behavior that constitutes gaming, market manipulation, failure to disclose changes in market share or other anomalous market behavior in violation of the Federal Power Act and the Commission's orders and regulations and the ISO and/or PX Tariffs during the period the Commission authorized Enron to sell power at market-based rates.²⁶⁸ The *El Paso* case demonstrates that EPMI's use of its market-based rate after January 2000 was based on false information supplied to the Commission, misleading the Commission as to EPMI's true market power. The Commission's market-based rate regime depends on a functioning market and sellers lacking market power; circumstances the Commission has concluded were not present for EPMI after January of 2000.

172. If the Commission is to give effect to the broad authority reposed in it under Section 309 and Staff's analysis of the evidence of EPMI's abuse of its authority, the Commission must invoke a remedy that fully remedies EPMI's initial

²⁶⁷ See *Alternative to Traditional Cost of Service for Natural Gas Pipeline*, 74 FERC ¶ 61,076 at 61,230 (1996) (establishing the test for authorization of market-based rates).

²⁶⁸ See Final Report at pp. VI-1 to VI-59. See also Enron's Market-Based Rate Authority Orders in Docket No. EL03-77-000.

violations, even if such relief is in some sense retroactive. Such relief is necessary to maintain the balance on which the Commission's market-based rate regime rests.

173. Although the Commission states that the remedy for Enron's actions is predicated on the Commission's authority under Sections 206 and 309, the Commission only ordered, in its Order Revoking Market-Based Rate Authorities and Terminating Blanket Marketing Certifications, a prospective change in rates, terms and conditions of service.²⁶⁹ The order did not address any other remedy available to the Commission pursuant to Sections 206 or 309. However, the Commission has ample authority to remedy EPMI's violations beyond the self-imposed limit stated in the Order Revoking Market-Based Rate Authorities.²⁷⁰ As the order noted, the Commission's authority is "at zenith when the action assailed relates primarily . . . to the fashioning of policies, remedies and sanctions, including enforcement . . . to arrive at maximum effectuation of Congressional objectives."²⁷¹ Congress intends for the Commission to forcefully use all the tools at its disposal to provide appropriate relief to western consumers for their economic harm resulting from manipulation of wholesale energy markets by EPMI and others. Since the Federal Power Act authorizes the Commission to fashion a remedy for violation of its orders that precludes the offending public utility from profiting from its illegal actions, the Commission should avail itself of this remedy, by precluding EPMI's continued use of market-based rate authority to compute contract

²⁶⁹ See Order Revoking Market-Based Rate Authorities, 103 FERC at 62,295.

²⁷⁰ See *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986).

²⁷¹ *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967) (addressing the denial of wrongdoer of participation in a government program to maintain fairness, equity and efficiency). See Order Revoking Market Based Rate Authorities, 103 FERC at 62,305.

damages and requiring all charges under the Early Termination Payment provisions of the Master Agreement and long-term confirmations to be based upon cost-of-service rates.²⁷² Alternatively, the revocation of EPMI's market-based rates must be made effective as of the date of the first violation found by the Commission, i.e., as of January 2000.

174. Where a public utility fails to fulfill its obligation to notify the Commission of a change in status, thereby denying the Commission information needed to determine that status until a much later date, the Commission has authority to address the legal status of a public utility as of the date of such violation. The Commission has exercised such authority by ordering the retroactive imposition of the obligation for payments by public utilities that violate the Federal Power Act.²⁷³

175. The Commission should utilize its additional remedial authority under Sections 206 and 309 of the Federal Power Act to afford a full remedy from EPMI's egregious acts.²⁷⁴ Section 309 is subject to a "broad interpretation to enable the Commission to effectively regulate the . . . power industr[y]."²⁷⁵ Under Section 309, the Commission has the authority to undo its errors.²⁷⁶ A corollary to that authority is to undo wrongdoing by a public utility that violates the Commission's orders, as the

²⁷² See *Coastal Oil & Gas Corp.*, 782 F.2d at 1253.

²⁷³ See *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d at 159.

²⁷⁴ See Section 309 of the Federal Power Act, 16 U.S.C. §825h (authorizing the Commission to "rescind such orders rules and regulations as it may find necessary or appropriate to carry out the provisions of this Act.").

²⁷⁵ *Mesa Petroleum Co. v. FPC*, 441 F.2d 182, 187 (5th Cir. 1971).

²⁷⁶ *United Gas Improvement Co. v. Callery Properties*, 382 U.S. 223, 289-90 (1965).

Commission has shown EPMI to have done.²⁷⁷ Such an exercise of authority is necessary to protect consumers, which is a primary purpose of the Federal Power Act, and to reach a balance between the interests of the consumer, producer, and those whose interests fall in between.²⁷⁸ Section 309 specifically authorizes the Commission to take all actions “necessary and appropriate” to administer its jurisdiction for the protection of consumers consistent with the policies of Congress and the language of the Federal Power Act.²⁷⁹ The authority under Section 309 of the Federal Power Act to perform all actions necessary and appropriate is available to the Commission, and should be exercised to remedy EPMI’s violations of its market-based rate authority. The enormity of EPMI’s misdeeds and the magnitude of the harm to the market and to market participants dictate that this is the “ideal case,” as it were, for the meaningful and necessary exercise of such broad remedial authority.

176. Furthermore, the Commission’s power to enforce the terms of a filed rate is not limited to the authority under Sections 206 and 309 to order prospective remedies.²⁸⁰ Since a public utility is only permitted to charge the filed rate,²⁸¹ a public

²⁷⁷ See *Consolidated Edison Co. of New York v. FERC*, 347 F.3d 964, 967 (D.C. Cir. 2003) (providing that Section 309 authorizes FERC to order retroactive relief if it finds a tariff violation).

²⁷⁸ See *California Gas Producers Ass’n v. FPC*, 421 F.2d 422, 428 (9th Cir. 1970).

²⁷⁹ See *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 158 (D.C. Cir. 1967).

²⁸⁰ See *San Diego Gas & Electric Co.*, 93 FERC at 61,381 (stating the Commission may order retroactive remedies “where the rates charged were in violation of the filed rate.”).

²⁸¹ See *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-52 (1951); *Southern Co. Servs., Inc.*, 37 FERC ¶ 61,256 at 61,653 (1986); *Sierra Pacific Power Co. v. Utah Power & Light Co.*, 12 FERC ¶ 61,020 at 61,038 (1980); *City of Alexandria, Minn. v. Otter Tail Power Co.*, 8 FERC ¶ 61,312 at 61,911 (1979).

utility that violates the terms of its filed rate ceases to conform to that rate. The Commission Staff's findings with respect to EPMI, as used by the Commission, establish that EPMI failed to adhere to the conditions of its filed rate. Therefore, the Commission's authority to remedy Enron's violation of the filed rate is not limited to the authority under Section 206 to order prospective relief. The relief City requests is necessary to ensure that market participants such as City are restored to the *status quo ante*.²⁸²

177. In fact, though similar requests were raised in the proceedings in Docket No. EL03-77, the Commission dismissed these requests solely on a procedural basis. In its Order Denying Rehearing of its Order Revoking Market-Based Rate Authorities the Commission, dismissing requests for rehearing seeking retroactive remedies, reiterated its holding that the proceedings in Docket No. EL03-77 were investigations under Part 1b of the Commission Rules and Procedures for which there can be "no 'parties' and thus no requests for rehearing."²⁸³ The Commission further stated that the "[proceedings in Docket No. EL03-77], and the Show Cause and Revocation Orders, were focused only on the prospective revocation of market-based rate authorities and blanket marketing certificates. Other remedies are beyond the scope of these proceedings."²⁸⁴ However, recognizing that such remedies are within the Commission's authority, the Commission stated that such retroactive remedies "are the subjects of, for

²⁸² See *Coastal Oil & Gas Corp.*, 782 F.2d at 1253.

²⁸³ Order Denying Rehearing, 106 FERC at 61,096.

²⁸⁴ *Id.*

example, the proceedings instituted in the [Gaming and Partnership Show Cause Orders], as well as in [the Refund Proceeding in Docket No. EL00-95].”²⁸⁵

5. The Commission Should Adopt Alternative Relief Respecting EPMI’s Market-Based Rate Authority to Avoid EPMI’s Enjoyment of the Benefits of Market-Based Rate Authority after June 25, 2003.

178. As shown, there is ample reason and authority for the Commission to revoke EPMI’s market-based rates as of January 2000. One area of concern arises with respect to the practical implications of revoking EPMI’s market-based rates effective in January 2000, *i.e.*, that such a change in the revocation date could result in substantial additional claims being asserted against EPMI for transactions that occurred from City’s proposed revocation date of January 2000 to the revocation date of June 25, 2003. This concern, however, can be obviated, if necessary, by the Commission’s adoption of an order which does not apply to completed transactions, but requires EPMI to calculate on a cost basis any charges under agreements, such as the long-term confirmations, for deliveries which were never completed. Such a distinction would avoid revisiting completed transactions, but will appropriately deny EPMI the ability to be unjustly enriched by applying its market-based rate authority to calculate payments for transactions for which deliveries did not occur, and which extend beyond the date of the Revocation Order.

179. City, further, is in a unique position. Whereas the long-term confirmations were entered into prior to June 25, 2003, the term of the August 29, 2000 long-term confirmations runs through 2009 and the term of the April 17, 2001 long-term

²⁸⁵ *Id.* (citations omitted).

confirmation runs through 2005. Thus, by their terms, City's long-term confirmations, which commenced before the June 25, 2003 revocation of EPMI's market-based rate authority, extend well past the date of revocation. Due to EPMI's actions, however, City received only one year of performance under the nine year transaction, and received no performance (including no delivery of the requisite guaranty) under the April 17, 2001 transaction. To allow EPMI to obtain the benefits of the computation of the Early Termination Payment under the two long-term confirmations based upon a market-based calculation will effectively eviscerate the impact of the Commission's June 25, 2003 Revocation Order with respect to the City's long-term transactions. Had EPMI survived as a functioning utility and performed under City's two long-term confirmations, the revocation of EPMI's market-based rate authority effective on June 25, 2003, would have resulted in City's payments to EPMI being cost-based commencing on June 25, 2003. Due to EPMI's actions, however, no deliveries occurred after December 2001. As would be the case if EPMI performed the transactions, any Early Termination Payment should be calculated based on cost-based rates and not based on a market-based analysis.

180. Under the totality of the circumstances and the unique facts presented, the Commission can ensure just and reasonable termination payments, while avoiding recalculation of completed transactions, by requiring EPMI to calculate on a cost basis any additional charges it seeks under its market-based contracts for energy not delivered under the two long-term confirmations. The relief would apply to EPMI's market-based contracts, which were not fully performed, and the terms of which created obligations to deliver after June 25, 2003, such as the City's long-term confirmations.

6. The Relief Sought Is Necessary to Protect City from Unjust and Unreasonable Charges and Practices

181. City vigorously opposes EPMI's right to an Early Termination Payment from City. If, however, the Commission determines such charge is permitted under the Master Agreement and required under the circumstances, the Commission should only permit such charge on the basis of EPMI's actual costs.

182. EPMI has forfeited its right to charge market-based rates. The Commission has cancelled all such authority based on EPMI's violations of its Tariff and the Federal Power Act, beginning on or before January 2000. To the extent EPMI continues to seek to benefit from violation of its market-based rate authority by extracting unjust and unreasonable payments from City, the Commission should deny EPMI that right. The Commission should order EPMI, to the extent it is found to be entitled to an Early Termination Payment from City, to calculate any further charges under the Master Agreement and the long-term confirmations thereunder solely on the basis of actual costs. Alternatively, the Commission must revoke EPMI's market-based rates on the date of the first violation found (i.e., January 2000) and prevent EPMI from recovering any additional market-based charges after that date.

VI. RELIEF REQUESTED

WHEREFORE, for the foregoing reasons, City respectfully requests that the Commission enter an order providing, as follows:

- (1) EPMI is not entitled to the claimed Early Termination Payment based on its improper attempt to cancel contracts with City;
- (2) EPMI's purported cancellation of the two long-term confirmations with City is void, and its attempt to obtain an Early

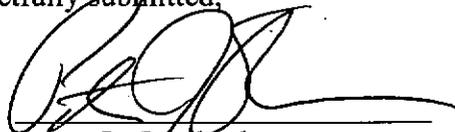
Termination Payment is a nullity due to EPMI's failure to provide notice to, and obtain approval from, the Commission;

(3) In the alternative, if any Early Termination Payment can be claimed by EPMI, require EPMI to calculate the charge on a cost of service basis, and/or revoke EPMI's market-based rate authority effective at least as of January 2000 and order EPMI to calculate all charges under its jurisdictional contracts on a cost-of-service basis; and

(4) Grant such alternative and additional relief as may be necessary and appropriate to provide complete relief to City.

Dated: July 2, 2004

Respectfully submitted,



James D. Pembroke
Peter J. Scanlon
Duncan, Weinberg, Genzer
& Pembroke, P.C.
1615 M Street, N.W.
Suite 800
Washington, D.C. 20036
(202) 467-6370

Attorneys for City of Santa Clara,
California

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Santa Clara, California)	
)	
v.)	Docket No. EL04-___-000
)	
Enron Power Marketing, Inc.)	

NOTICE OF FILING

(July __, 2004)

Take notice that on July 2, 2004, the City of Santa Clara, California ("City"), filed a formal complaint against Enron Power Marketing, Inc. ("EPMI") pursuant to Sections 206, 306 and 309 of the Federal Power Act, 16 U.S.C. §§ 824e, 825e and 825h (2000), and Rule 206 of the Federal Energy Regulatory Commission's ("Commission") Rules of Practice and Procedure, 18 C.F.R. § 385.206 (2003), *inter alia*, seeking relief from EPMI's unlawful attempts to terminate certain contracts with the City, and seeking to prohibit EPMI from collecting unjust and unreasonable termination charges from City.

Any person desiring to intervene or protest this filing should filed with the 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 (18 C.F.R. §§ 385.211 and 385.214 (2003)). 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. Any person wishing to become a party must file a motion to intervene. All such motions or protests should be filed on or before the comment date, and, to the extent applicable, must be served on the complainant and on any other person designated on the official service list. This filing is available for review at the Commission or may be viewed on the Commission's web site at <http://www.ferc.gov>, using the eLibrary link. Enter the docket number excluding the last three digits in the docket number filed to access the document. For assistance, please contact FERC Online Support at FERCOnlineSupport@ferc.gov or toll-free at (866) 208-3676, or for TTY, contact (202) 502-8659. The answer to the complaint, comments, protests, and interventions may be filed electronically via the Internet in lieu of paper; see 18 C.F.R. § 385.2001(a)(1)(iii) and the instructions on the Commission's web site under the "e-Filing" link. The Commission strongly encourages electronic filings.

Comment Date: July __, 2004.

Magalie R. Salas, Secretary

Appendix A

List of Exhibits

In accordance with Rule 206(b)(8), the following documents are attached as Exhibits to this Complaint:

1. The Affidavit of Ann Hatcher;
2. The September 10, 1999 Master Agreement;
3. The August 29, 2000 confirmation letter;
4. The April 17, 2001 confirmation letter;
5. EPMI's November 8, 2001 Press Release providing additional information about related party and off-balance sheet transactions and announcing that EPMI would restate its earnings for 1997-2001.
6. EPMI's May 30, 2002 letter asserting a right to an Early Termination Payment in the amount of \$147 million.
7. Excerpts from EPMI's quarterly report dated January 31, 2000;
8. City's December 11, 2001 letter disputing the amounts owed under the invoice;
9. EPMI's invoice dated December 14, 2001;
10. EPMI's December 21, 2001 letter regarding the invoice and Notice of Default;
11. City's December 21, 2001 letter regarding the invoice;
12. EPMI's December 28, 2001 letter claiming a right to declare an early termination;
13. City's January 10, 2002 letter regarding amounts owed by EPMI to City;
14. EPMI's November 27, 2001 letter demanding cash "margin";
15. City's November 28, 2001 response;
16. Articles and EPMI's November 28, 2001 Press Releases regarding Enron's financial collapse and credit downgrade in November, 2001;

17. City's November 29, 2001 demand for Performance Assurance;
18. City's December 3, 2001 notice of suspension of its short-term deliveries;
19. E-mail from Christian Yoder to Paul Choi, Stewart Rosman, Chris Lackey, and Jim Buerkle (Nov. 30, 2001, 12:48 p.m.).
20. *Enron Power Marketing, Inc., and Enron Energy Services, Inc.*, Docket No. EL03-180-000, Deposition of Paul I. Choi, Feb. 12, 2004, at 106-108.
21. E-mail from Tim Beldon to Staff Members (Nov. 28, 2001, 12:20 p.m.).
22. E-mails dated Nov. 7, 2001 – Nov. 28, 2001.
23. E-mail from Carol St. Clair to Marie Heard (Nov. 28, 2001, 3:18 p.m.).
24. E-mail from Carol St. Clair to Lisa Mellencamp (Dec. 19, 2001, 4:13 p.m.).
25. E-mail from Lisa Mellencamp to Sara Shackleton (Dec. 27, 2001, 5:22 p.m.).
26. Excerpts from the Second Interim Report of Neal Batson, Court-Appointed Examiner, dated January 21, 2003 (pp. 1-30, App. Q).

Appendix B

List of Exhibits in Chronological Order

<u>Exhibit Description</u>	<u>Exhibit No.</u>
The September 10, 1999 Master Agreement	2
Excerpts from EPMI's quarterly report dated January 31, 2000	7
The August 29, 2000 confirmation letter	3
The April 17, 2001 confirmation letter	4
E-mails dated Nov. 7, 2001 – Nov. 28, 2001	22
EPMI's November 8, 2001 Press Release providing additional information about related party and off-balance sheet transactions and announcing that EPMI would restate its earnings for 1997-2001	5
EPMI's November 27, 2001 letter demanding cash "margin"	14
City's November 28, 2001 response	15
Articles and EPMI's Press Releases regarding the collapse of the Dynegy merger and Enron's credit downgrade	16
E-mail from Tim Beldon to Staff Members (Nov. 28, 2001, 12:20 p.m.)	21
E-mail from Carol St. Clair to Marie Heard (Nov. 28, 2001, 3:18 p.m.)	23
City's November 29, 2001 demand for Performance Assurance	17
E-mail from Christian Yoder to Paul Choi, Steward Rosman, Chris Lackey and Jim Buerkle (Nov. 30, 2001, 12:48 p.m.)	19
City's December 3, 2001 notice of suspension of its short-term deliveries	18
City's December 11, 2001 letter disputing the amounts owed under the invoice	8

EPMI's invoice dated December 14, 2001	9
E-mail from Carol St. Clair to Lisa Mellencamp (Dec. 19, 2001, 4:13 p.m.)	24
City's December 21, 2001 letter regarding the invoice	11
EPMI's December 21, 2001 letter regarding the invoice and Notice of Default	10
E-mail from Lisa Mellencamp to Sara Shackleton (Dec. 27, 2001, 5:22 p.m.)	25
EPMI's December 28, 2001 letter claiming a right to declare an early termination	12
City's January 10, 2002 letter regarding amounts owed by EPMI to City	13
EPMI's May 30, 2002 letter asserting a right to an Early Termination Payment in the amount of \$147 million	6
Excerpts from the Second Interim Report of Neal Batson, Court-Appointed Examiner, dated January 21, 2003 (pp. 1-30, App. Q)	26
<i>Enron Power Marketing, Inc. and Enron Energy Services, Inc.,</i> Docket No. EL03-180-000, Deposition of Paul I. Choi, Feb. 12, 2004, at 106-108	20
The Affidavit of Ann Hatcher	1

EXHIBIT 1

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Santa Clara, California)
)
)
)
v.)
)
Enron Power Marketing, Inc.)
)

Docket No. EL04-__-000

AFFIDAVIT
OF
ANN HATCHER
ON BEHALF OF
THE CITY OF SANTA CLARA, CALIFORNIA

its contracts despite good faith disputes are unjust and unreasonable practices; (3) EPMI's purported cancellation of the two long-term transactions with City is void due to EPMI's failure to provide notice to, and obtain approval from, the Commission; and (4) in the alternative, to the extent the Commission finds EPMI had a right to seek any Early Termination Payment from City under EPMI's jurisdictional contract as reasonably applied to the facts, City requests the Commission to order EPMI to calculate any Early Termination Payment based on EPMI's costs of service and/or revoke EPMI's market-based rate authority effective at least as of January 2000.

5. Debtor EPMI filed its Chapter 11 petition on December 2, 2001, and an adversary proceeding in bankruptcy court on July 22, 2002. EPMI erroneously claims that it is entitled to an Early Termination Payment of more than \$100 million under the Master Energy Purchase and Sale Agreement entered into with City on September 10, 1999, ("Master Agreement"). A copy of the Master Agreement is attached as Exhibit 2 to the Complaint. EPMI wrongly asserts that the Early Termination Payment is owed because EPMI terminated the Master Agreement based on three alleged Events of Default by the City: (i) City's failure to provide a cash "margin" after demand made by EPMI on November 27, 2001; (ii) City's suspension of deliveries to EPMI after EPMI's defaults, which defaults began November 29, 2001; and (iii) City's failure to pay a purportedly undisputed invoice for electricity purchases for November 2001.

6. Even if EPMI had properly terminated the Master Agreement (which it did not), the Early Termination Payment demanded is unjust and allegedly represents EPMI's potential future profit on electricity sales through 2009 that might have been realized had EPMI fully performed its obligations under the Master Agreement. The calculation of

future profits improperly assumes that EPMI could have performed, that the market price of electricity at the time of EPMI's purported termination would have remained constant through 2009, and that EPMI would have retained its authority to collect market-based rates.

7. The Master Agreement governs individual transactions for the purchase or sale of electricity that may thereafter be entered into by the parties. (Master Agreement § 1.1) EPMI's obligations were initially required by City to be guaranteed by its ultimate parent, Enron Corp., up to \$25 million. (Master Agreement § 4.7). The Master Agreement contemplated that the material terms of specific transactions would be agreed to in telephone conversations, which could be confirmed by EPMI in Confirmation Letters. All transactions between EPMI and the City were agreed to in telephonic, electronic and/or written communications between Houston, Texas and Santa Clara, California. The Master Agreement was drafted by EPMI and is governed by California law. (Master Agreement § 8.5).

8. City and EPMI entered into numerous transactions following the execution of the Master Agreement. These transactions generally were for a term of three months or less. At the time that EPMI and Enron Corp. filed for bankruptcy on December 2, 2001, there were approximately 60 open EPMI buy orders with City, with the latest delivery date being March 31, 2002. As of December 20, 2001, the date on which EPMI claims City technically defaulted, EPMI owed the City, with respect to actual sales of electricity, the net sum of \$1,091,670.50.

9. City and EPMI entered into a long-term transaction pursuant to the Master Agreement on or about August 29, 2000, under which EPMI agreed to sell City

electricity. The terms of this transaction are reflected in a document titled "Confirmation Letter Pursuant To The Master Energy Purchase and Sale Agreement and Amendment No. 1 Thereto By and Between The City of Santa Clara, California and Enron Power Marketing, Inc." entered into on August 29, 2000, and a three page attachment thereto (the "August 2000 Confirmation"). A copy of the August 2000 Confirmation is attached as Exhibit 3 to the Complaint.

10. This transaction was for the term January 1, 2001, through December 31, 2009. EPMI was to deliver electricity at fixed rates of \$43.95 and \$47.15 per megawatt hour ("MWh") to the City at two locations, Palo Verde, located in Arizona, and the California-Oregon Border.

11. Thereafter, City and EPMI entered into a second long-term transaction pursuant to the Master Agreement on or about April 17, 2001, under which EPMI agreed to sell City additional amounts of electricity. The terms of this transaction are reflected in a second document titled "Confirmation Letter Pursuant To The Master Energy Purchase and Sale Agreement and Amendment No. 1 Thereto By and Between the City of Santa Clara, California and Enron Power Marketing, Inc." entered into on April 17, 2001, and a two page attachment thereto (the "April 2001 Confirmation"). A copy of the April 2001 Confirmation is attached as Exhibit 4 to the Complaint.

12. This transaction was for the term from January 1, 2002, through December 31, 2006. EPMI was to deliver electricity to City at NP-15 in California, at a fixed rate of \$64.00 per MWh.

13. Paragraph 4 of the April 2001 Confirmation expressly required that EPMI provide City with a guaranty from Enron Corp. in the amount of \$350 million, which I

understand constitutes a condition precedent to City's obligation to perform. EPMI never caused Enron Corp. to execute and deliver to City the requisite guaranty. Nor did EPMI ever deliver a single MWh under the April 2001 Confirmation. Delivery was to begin on January 1, 2002, the day before the effective date of EPMI's purported termination of the Master Agreement.

14. The August 2000 Confirmation and the April 2001 Confirmation included terms that modified the Master Agreement to better address issues anticipated under long term transactions. The long-term confirmations specify that their terms control in the event of any inconsistency between the confirmations and the Master Agreement.

15. With these long-term transactions, City sought price stability and a reliable source of power to protect its customers from the extreme volatility of the dysfunctional spot markets. City's internal risk management guidelines prohibited it from entering long-term contracts with non-investment grade counterparties. However, EPMI, at the time, held its parent out as an investment grade corporation and offered both its parent's financial statements and its parent guaranty to City. In particular, EPMI delivered to City copies of Enron Corp.'s financial statement for 1999 before City would execute the first of the long-term confirmations with EPMI and EPMI agreed to increase the amount of its parent guaranty as part of each of the two long-term transactions. Thus, in entering into these long-term transactions, City relied on the alleged financial strength of EPMI's corporate parent, Enron Corp., and agreed to accept Enron Corp.'s guarantees of EPMI's obligations. City expected that it would receive reliable power and good faith performance of the contracts, throughout their five and nine year terms. As noted above, City never received the promised parent guarantee required as a condition of the April

2001 Confirmation. City never received any energy under the five-year April 2001 transactions, and received only one year of deliveries under the nine year August 2000 transaction.

16. Beginning in October 2001, reports surfaced of financial irregularities at Enron, including reports of a Securities Exchange Commission inquiry, and restatements of financial statements by Enron. (See Exhibit 16). By late November 2001, EPMI began defaulting in performing its obligations under the Agreements and confirmations. Apparently, seeking to avoid loss of the potential future profits created by market manipulations, it appears EPMI developed a scheme under which, by its own defaults, it would force City to act to protect its interests, which actions EPMI would allege entitled it to terminate the Master Agreement and capture, through the Early Termination Payment, the purported long-term profits that EPMI might otherwise be unable to earn by performance. First, EPMI attempted to manufacture a default on City's part by sending an improper and bad faith demand for a cash "margin" payment dated November 27, 2001. This improper "margin" call was made one day before Enron Corp.'s credit rating was lowered to below BBB-, two days before EPMI began to default on its obligations to City, and one week before EPMI's bankruptcy filing. Two versions of the November 27, 2001 demand for a "margin" payment are attached as Exhibit 14 to the Complaint. The first version, which City received by facsimile, has the fax number and name scratched out. The second version was attached to EPMI's bankruptcy complaint. EPMI's version shows that the letter began "Dear Mr. White," an individual not employed by City, and was to be sent to fax number (425) 783-8640, which is not City's fax number. In fact, based on my internet search, it is apparent that (425) 783-8640 is a fax number for

Snohomish Public Utility District, another EPMI counterparty. The margin demand contained numerous other defects: it was not sent to the correct person designated in the contract; it demanded “margin” a term not used in the contract; it demanded a \$79 million cash payment, and demanded that the payment be made within one day, neither the form nor timing of which is required by the contract; the amount demanded was improperly calculated and included amounts from a contract that was not effective due to EPMI’s failure to deliver its guaranty; and it referenced “Annex A, of the Agreement,” which does not exist.

17. EPMI had never before sought margin from City. There was no triggering event for this demand other than EPMI’s own extreme financial distress and its desire to default City. City’s credit rating had not declined. City had not failed to perform any of its obligations. EPMI’s exposure under the long-term transactions had actually declined during the weeks prior to its making the margin demand as the price of the electricity in question had increased. Indeed, City had not experienced any of the events customarily recognized in the Western electricity market as indicators of changed financial conditions and grounds for demanding performance assurance.

18. City responded to the margin demand the next day, explaining that it was unwarranted. City’s November 28, 2001 letter to Enron is attached as Exhibit 15 to the Complaint. EPMI did not respond to City’s letter and never pursued its demand for margin. Apparently recognizing the lack of merit to its demand for margin from City, EPMI did not identify the City’s refusal to provide margin as one of the enumerated grounds for termination of the Master Agreement alleged in its December 28, 2001 letter

claiming a right to terminate. EPMI's December 28, 2001 letter is attached as Exhibit 12 to the Complaint.

19. On November 29, 2001, EPMI notified City that it would not fully honor its contractual obligations to supply electricity under the Agreements. Commencing December 1, 2001, EPMI failed to deliver the energy it was required to deliver. Additional delivery failures by EPMI occurred on each of the next seven days of December 2001 and on 22 of the 31 days of December 2001. EPMI ceased to perform altogether on January 2, 2002. EPMI's decision to interrupt deliveries to City in December 2001 appears to have been part of its scheme to force a termination of the contracts. (See Exhibits 19-25) City remained ready, willing and able to perform its obligations under the agreements, as demonstrated by City's continued willingness to accept EPMI's assignment of the agreements to a creditworthy counterparty.

20. Following the lowering of Enron Corp.'s credit rating (and having been informed by EPMI of its intention to fail to honor its delivery obligations), City, by letter dated November 29, 2001, properly requested Performance Assurance from EPMI in accordance with Sections 4.1(e), 4.1(f) and 4.8 of the Master Agreement based upon a Material Adverse Change as defined in Appendix One to the Master Agreement. A copy of this letter is attached as Exhibit 17 to the Complaint. The Material Adverse Change was the downgrading of Enron Corp.'s credit rating below BBB-. Additional grounds for insecurity included Enron Corp.'s restatement of financial statements, impacting financial statements City relied on in entering into the long-term transactions, as well as EPMI's notification to City that EPMI would fail to deliver energy to City. EPMI failed to provide the requested Performance Assurance or to otherwise respond to City's letter.

EPMI's failure to provide such Performance Assurance constituted an Event of Default by it pursuant to Section 4.1(f) of the Master Agreement.

21. As of December 1, 2001, EPMI had ceased to fully perform under its agreements with City. EPMI was neither responding to requests for Performance Assurances, nor providing all of the energy scheduled by City.

22. Additional Events of Default by EPMI occurred on December 2, 2001, when EPMI and Enron Corp. each filed Chapter 11 petitions and when numerous of their financial obligations were accelerated.

23. On November 29, 2001, EPMI approached City regarding an assignment of the agreements by EPMI. City consented to an assignment of these agreements to PG&E Energy Trading. The assignment was on the verge of being consummated when Enron filed for bankruptcy protection on December 2, 2001. EPMI walked away from the assignment following Enron's bankruptcy filing. Subsequent discussions with EPMI regarding assignment were also unproductive. In April of 2002, EPMI again approached City about assignment. City worked with EPMI's representatives, Chuck Ward and Rick Hill in an attempt to arrange an assignment until EPMI, once again, abandoned the process in June of 2002. When they ended the second discussions regarding assignment, EPMI's representatives informed me that EPMI decided it had a chance to receive more money in litigation than it would through assignment, and if EPMI lost in litigation it would just restart deliveries under the agreements it purportedly terminated and earn profits through the energy deliveries.

24. Following EPMI's additional defaults and failure to provide the requisite performance assurances, City, by letter dated December 3, 2001, notified EPMI that

pursuant to section 4.1(b), 4.1(c), 4.1(d), 4.1(e), 4.1(f), and 4.1(g) of the Master Agreement, EPMI was in default and that, as a result, City would suspend deliveries of energy to EPMI until EPMI provided the performance assurances demanded. City reiterated that its letter did not constitute a termination of the Agreement and that, once it is provided adequate performance assurance, deliveries of energy again would be scheduled by City. The December 3, 2001 letter is attached as Exhibit 18 to the Complaint.

25. In view of EPMI's numerous defaults and failures to deliver electricity, and EPMI's refusal to provide the requisite performance assurance, City, in accordance with the terms of the Master Agreement, in good faith advised EPMI by letter dated December 11, 2001, that it disputed EPMI's claim that any payment was due to EPMI for November 2001. A copy of this letter is attached as Exhibit 8 to the Complaint. The letter advised that under the Master Agreement, §6.2, City had the right to setoff amounts then owed to City by EPMI for deliveries made by City prior to suspension against the \$1,010,439.50 sum claimed by EPMI for deliveries to City and that City had the right to withhold any balance of such sum as security for performance assurance for City's deliveries to EPMI during the first four days of December 2001, and as security for liquidated damages. City's deliveries from December 1, 2001 through December 4, 2001, resulted in EPMI owing City \$1,306,370, which exceeds the \$1,010,439.50 claimed by EPMI. In addition, by December 20, 2001, the date EPMI claimed City was in default, EPMI owed City \$1,091,670.50, net of the November amounts, based upon financially settled sales of electricity between the parties.

26. City's December 11, 2001 letter explained, in accordance with the Master Agreement, the grounds upon which City in good faith believed it was not obligated to make a payment to EPMI in connection with EPMI's November 2001 invoice, which grounds were based on both applicable law and the terms of the Master Agreement.

27. EPMI did not respond to City's letter and did not seek mediation of any dispute, as required by the Master Agreement. (Master Agreement § 8.6). Instead, and despite the fact that City posed no credit risk to EPMI, on December 21, 2001, the first day that it could arguably assert that City was in default under the Master Agreement for failing to pay monies relating to November 2001, EPMI sent a notice of default, without having addressed City's payment dispute. EPMI's December 21, 2001 Notice of Default is attached as Exhibit 10 to the Complaint. At the time EPMI sent the notice, EPMI owed City over \$1 million on a net basis.¹

28. On the same date, City, via letter sent by counsel for City, responded to EPMI's notice of default and reiterated that the amount owed was subject to a good faith dispute and that City was not in default. Rather, as indicated in City's December 21 letter, City, as it had notified EPMI on December 11, was holding payment as security for amounts owed City in good faith based upon the terms of the Master Agreement. The December 21, 2001 letter from City's counsel to EPMI is attached as Exhibit 11 to the Complaint.

29. Then, on December 28, 2001, EPMI sent a termination notice to City declaring that the Master Agreement would terminate on January 2, 2002, and claiming

¹ Such sum relates only to actual deliveries of electricity by City and transactions financially settled prior to December 20, 2001 and does not include liquidated damages owed by EPMI to City pursuant to the Master Agreement caused when City was required to resell electricity not delivered to EPMI. The liquidated damages total in excess of \$4 million.

the Early Termination Payment, which it now asserts is in excess of \$100 million. EPMI's December 28, 2001 notice of termination is attached as Exhibit 12 to the Complaint.

30. In sending the termination letter, EPMI ignored Master Agreement §§ 4.1(a) and 6.1, which specified that non-payment does not constitute an Event of Default where a good faith dispute exists. EPMI further ignored the compulsory mediation provision in § 8.6 of the Master Agreement. Moreover, by including the alleged anticipated profits from the long-term transactions in its Early Termination Payment calculation, EPMI ignored the fact that it never satisfied the condition precedent to City's obligations under the April 2001 confirmation. Lastly, EPMI ignored the fact that on December 21, 2001, EPMI owed City more than \$1 million on a net basis for completed deliveries by City to EPMI. City's dispute and resulting refusal to pay the November 2001 bill from EPMI was not an Event of Default because a good faith dispute existed as to who owed what and, in fact, no net amount was owed to EPMI on December 20, 2001.

31. City disputes the other factual allegations that purportedly support EPMI's claims. In particular, and among numerous other factual disputes, City denies that it was in default under the Master Agreement in any respect. EPMI's discretionary margin call was improper and made in bad faith. City immediately informed EPMI that it contested EPMI's improper margin call and EPMI never responded. City asserts that non-payment of the margin call demanded by EPMI was not an Event of Default under the Master Agreement. City further contends that its suspension of deliveries following EPMI's breaches was justified and not an Event of Default, since the Master Agreement permitted such suspension pending receipt of Performance Assurance, which City demanded, but

never received from EPMI, and, in any event, even an improper suspension of deliveries is not an Event of Default under §4.1(c) of the Master Agreement.

32. City asserts that EPMI's attempts to terminate the Master Agreement were unjust and unreasonable practices, as part of a scheme to improperly collect in excess of \$100 million of anticipated lost future profits from City, and its resident-ratepayers, on projected future power sales that EPMI was apparently incapable of making.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

City of Santa Clara, California)
)
 v.) Docket No. EL04-___-000
)
 Enron Power Marketing, Inc.)

AFFIDAVIT OF ANN HATCHER

COUNTY OF SANTA CLARA)
State of California) ss:

I, Ann M. Hatcher, being duly sworn, depose and state that the foregoing is my Affidavit in the above entitled proceeding, that I have read the same and am familiar with the contents thereof, and that the matters and facts set forth in the foregoing Affidavit, are true and correct to the best of my knowledge, information and belief.

Ann M Hatcher
Ann M. Hatcher

Subscribed and sworn before me this
___ day of July, 2004

Notary Public

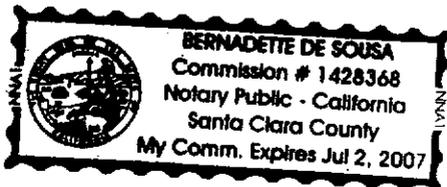
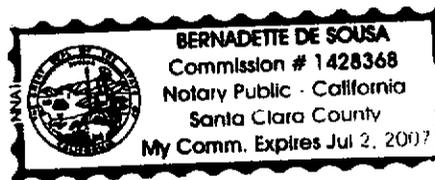


EXHIBIT 2

MASTER ENERGY PURCHASE AND SALE AGREEMENT

This Master Energy Purchase and Sale Agreement (this "Master Agreement" and together with all Transactions, collectively, the "Agreement") is entered into effective as of the 10th day of September, 1999 (the "Effective Date") by and between Enron Power Marketing, Inc., a Delaware corporation ("EPMI"), and City of Santa Clara, California dba Silicon Valley Power, a chartered California municipal corporation ("Counterparty"). Each of EPMI and Counterparty may also be referred to individually as "Party" or collectively as "Parties." The definitions set forth in Appendix "1" shall apply to this Agreement.

SECTION 1.

SCOPE OF AGREEMENT

1.1. Scope of Agreement. From time to time, the Parties may, but shall not be obligated to, enter into Transactions for the purchase or sale of Energy hereunder. Each Transaction shall be effectuated and evidenced in accordance with this Master Agreement and shall constitute a part of this Master Agreement. The Parties are relying upon the fact that all Transactions, together with this Master Agreement, shall constitute a single integrated agreement, and that the Parties would not otherwise enter into any Transaction. Any conflict between this Master Agreement and a Transaction shall be resolved in favor of the Transaction. This Master Agreement shall govern all Transactions between the Parties from and after the Effective Date unless expressly stated otherwise and shall govern all transactions between the Parties entered into prior to the date hereof that relate to the purchase and sale of Energy or options thereon.

1.2. Transaction Procedures. During the term of this Agreement, the Parties may notify each other that Energy is available for purchase or sale. Each Transaction shall be effectuated in a telephone conversation between the Parties whereby an offer and acceptance shall constitute the agreement of the Parties. The specific terms to be established by the Parties for each Transaction shall include the Buyer and Seller, the Delivery Term, the Contract Price, the Delivery Point, the Contract Quantity, whether the Transaction is Firm or Non-Firm and such other terms as the Parties shall agree. EPMI may confirm a telephonic Transaction by forwarding to Counterparty a Confirmation Letter, which shall be executed by Counterparty (with any objections noted thereon) and returned to EPMI within two (2) Business Days of Counterparty's receipt of it or else be deemed correct as sent. Failure by EPMI to send a Confirmation Letter shall not invalidate any Transaction agreed to by the Parties. The Parties agree not to contest or assert any defense to the validity or enforceability of telephonic Transactions entered into in accordance with this Master Agreement under laws relating to whether certain agreements are to be in writing or signed by the Party to be thereby bound, or the authority of any employee of the Party to enter into a Transaction. Each Party consents to the recording of its representatives' telephone conversations without any further notice. All recordings may be introduced into evidence and used to prove oral agreements between the Parties.

1.3. Term of Agreement. The term of this Master Agreement shall commence on the Effective Date and shall remain in effect until terminated by either Party upon 30 days prior written notice; provided, however, that this Master Agreement shall remain in effect with respect to any Transaction(s) entered into prior to the effective date of the termination until both Parties have fulfilled all their obligations with respect to such Transaction(s).

SECTION 2.

REPRESENTATIONS AND WARRANTIES

On the Effective Date and the date of entering into each Transaction, each Party represents and warrants to the other Party that: (i) it is duly organized, validly existing and in good standing under the laws of the jurisdiction of its formation and is qualified to conduct its business in each jurisdiction in which a Transaction will be performed by it, (ii) it has all regulatory authorizations necessary for it to legally perform its obligations under this Master Agreement and each Transaction, (iii) the execution, delivery and performance of this Master Agreement and each Transaction are within its powers, have been duly authorized by all necessary action and do not violate any of the terms and conditions in its governing documents, any contracts to which it is a party or any Law applicable to it, (iv) this Master Agreement and each Transaction when entered into in accordance with this Master Agreement constitutes its legally valid and binding obligation enforceable against it in accordance with its terms, subject to any Equitable Defenses, (v) there are no Bankruptcy Proceedings pending or being contemplated by it or,

to its knowledge, threatened against it, (vi) there are no Legal Proceedings that materially adversely affect its ability to perform its obligations under this Master Agreement and each Transaction, (vii) it has knowledge and experience in financial matters and the electric industry that enable it to evaluate the merits and risks of entering into this Master Agreement and each Transaction, and (viii) with respect to Options, it is a producer, processor, commercial user of, or merchant handling, the Commodity subject to the Transaction or the products or byproducts thereof, and is entering into each Option Transaction solely for purposes related to its business as such. Each Party covenants that it will cause these representations and warranties to be true and correct throughout the term of the Agreement.

SECTION 3. OBLIGATIONS AND DELIVERIES

3.1. **Seller's and Buyer's Obligations.** With respect to each Transaction and subject to the terms of this Master Agreement, Seller shall sell and deliver, or cause to be delivered, and Buyer shall purchase and receive, or cause to be received, at the Delivery Point the Contract Quantity, and Buyer shall pay Seller the Contract Price. Seller shall be responsible for any costs or charges imposed on or associated with the delivery of the Contract Quantity (excluding any Stranded Costs), including control area services, inadvertent energy flows, transmission losses and loss charges relating to the transmission of the Contract Quantity (excluding any Stranded Costs), up to the Delivery Point. Buyer shall be responsible for any costs or charges imposed on or associated with the Contract Quantity, including control area services, inadvertent energy flows, transmission losses and loss charges relating to the transmission of the Contract Quantity, at and from the Delivery Point.

3.2. **Transmission and Scheduling.** Seller shall arrange and be responsible for transmission service to the Delivery Point and shall Schedule or arrange for Scheduling services with its Transmission Providers to deliver the Energy to the Delivery Point. Buyer shall arrange and be responsible for transmission service at and from the Delivery Point and shall Schedule or arrange for Scheduling services with its Transmission Providers to receive the Energy at the Delivery Point. Each Party shall designate authorized representatives to effect the Scheduling of the Contract Quantity of Energy.

3.3. **Title, Risk of Loss and Indemnity.** As between the Parties, Seller shall be deemed to be in exclusive control (and responsible for any damages or injury caused thereby) of the Energy prior to the Delivery Point and Buyer shall be deemed to be in exclusive control (and responsible for any damages or injury caused thereby) of the Energy at and from the Delivery Point. Seller warrants that it will deliver to Buyer the Contract Quantity free and clear of all liens, claims and encumbrances arising prior to the Delivery Point. Title to and risk of loss related to the Contract Quantity shall transfer from Seller to Buyer at the Delivery Point. Seller and Buyer shall each indemnify, defend and hold harmless the other Party from any Claims arising from any act or incident occurring when title to the Energy is vested in the indemnifying Party.

3.4. **Force Majeure.** If either Party is rendered unable by Force Majeure to carry out, in whole or part, its obligations under a Transaction and such Party gives notice and full details of the event to the other Party as soon as practicable, then during the pendency of such Force Majeure but for no longer period, the obligations of the Party claiming excuse of its obligations by the event (other than the obligation to make payments then due or becoming due with respect to performance prior to the event) shall be suspended to the extent required; provided, however, Buyer shall be obligated to pay Demand Charges, if any, with respect to a Transaction notwithstanding the Force Majeure. The Party claiming the Force Majeure shall remedy the Force Majeure with all reasonable dispatch; provided, however, that this provision shall not require Seller to deliver, or Buyer to receive, Energy at points other than the Delivery Point. The Party claiming Force Majeure (the "Claiming Party") shall provide the non-claiming Party notice of the Claiming Party's best estimate of the duration of the Force Majeure (the "Estimated Duration"). During the Estimated Duration, the non-claiming Party shall not be required to resume its obligations to the Claiming Party with respect to the part of the Transaction which the Claiming Party has claimed is subject to Force Majeure. Notwithstanding the foregoing, as soon as all or part of the Force Majeure ceases, the Claiming Party shall notify the non-claiming Party who shall have the option to require the Claiming Party to resume all or part of its obligations under the Transaction prior to the expiration of the Estimated Duration; provided, however, in all events the Parties shall resume their obligations under the Transaction upon the expiration

of the Estimated Duration with respect to all or that part of the Transaction that is no longer subject to the Force Majeure. If all or part of the Force Majeure continues to exist beyond the Estimated Duration, then the non-claiming Party may take any action it deems commercially reasonable under the circumstances.

3.5. **Buyer's Cover Remedy for Seller's Failure to Deliver in Firm Transactions.** Unless excused by Force Majeure or Buyer's failure to perform, if Seller fails to schedule and/or deliver all or part of the Contract Quantity pursuant to a Firm Transaction, Seller shall pay Buyer an amount for each unit of Energy in such deficiency equal to the positive difference, if any, obtained by subtracting the Contract Price from the Replacement Price. "Replacement Price" means the price at which Buyer, acting in a commercially reasonable manner, purchases substitute units of Energy not delivered by Seller (plus costs reasonably incurred by Buyer in purchasing substitute units of Energy, including additional transmission charges, if any, incurred by Buyer) or, absent a purchase, the market price for such quantity at such Delivery Point as determined by Buyer in a commercially reasonable manner; provided, however, in no event shall the Replacement Price include any penalties, ratcheted demand or similar charges or any Stranded Costs. Amounts payable pursuant to this Section 3.5 shall be payable on or before 3 Business Days after receipt of an invoice from Buyer.

3.6. **Seller's Cover Remedy for Buyer's Failure to Receive in Firm Transactions.** Unless excused by Force Majeure or Seller's failure to perform, if Buyer fails to schedule and/or receive (i) the minimum requirement of the Contract Quantity, if any, as required to be received pursuant to a Firm Transaction or (ii) amounts of Energy that the Parties agreed to Schedule pursuant to a Firm Transaction, Buyer shall pay Seller an amount for each unit of Energy in such deficiency equal to the sum of (1) the positive difference, if any, obtained by subtracting the Sales Price from the Contract Price, and (2) additional costs reasonably incurred by Seller in reselling such Energy not received by Buyer, including additional transmission charges, if any. "Sales Price" means the price per unit of Energy at which Seller, acting in a commercially reasonable manner, resells or would be able to resell (if at all), the Energy not received by Buyer. Amounts payable pursuant to this Section 3.6 shall be payable on or before 3 Business Days after receipt of an invoice from Seller.

3.7. **Failure to Deliver/Receive in Non-Firm Transactions.** A Party may be excused from delivering or receiving the Contract Quantity, in whole or in part, in a Non-Firm Transaction for any reason without liability unless otherwise provided in a Confirmation Letter.

SECTION 4. DEFAULTS AND REMEDIES

- 4.1. **Events of Default.** An "Event of Default" shall mean with respect to a Party ("Defaulting Party"):
- (a) the failure by the Defaulting Party to make, when due, any payment required pursuant to this Agreement if such failure is not remedied within three (3) Business Days after written notice of such failure is given to the Defaulting Party by the other Party ("Non-Defaulting Party") and provided the payment is not the subject of a good faith dispute as described in Section 6; or
 - (b) any representation or warranty made by the Defaulting Party herein shall at any time prove to be false or misleading in any material respect; or
 - (c) the failure by the Defaulting Party to perform any covenant set forth in this Agreement (other than the events that are otherwise specifically covered in this Section 4.1 as a separate Event of Default or its obligations to deliver or receive Energy a remedy for which is provided in Section 3), and such failure is not excused by Force Majeure or cured within five Business Days after written notice thereof to the Defaulting Party; or
 - (d) the Defaulting Party shall be subject to a Bankruptcy Proceeding; or
 - (e) the occurrence of a Material Adverse Change with respect to the Defaulting Party; provided, such Material Adverse Change shall not be considered an Event of Default if the Defaulting Party establishes and maintains for so long as the Material Adverse Change is continuing, Performance Assurance to the Non-Defaulting Party in form and amount acceptable to the Non-Defaulting Party; or

- (f) the Defaulting Party fails to establish, maintain, extend or increase Performance Assurance when required pursuant to this Agreement; or
- (g) with respect to EPMI, at any time, Enron Corp. shall have defaulted on its indebtedness to third parties, resulting in obligations of Enron Corp. in excess of \$100,000,000, being accelerated or capable of becoming accelerated, or with respect to Counterparty, at any time, Counterparty shall have defaulted on its indebtedness to third parties, resulting in obligations of Counterparty in excess of \$25,000,000 being accelerated or capable of becoming accelerated; or
- (h) the Guarantor of the Defaulting Party fails to perform any covenant set forth in the guarantee agreement it delivered in respect of this Agreement, any representation or warranty made by such Guarantor in said guarantee agreement shall prove to have been false or misleading in any material respect when made or when deemed to be repeated, the guaranty agreement shall expire or be terminated or shall in any way cease to guaranty the obligations of the Defaulting Party under this Agreement or such Guarantor shall take or suffer any actions set forth in item (d) above as applied to it.

4.2. **Early Termination Date.** If an Event of Default occurs with respect to a Defaulting Party at any time during the term of this Agreement, the Non-Defaulting Party may, in its sole discretion, for so long as the Event of Default is continuing,

- (a) by no more than 20 days notice to the Defaulting Party, designate a day no earlier than the day such notice is effective as an early termination date ("Early Termination Date") on which all Transactions shall terminate (individually a "Terminated Transaction" and collectively the "Terminated Transactions"); and
- (b) withhold any payments due in respect of the Terminated Transactions.

4.3. **Early Termination Payment Calculation.**

- (a) If an Early Termination Date has been designated, the Non-Defaulting Party shall in good faith calculate its Gains, Losses and Costs resulting from the termination of the Terminated Transactions.

As used herein with respect to each Party:

- (i) "**Gains**" means, with respect to a Party, an amount equal to the present value of the economic benefit (exclusive of Costs), if any, to it resulting from the termination of its obligations with respect to a Terminated Transaction, determined in a commercially reasonable manner;
- (ii) "**Losses**" means, with respect to a Party, an amount equal to the present value of the economic loss (exclusive of Costs), if any, to it resulting from the termination of its obligations with respect to a Terminated Transaction, determined in a commercially reasonable manner; and
- (iii) "**Costs**" means, with respect to a Party, brokerage fees, commissions and other similar transaction costs and expenses reasonably incurred by such Party either in terminating any arrangement pursuant to which it has hedged its obligations or entering into new arrangements which replace a Terminated Transaction, and attorneys' fees, if any, incurred in connection with enforcing its rights under this Agreement.

In no event, however, shall a Party's Gains, Losses or Costs include any penalties, ratcheted demand or similar charges or any Stranded Costs.

- (b) The Gains, Losses and Costs shall be determined by comparing the value of the remaining term, Contract Quantities and Contract Prices under each Terminated Transaction had it not been terminated to the equivalent quantities and relevant market prices for the remaining term either quoted by a bona fide third-party offer or which are reasonably expected to be available in the market under a replacement contract for each Terminated Transaction.

- (c) To ascertain the market prices of a replacement contract, the Non-Defaulting Party may consider, among other valuations, any or all of the settlement prices of NYMEX Power futures contracts, quotations from leading dealers in energy swap contracts and other bona fide third party offers, all adjusted for the length of the remaining term and differences in transmission.
- (d) It is expressly agreed that a Party shall not be required to enter into replacement transactions in order to determine the Early Termination Payment.
- (e) The Non-Defaulting Party shall aggregate such Gains, Losses and Costs with respect to all Transactions into a single net amount ("Early Termination Payment") and notify the Defaulting Party.

4.4. Obligation to Pay Early Termination Payment.

- (a) If the Non-Defaulting Party's aggregate Losses and Costs exceed its aggregate Gains, the Defaulting Party shall, within three (3) Business Days of receipt of such notice, pay the net amount to the Non-Defaulting Party, which amount shall bear interest at the Interest Rate from the Early Termination Date until paid.
- (b) If the Non-Defaulting Party's aggregate Gains exceed its aggregate Losses and Costs, if any, resulting from the termination of the Terminated Transactions, the Non-Defaulting Party shall pay such excess to the Defaulting Party on or before the later of (1) ten (10) days after the end of the month ending on or after the Early Termination Date and (2) the date five (5) Business Days after receipt by the Defaulting Party of the Non-Defaulting Party's notice given above, which amount shall bear interest at the Interest Rate from the Early Termination Date until paid.
- (c) At the time for payment of any amount due under this Section 4.4, each Party shall pay to the other Party all additional amounts payable by it pursuant to this Agreement, but all such amounts shall be netted and aggregated with any Early Termination Payment payable hereunder.
- (d) In the event of an occurrence of an Early Termination Date, if the Defaulting Party would be owed amounts in respect of the obligations relating to such occurrence of an Early Termination Date, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to set-off against such amount any amounts payable by the Defaulting Party to the Non-Defaulting Party or any of its Affiliates under this Agreement or any other agreements, instruments or undertakings between the Defaulting Party and the Non-Defaulting Party or any of its Affiliates. This Section shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise).

4.5. Failure to Pay Any Amounts Due. Notwithstanding any other provision of this Agreement, if Buyer or Seller fails to pay to the other Party any amounts when due, the aggrieved Party shall have the right to

- (i) suspend performance under any or all Transactions, upon notice of this election to the nonpaying Party, until such amounts plus interest at the Interest Rate have been paid (but in no event for longer than five (5) Business Days following delivery of such notice relating to any continuing nonpayment under such Transaction(s)) and/or
- (ii) exercise any remedy available at law, including under this Agreement, or in equity to enforce payment of such amount plus interest at the Interest Rate;

provided, however, if the non-paying Party, in good faith, shall dispute the amount of any such billing or part thereof and shall pay such amounts as it concedes to be correct, no suspension shall be permitted.

4.6. Other Events. If Buyer is regulated by a federal, state or local regulatory body, and such body disallows all or any portion of any costs incurred or yet to be incurred by Buyer under any provision of this Agreement, such action shall not operate to excuse Buyer from performance of any obligation nor shall such action give rise to any right of Buyer to any refund or retroactive adjustment of the Contract Price provided in any Transaction. Notwithstanding the foregoing, if a Party's (the "Affected Party") activities hereunder become subject to regulation of any kind whatsoever under any law (other than with respect to Stranded Costs) to a greater or different extent than that existing on the Effective Date and such regulation renders this Agreement illegal or unenforceable, either

Party shall at such time have the right to declare an Early Termination Date in accordance with the provisions hereof; provided, notwithstanding the rights of the Parties to declare an Early Termination Date as above stated, the appropriate Party shall be liable for payment of the Termination Payment as provided in Section 4.2 calculated by the Non-Affected Party.

4.7 Security. In order to secure all payment obligations of EPMI to Counterparty hereunder, EPMI shall cause its Guarantor to execute and deliver to Counterparty the guarantee agreement in the amount of Twenty-Five Million U.S. Dollars (\$25,000,000), which guarantee agreement shall be substantially in the form attached hereto as Exhibit "C-1".

4.8 Collateral Requirement/Termination Payment Threshold. If at any time and from time to time during the term of this Agreement (and notwithstanding whether an Event of Default has occurred) the Early Termination Payment that would be owed to (i) EPMI in respect of all Transactions then outstanding should exceed \$15,000,000, EPMI, on any Business Day, may request Counterparty to provide Performance Assurance (in such form as selected by Counterparty) in an amount equal to the Early Termination Payment in excess of \$15,000,000 (rounding upwards for any fractional amount to the next \$250,000), or such other collateral as may be reasonably acceptable to EPMI and (ii) Counterparty in respect of all Transactions then outstanding should exceed \$20,000,000, Counterparty, on any Business Day, may request EPMI to provide Performance Assurance (in such form as selected by EPMI) in an amount equal to the Early Termination Payment in excess of \$20,000,000 (rounding upwards for any fractional amount to the next \$250,000), or such other collateral as may be reasonably acceptable to Counterparty. The Performance Assurance or other collateral shall be delivered within two Business Days of the date of such request. On any Business Day (but no more frequently than weekly with respect to Letters of Credit and daily with respect to cash), a Party, at its sole cost, may request such Performance Assurance be reduced correspondingly to the amount of such excess Termination Payment (rounding upwards for any fractional amount to the next \$250,000). For purposes of this Section 4.8, the calculation of "Early Termination Payment" shall include all amounts owed but not yet paid by one Party to the other Party whether or not such amounts are then due, for performance already provided pursuant to any and all Transactions.

4.9 Grant of Security Interest/Remedies. To secure its obligations under the Agreement and all Transactions, each Party hereby grants to the other Party a present and continuing first-priority security interest in, and lien on (and right of setoff against), and assignment of, all cash collateral and cash equivalent collateral and any and all proceeds resulting from such collateral or the liquidation thereof, whether now or hereafter held by, on behalf of, or for the benefit of, such other Party, and each Party agrees to take such action as the other Party reasonably requires in order to perfect the other Party's first-priority security interest in, and lien on (and right of setoff against), such collateral and any and all proceeds resulting from such collateral or the liquidation thereof. Upon or any time after the occurrence or deemed occurrence of an Event of Default or an Early Termination Date as a result of an Event of Default and the failure of a Party (the "Pledgor") to make all payments due and owing to the other Party (the "Secured Party") in accordance with the terms of the Agreement (including any related grace or notice period or both), the Secured Party may do any one or more of the following: (i) exercise any of the rights and remedies of a secured party with respect to all collateral, including any such rights and remedies under law then in effect; (ii) exercise its rights of setoff against any and all property of the Pledgor in the possession of the Secured Party or its agent for safekeeping; (iii) draw on any outstanding Letter of Credit issued for its benefit; and (iv) liquidate all collateral then held by or for the benefit of the Secured Party (free from any claim or right of any nature whatsoever of the Pledgor, including any equity or right of purchase or redemption by the Pledgor. The Secured Party shall apply the proceeds of the collateral realized upon the exercise of any such rights or remedies to reduce the Pledgor's obligations under the Agreement (the Pledgor remaining liable for any amounts owing to the Secured Party after such application), subject to the Secured Party's obligation to return any surplus proceeds remaining after such obligations are satisfied in full.

SECTION 5.
LIMITATIONS; DUTY TO MITIGATE

5.1. **Limitation of Remedies, Liability and Damages.** THE PARTIES CONFIRM THAT THE EXPRESS REMEDIES AND MEASURES OF DAMAGES PROVIDED IN THIS AGREEMENT SATISFY THE ESSENTIAL PURPOSES HEREOF. FOR BREACH OF ANY PROVISION FOR WHICH AN EXPRESS REMEDY OR MEASURE OF DAMAGES IS PROVIDED, SUCH EXPRESS REMEDY OR MEASURE OF DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY, THE OBLIGOR'S LIABILITY SHALL BE LIMITED AS SET FORTH IN SUCH PROVISION AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. IF NO REMEDY OR MEASURE OF DAMAGES IS EXPRESSLY HEREIN PROVIDED, THE OBLIGOR'S LIABILITY SHALL BE LIMITED TO DIRECT ACTUAL DAMAGES ONLY. SUCH DIRECT ACTUAL DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. UNLESS EXPRESSLY HEREIN PROVIDED, NEITHER PARTY SHALL BE LIABLE FOR CONSEQUENTIAL, INCIDENTAL, PUNITIVE, EXEMPLARY OR INDIRECT DAMAGES, LOST PROFITS OR OTHER BUSINESS INTERRUPTION DAMAGES, BY STATUTE, IN TORT OR CONTRACT, UNDER ANY INDEMNITY PROVISION OR OTHERWISE. IT IS THE INTENT OF THE PARTIES THAT THE LIMITATIONS HEREIN IMPOSED ON REMEDIES AND THE MEASURE OF DAMAGES BE WITHOUT REGARD TO THE CAUSE OR CAUSES RELATED THERETO, INCLUDING THE NEGLIGENCE OF ANY PARTY, WHETHER SUCH NEGLIGENCE BE SOLE, JOINT OR CONCURRENT, OR ACTIVE OR PASSIVE. TO THE EXTENT ANY DAMAGES REQUIRED TO BE PAID HEREUNDER ARE LIQUIDATED, THE PARTIES ACKNOWLEDGE THAT THE DAMAGES ARE DIFFICULT OR IMPOSSIBLE TO DETERMINE, OTHERWISE OBTAINING AN ADEQUATE REMEDY IS INCONVENIENT AND THE LIQUIDATED DAMAGES CONSTITUTE A REASONABLE APPROXIMATION OF THE HARM OR LOSS.

5.2. **Duty to Mitigate.** Each Party agrees that it has a duty to mitigate damages and covenants that it will use commercially reasonable efforts to minimize any damages it may incur as a result of the other Party's performance or non-performance of this Agreement.

5.3. **UCC.** Except as otherwise provided for herein, the provisions of the Uniform Commercial Code ("UCC") of the state whose laws shall govern this Agreement shall be deemed to apply to all Transactions and Energy shall be deemed to be a "good" for purposes of the UCC. EXCEPT AS EXPRESSLY SET FORTH HEREIN, SELLER EXPRESSLY NEGATES ANY OTHER REPRESENTATION OR WARRANTY, WRITTEN OR ORAL, EXPRESS OR IMPLIED, INCLUDING, WITHOUT LIMITATION, ANY REPRESENTATION OR WARRANTY WITH RESPECT TO CONFORMITY TO MODELS OR SAMPLES, MERCHANTABILITY, OR FITNESS FOR ANY PARTICULAR PURPOSE.

SECTION 6.
BILLING; PAYMENT

6.1. **Billing and Payment.** Seller shall render to Buyer (by regular mail, facsimile or other acceptable means pursuant to Section 8.3) for each calendar month during which purchases/sales are made, a statement setting forth the total quantity of Energy that was Scheduled or that Buyer was obligated to purchase and any other charges due Seller, including Demand Charges or payments or credits between the Parties pursuant to Section 3.5, under this Agreement during the preceding month and the amounts due to Seller from Buyer therefor (such statement to include the final result of all netting applicable hereunder). Billing and payment will be based on Scheduled hourly quantities. On or before the 20th day of the month, if a Business Day or the immediately following Business Day, Buyer shall render, by wire transfer, the amount set forth on such statement to the payment address provided in Exhibit "A". Overdue payments shall accrue interest from, and including, the due date to, but excluding, the date of payment at the Interest Rate. If Buyer, in good faith, disputes a statement, Buyer shall provide a written explanation of the basis for the dispute and pay the portion of such statement conceded to be correct no later than the due date. If any amount disputed by Buyer is determined to be due to Seller, it shall be paid within ten days of such determination, along with interest accrued at the Interest Rate until the date paid.

6.2. **Netting/Setoff.** If Buyer and Seller are each required to pay an amount in the same month, then such amounts with respect to each Party shall be aggregated and the Parties shall discharge their obligations to pay through netting, in which case the Party, if any, owing the greater aggregate amount shall pay to the other Party the difference between the amounts owed. Each Party reserves to itself all rights, setoffs, counterclaims and other remedies and defenses consistent with Section 5 (to the extent not expressly herein waived or denied) which such Party has or may be entitled to arising from or out of this Agreement. All outstanding Transactions and the obligations to make payment in connection therewith or under this Agreement or any other agreement between the Parties may be offset against each other, set off or recouped therefrom.

6.3. **Audit.** Each Party (and its representative(s)) has the right, at its sole expense and during normal working hours, to examine the records of the other Party to the extent reasonably necessary to verify the accuracy of any statement, charge or computation made pursuant to this Agreement. If requested, a Party shall provide to the other Party statements evidencing the quantities of Energy delivered at the Delivery Point. If any such examination reveals any inaccuracy in any statement, the necessary adjustments in such statement and the payments thereof will be promptly made and shall bear interest calculated at the Interest Rate from the date the overpayment or underpayment was made until paid; provided, however, that no adjustment for any statement or payment will be made unless objection to the accuracy thereof was made prior to the lapse of two years from the rendition thereof; and provided further that this agreement will survive any termination of the Agreement for a period of two years from the date of such termination for the purpose of such statement and payment objections.

SECTION 7. TAXES

7.1. **Taxes** The Contract Price shall include full reimbursement for, and Seller is liable for and shall pay, or cause to be paid, or reimburse Buyer if Buyer has paid, all Taxes applicable to a Transaction arising prior to the Delivery Point. If Buyer is required to remit such Tax, the amount shall be deducted from any sums due to Seller. Seller shall indemnify, defend and hold harmless Buyer from any Claims for such Taxes. The Contract Price does not include reimbursement for, and Buyer is liable for and shall pay, cause to be paid, or reimburse Seller if Seller has paid, all Taxes applicable to a Transaction arising at and from the Delivery Point, including any Taxes imposed or collected by a taxing authority with jurisdiction over Buyer. Buyer shall indemnify, defend and hold harmless Seller from any Claims for such Taxes. Either Party, upon written request of the other, shall provide a certificate of exemption or other reasonably satisfactory evidence of exemption if either Party is exempt from taxes, and shall use reasonable efforts to obtain and cooperate with obtaining any exemption from or reduction of any Tax. Each Party shall use reasonable efforts to administer this Agreement and implement the provisions in accordance with the intent to minimize Taxes.

SECTION 8. MISCELLANEOUS

8.1. **Assignment.** Neither Party shall assign this Agreement or its rights hereunder without the prior written consent of the other Party, which consent may be withheld in its sole discretion; provided, however, either Party may, without the consent of (but with notice to) the other Party (and without relieving itself from liability hereunder), (i) transfer, sell, pledge, encumber or assign this Agreement or the accounts, revenues or proceeds hereof in connection with any financing or other financial arrangements, (ii) transfer or assign this Agreement to an Affiliate of such Party, or (iii) transfer or assign this Agreement to any person or entity succeeding to all or substantially all of the assets of such Party; provided, however, that in each such case, any such assignee shall agree in writing to be bound by the terms and conditions hereof.

8.2. **Financial Information.** If requested by Counterparty, EPMI shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report of Enron Corp. containing audited consolidated financial statements for such fiscal year certified by independent certified public accountants and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of the quarterly report of Enron Corp. containing unaudited consolidated financial statements for such fiscal quarter. If requested by EPMI, Counterparty or its Guarantor shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report of the City of Santa Clara, California dba Silicon Valley Power containing audited consolidated financial

statements for such fiscal year certified by independent certified public accountants and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of the quarterly report of the City of Santa Clara, California dba Silicon Valley Power containing unaudited consolidated financial statements for such fiscal quarter. In all cases the statements shall be for the most recent accounting period and prepared in accordance with GAAP or such other principles then in effect; provided, should any such statements not be available timely due to a delay in preparation or certification, such delay shall not be considered a default so long as such Party diligently pursues the preparation, certification and delivery of the statements.

8.3. **Notices.** All notices, requests, statements or payments shall be made as specified in Exhibit "A". Notices required to be in writing shall be delivered by letter, facsimile or other documentary form. Notice by facsimile or hand delivery shall be deemed to have been received by the close of the Business Day on which it was transmitted or hand delivered (unless transmitted or hand delivered after close in which case it shall be deemed received at the close of the next Business Day). Notice by overnight mail or courier shall be deemed to have been received two Business Days after it was sent. A Party may change its addresses by providing notice of same in accordance herewith.

8.4. **Confidentiality.** Neither Party shall disclose the terms or conditions of this Agreement to a third party (other than the Party's and its Affiliates' employees, lenders, counsel, accountants or advisors who have a need to know such information and have agreed to keep such terms confidential) except in order to comply with any applicable Law or exchange rule; provided, each Party shall notify the other Party of any proceeding of which it is aware which may result in disclosure and use reasonable efforts to prevent or limit the disclosure. The Parties shall be entitled to all remedies available at law or in equity to enforce, or seek relief in connection with, this confidentiality obligation.

8.5. **Governing Law.** THIS AGREEMENT AND THE RIGHTS AND DUTIES OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY AND CONSTRUED, ENFORCED AND PERFORMED IN ACCORDANCE WITH THE LAWS OF THE STATE OF CALIFORNIA, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW.

8.6. **Alternative Dispute Resolution.** Any controversies between the Parties regarding the construction or application of this Agreement, and claims arising out of this Agreement or any Transaction subject to this Agreement, or breach thereof, shall be submitted to mediation within thirty (30) days of the written request of one Party after the service of that request on the other Party. The Parties may agree on one (1) mediator. If they cannot agree on one (1) mediator, the Party demanding the mediation shall request that the Superior Court of the county in which the party is situated appoint a mediator. The mediation meeting shall not exceed one day (eight (8) hours). The Parties may agree to extend the time allowed for mediation under this Agreement. Each Party shall bear their own attorney's fees. The costs of mediation shall be borne by the Parties equally. Mediation under this paragraph is a condition precedent to filing an action in any court.

8.7. **Winding Up Arrangements.** All indemnity and audit rights shall survive the termination of this Agreement. All obligations provided in this Agreement shall remain in effect for the purpose of complying herewith.

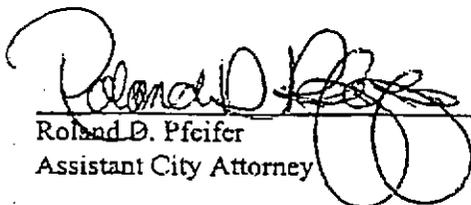
8.8. **General.** This Master Agreement, the Exhibits and Appendices hereto, if any, and each Transaction, constitute the entire agreement between the Parties relating to the subject matter contemplated by this Agreement. No amendment or modification to this Master Agreement shall be enforceable unless reduced to writing and executed by both Parties. This Master Agreement shall not impart any rights enforceable by any third-party other than a permitted successor or assignee bound to this Agreement. No waiver by a Party of any default by the other Party shall be construed as a waiver of any other default. Nothing in this Master Agreement shall be construed to create a partnership or joint venture between the Parties. Any provision declared or rendered unlawful by any applicable court of law or regulatory agency or deemed unlawful because of a statutory or regulatory change (individually or collectively, such events referred to as a "Regulatory Event") will not otherwise affect the remaining lawful obligations that arise under this Agreement; further, if a Regulatory Event occurs, the Parties shall use their best efforts to reform the Agreement in order to give effect to the original intention of the Parties.

Notwithstanding the foregoing, or anything else in the Agreement to the contrary, in the event that, as a result of a Regulatory Event, a Party (the "Excused Party") is excused from any payment or performance obligation, the other Party shall be correspondingly excused from any payment or performance obligation that would have arisen but for the failure or inability of the Excused Party to perform. The term "including" when used in this Agreement shall be by way of example only and shall not be considered in any way to be in limitation. The headings used herein are for convenience and reference purposes only.

The Parties have executed this Master Agreement in multiple counterparts to be construed as one effective as of the Effective Date.

CITY OF SANTA CLARA, CALIFORNIA

APPROVED AS TO FORM:

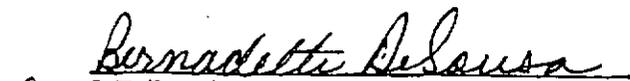


Roland D. Pfeifer
Assistant City Attorney

By: 

Jennifer Sgaracino
City Manager

ATTEST:



for J. E. Boccignone
City Clerk

Address:
1500 Warburton Avenue
Santa Clara, CA 95050
Telephone: (408) 261-5292
Fax: (408) 241-8291

ENRON POWER MARKETING, INC.

By: 

Name: Tim Belden
Title: Vice President
Date: September 10, 1999

APPENDIX "1" - DEFINITIONS
to the
MASTER ENERGY PURCHASE AND SALE AGREEMENT

All references to Articles and Sections are to those set forth in this Agreement. Reference to any document means such document as amended from time to time and reference to any Party includes any permitted successor or assignee thereof. The following definitions and any terms defined internally in this Agreement shall apply to this Agreement and all notices and communications made pursuant to this Agreement.

"Affiliate" means, with respect to any person, any other person (other than an individual) that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such person. For this purpose, "control" means the direct or indirect ownership of fifty percent (50%) or more of the outstanding capital stock or other equity interests having ordinary voting power.

"Bankruptcy Proceeding" means with respect to a Party or entity, [any instance in which] such Party or entity (i) makes an assignment or any general arrangement for the benefit of creditors, (ii) files a petition or otherwise commences, authorizes or acquiesces in the commencement of a proceeding or cause of action under any bankruptcy or similar law for the protection of creditors, or has such petition filed against it and such petition is not withdrawn or dismissed for 30 days after such filing, (iii) otherwise becomes bankrupt or insolvent (however evidenced) or (iv) is unable to pay its debts as they fall due.

"Business Day" means a day on which Federal Reserve member banks in New York City are open for business; and a Business Day shall open at 8:00 a.m. and close at 5:00 p.m. local time for each Party's principal place of business.

"Buyer" means the Party to a Transaction who is obligated to purchase and receive, or cause to be received, Energy during a Delivery Term.

"Call Option" means an option entitling, but not obligating, the option Buyer to purchase and receive Energy from the option Seller at a price equal to the Strike Price for the Delivery Term(s) for which the option may be exercised, all as agreed to by the Parties in a Transaction.

"Claims" means all claims or actions, threatened or filed and whether groundless, false or fraudulent, that directly or indirectly relate to the subject matter of an indemnity, and the resulting losses, damages, expenses, attorneys' fees and court costs, whether incurred by settlement or otherwise, and whether such claims or actions are threatened or filed prior to or after the termination of this Agreement.

"Confirmation Letter" means a written notice confirming the specific terms of a Transaction which shall be in the form attached hereto as "Exhibit B".

"Contract Price" means the price in \$U.S. (unless otherwise provided for) to be paid by Buyer to Seller for the purchase of Energy, including the Energy Price, Demand Charges, Transmission Charges and any other charges, if any, pursuant to a Transaction.

"Contract Quantity" means that quantity of Energy that Seller agrees to sell and deliver, or cause to be delivered, to Buyer, and that Buyer agrees to purchase and receive, or cause to be received, from Seller, pursuant to the terms of a Transaction.

"Costs" shall have the meaning defined in Section 4.3(a)(iii)

"Delivery Point" means the agreed point of delivery and receipt of Energy pursuant to a Transaction.

"Delivery Term" means the period of time from the date physical delivery of the Energy is to commence to the date physical delivery is to terminate under a Transaction.

"Demand Charges" mean the amount, if any, to be paid by Buyer to Seller for capacity as agreed to by the Parties in a Transaction.

"Early Termination Payment" shall have the meaning defined in Section 4.3(b)

"Energy" means Merchantable Energy expressed in megawatt hours (MWh) or to the extent specifically agreed to by the Parties, capacity or other related products and services and specifically includes the Commodity.

"Energy Price" means the price in \$U.S. (unless otherwise provided for) per MWh to be paid by Buyer to Seller for Energy in a Transaction.

"Equitable Defenses" means any bankruptcy, insolvency, reorganization and other laws affecting creditor's rights generally, and with regard to equitable remedies, the discretion of the court before which proceedings to obtain same may be pending.

"Event of Default" shall have the meaning defined in Section 4.1.

"Firm" means, with respect to a Transaction, that the only excuses for the failure to deliver Energy by Seller or the failure to receive Energy by the Buyer pursuant to a Transaction are Force Majeure or the other Party's non-performance.

"Force Majeure" means (with respect to Firm Transactions) an event not anticipated as of the Effective Date, which is not within the reasonable control of the Party claiming suspension (the "Claiming Party"), and which by the exercise of due diligence the Claiming Party is unable to overcome or obtain or cause to be obtained a commercially reasonable substitute therefor; provided that (i) neither the loss of Buyer's markets, (ii) nor Buyer's inability economically to use or resell Energy purchased hereunder, nor (iii) Seller's ability to sell Energy to a market at a more advantageous price, shall constitute an event of Force Majeure.

"GAAP" means generally accepted accounting principles, consistently applied.

"Gains" shall have the meaning defined in Section 4.3(a)(i)

"Guarantor" means, as to EPMI, Enron Corp.

"Interest Rate" means, for any date, two percent over the per annum rate of interest equal to the prime lending rate as may from time to time be published in The Wall Street Journal under "Money Rates"; provided, the Interest Rate shall never exceed the maximum lawful rate permitted by applicable law.

"Law" means any law, rule, statute, regulation, order, writ, judgment, decree or other legal or regulatory determination by a court, regulatory agency or governmental authority of competent jurisdiction.

"Legal Proceedings" means any suits, proceedings, judgments, rulings or orders by or before any court or any governmental authority.

"Letter of Credit" means one or more irrevocable, transferable standby letters of credit from a major U.S. commercial bank or a foreign bank with a U.S. branch office, with such bank having a credit rating of at least "A-" from S&P.

"Losses" shall have the meaning defined in Section 4.3(a)(ii)

"Material Adverse Change" means (i) with respect to Counterparty, Counterparty's underlying rating (SPUR) tied to Subordinated Electric Revenue Refunding Bonds Series 1998A dated 03/01/1998 due 07/01/2027 is rated by S&P below "BBB-" or (b) is not rated by S&P or (ii) with respect to EPMI, Enron Corp. shall have long-term, senior, unsecured debt not supported by third party credit enhancement that is (a) rated by S&P below "BBB-" or (b) is not rated by S&P.

"Merchantable Energy" means electric energy of the character commonly known as three-phase, sixty-hertz electric energy that is delivered at the nominal voltage of the Delivery Point.

"Non-Firm" means, with respect to a Transaction, that delivery or receipt of Energy may be interrupted for any reason, without liability by either Party, including, without limitation, price fluctuations.

"Option" means a Call Option, Put Option or other option transaction.

"Performance Assurance" means collateral in the form of either cash or Letters of Credit.

"Put Option" means an option entitling, but not obligating, the option Buyer to sell and deliver Energy to the option Seller at a price equal to the Strike Price for the Delivery Term(s) for which the option may be exercised, all as agreed to by the Parties in a Transaction.

"Regulatory Approvals" means all permissions required under current and future valid and applicable Laws.

"Replacement Price" shall have the meaning defined in Section 3.5.

"Sales Price" shall have the meaning defined in Section 3.6.

"Scheduling" or **"Schedule"** means the acts of Seller, Buyer and/or their designated representatives, including each Party's Transmission Providers, if applicable, of notifying, requesting and confirming to each other the quantity and type of Energy to be delivered hourly on any given day or days during the Delivery Term at a specified Delivery Point.

"Seller" means the Party to a Transaction who is obligated to sell and deliver or cause to be delivered Energy during a Delivery Term.

"Stranded Costs" means any charges or costs that are assessed or levied by any entity, including local, state or federal regulatory or taxing authorities or any Transmission Providers, in order to recoup the expenses and liabilities associated with stranded investments and that would affect an ongoing Transaction, either directly or indirectly; provided, however, such charges or costs must be uniformly applied in a non-discriminatory manner and applicable to all similarly situated parties.

"Strike Price" means the price in S.U.S. (unless otherwise provided for) to be paid by the appropriate Party for the purchase of Energy pursuant to a Call Option or Put Option, as the case may be.

"Taxes" means any or all ad valorem, property, occupation, severance, generation, first use, conservation, Btu or energy, transmission, utility, gross receipts, privilege, sales, use, consumption, excise, lease, transaction, and other taxes or, governmental charges, licenses, fees, permits and assessments, or increases therein, other than taxes based on net income or net worth.

"Transaction" means a particular transaction agreed to by the Parties relating to the purchase and sale of Energy pursuant to this Master Agreement.

"Transmission Charges" means the amount, if any, to be paid by Buyer to Seller for transmission services as agreed to by the Parties in a Transaction.

"Transmission Providers" means the entity or entities transmitting Energy on behalf of Seller or Buyer (but not including Buyer or Seller) to or from the Delivery Point in a particular Transaction.

EXHIBIT "A"
to the
MASTER ENERGY PURCHASE AND SALE AGREEMENT
NOTICES AND PAYMENT

EPMI:

NOTICES & CORRESPONDENCE:

Enron Power Marketing, Inc.
P. O. Box 4428
Houston, Texas 77210-4428
Attn.: Power Contract Documentation Manager
FAX No.: (713) 646-2443

With a copy of any notices
pursuant to Section 4 also to:

Enron Power Marketing, Inc.
1400 Smith
Houston, Texas 77002-7361
Attn.: Assistant General Counsel, Trading Group
FAX No.: (713) 646-4818

INVOICES:

Enron Power Marketing, Inc.
1400 Smith Street
P. O. Box 4428
Houston, Texas 77210-4428
Attn.: Power Contract Settlements Manager
FAX No.: (713) 646-4061

Counterparty:

NOTICES & CORRESPONDENCE:

The City of Santa Clara – Silicon Valley Power
1500 Warburton Avenue
Santa Clara, California 95050
Attn.: Risk Manager
FAX No.: (408) 247-3730
Phone No.: (408) 615-5679

INVOICES:

The City of Santa Clara – Silicon Valley Power
1500 Warburton Avenue
Santa Clara, California 95050
Attn.: Back Office
FAX No.: (408) 247-3730
Phone No.: (408) 615-5680

PAYMENTS:

NationsBank of Texas-Dallas
for: Enron Power Marketing, Inc.
ABA Routing # 111000012
Account #375 046 9312
Confirmation: Enron Power Marketing, Inc.
Credit and Collections
(713) 853-5667

PAYMENTS:

Bank of America, NT & SA, San Francisco
Government Services – San Francisco #1427
Credit: Silicon Valley Power
ABA No.: 026009593
Account No.: 14363-80211
Confirmation: Credit Manager
Phone No.: (408) 615-5664

or to such other address as Counterparty or EPMI shall from time to time designate by letter properly addressed.

EXHIBIT 3

**CONFIRMATION LETTER PURSUANT TO
THE MASTER ENERGY PURCHASE AND
SALE AGREEMENT AND AMENDMENT NO. 1 THERETO
BY AND BETWEEN THE
CITY OF SANTA CLARA, CALIFORNIA
AND
ENRON POWER MARKETING, INC.**

This Confirmation Letter ("Confirmation") is made and entered into on this 29th day of August 2000, ("Effective Date") by and between the City of Santa Clara, California, a chartered California municipal corporation, doing business as Silicon Valley Power ("SVP") and Enron Power Marketing, Inc., a Delaware corporation ("Enron"). Enron and SVP may be referred to herein individually as a "Party" or collectively as the "Parties" or the "Parties to this Confirmation Letter".

RECITALS

- A. The Parties previously entered into an agreement entitled "Master Energy Purchase and Sale Agreement" dated September 10, 1999 (the "Original Agreement");
- B. The Original Agreement was previously amended by Amendment No. 1, dated June 8, 2000 and that Amendment is incorporated herein by this reference as though set forth in full. The Original Agreement and Amendment No. 1 are collectively referred to as the "Master Agreement");
- C. The Parties entered into the Master Agreement for the purpose enabling the Parties to purchase or sell Energy (as that term is defined in the Master Agreement) to each other on a short-term basis;
- D. SVP is permitted by City Council resolution to enter into the purchase and sale of Energy for short periods of time, not exceeding one year. SVP must obtain City Council approval for the purchase of Energy for a duration of several years; and
- E. Parties now wish to enter into an agreement for the long-term purchase of Energy from Enron by SVP, which agreement must be approved by the City Council.

In consideration of the above Recitals and the following mutual covenants and obligations, the Parties agree as follows:

AGREEMENT PROVISIONS

- 1. The terms which appear in initial capital letters in this Confirmation Letter, shall have the meaning set forth in the Master Agreement.
- 2. Paragraph number 1.2 "Transaction Procedures" shall be amended, for purposes of this Confirmation Letter only, to read as follows:

The Transaction that is the subject of Confirmation Letter is not the result of a telephonic transaction, but rather is the result of a response by Enron to a Request for Proposal issued by SVP. All terms and conditions of this Transaction are contained herein, and will not be the subject of a later Confirmation Letter.

3. Paragraph number 1.3 of the Master Agreement, "Term of Agreement", shall be amended for purposes of this Confirmation Letter only to read as follows:

The term of this Confirmation Letter shall commence at midnight on January 1, 2001 and shall terminate at close of business on December 31, 2009. This Confirmation Letter shall remain in full force and effect regardless of whether the Master Agreement is canceled. If the Master Agreement is canceled, then the Parties agree that the terms and conditions of the Master Agreement are incorporated herein by this reference to the extent that they do not conflict with the terms of this Confirmation Letter.

4. Paragraph number 4.7 of the Master Agreement "Security" is amended for purposes of this Confirmation Letter only, to read as follows:

In order to secure all delivery obligations of Enron to SVP hereunder, Enron shall cause its Guarantor to execute and deliver to SVP the guarantee agreement in the amount of Two Hundred Million Dollars and No Cents (\$200,000,000.00), which guarantee agreement shall be substantially in the form attached to the Master Agreement as Exhibit "C-1".

5. "WSPP Schedule C Firm Energy" means firm power that is or will be scheduled as firm power consistent with the most recent rules adopted by the WSCC for which the only excuses for failure to deliver or receive are if an interruption is (I) due to an event of force majeure as such term is defined under the Master Agreement between the Seller and the Buyer that governs the Transaction that is the subject of this Confirmation Letter; or (ii) where applicable, to meet Seller's public utility or statutory obligations to its customers. Notwithstanding any other provision in this Confirmation Letter, if Seller exercises its right to interrupt to meet its public utility or statutory obligations, Seller shall be responsible for payment of damages for failure to deliver firm power as provided in the applicable remedy section(s) of the Master Agreement.
6. SVP shall provide Enron with a copy of the Resolution by the City Council of the City of Santa Clara delegating authority to the City Manager to execute Power Purchase contracts for the purchase of up to seventy-five megawatts (75MW) of Energy.
7. For purposes of this Confirmation Letter only, Enron is the Seller and SVP is the Buyer. The Contract Price, Delivery Term, Delivery Point, Contract Quantity and whether the Transaction is Firm or Non-Firm, is set forth in Attachment "A", attached hereto and those terms are incorporated herein by this reference. No other terms or conditions set forth in Attachment "A" are made a part of this Confirmation Letter unless specifically agreed to in writing by SVP.

8. SVP and Enron bind themselves, their successors, assigns, executors and administrators to all covenants of this Confirmation Letter. Except as otherwise set forth in this Confirmation Letter, no interest in this Confirmation Letter shall be assigned or transferred, either voluntarily or by operation of law, without the prior written approval of the other Party. However, claims for money due to or to become due to Enron from SVP under this Confirmation Letter may be assigned to a bank, trust company or other financial institutions, or to a trustee in bankruptcy, provided that written notice of any such assignment or transfer shall be first furnished to SVP. Any such assignment shall not relieve Enron from any of its obligations or liability under the terms of this Confirmation Letter.
9. All other terms of the Master Agreement and Amendment No. 1, which are not in conflict with the provisions of this Confirmation Letter shall remain unchanged in full force and effect. In case of a conflict in the terms of the Master Agreement and this Confirmation Letter, the provisions of this Confirmation Letter shall control.
10. Subject to all of the conditions hereof being met, the pricing in Attachment A is valid until 9:00 a.m. P.D.T., August 30, 2000, after which Enron reserves the right, in its sole discretion, to change it. SVP may meet the foregoing requirement by the following: (1) obtaining approval on August 29, 2000 from the City Council of the City of Santa Clara of the Resolution delegating authority to the City Manager to execute Power Purchase contracts up to 75 MW of Energy and (2) informing Enron by telephone that the Resolution was adopted. Enron shall make its best effort to place in the Overnight Mail on August 29, two (2) originally signed copies of this Confirmation Letter to SVP, attention Roland D. Pfeifer, Assistant City Attorney, 1500 Warburton Avenue, Santa Clara, California 95050. As soon as SVP is in receipt of the originally signed copies of this Confirmation Letter, it will cause the City Manager to execute the same and shall provide one original to Enron. Enron acknowledges that the City Manager may not be able to execute this Confirmation Letter by 9:00 a.m. August 30 in the event that the original Confirmation Letter has not been yet received by SVP. Enron's pricing in the attached Attachment A shall not be changed if the sole delay is due to the foregoing.

///

///

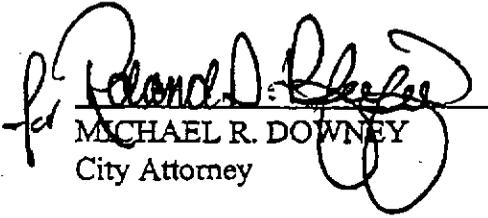
///

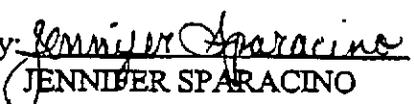
///

The Parties acknowledge and accept the terms and conditions of this Confirmation Letter as evidenced by the following signatures of their duly authorized representatives. It is the intent of the Parties that this Confirmation Letter shall become operative on the Effective Date first set forth above.

**CITY OF SANTA CLARA, CALIFORNIA,
a Chartered California Municipal Corporation**

APPROVED AS TO FORM:


MICHAEL R. DOWNEY
City Attorney

By: 
JENNIFER SPARACINO
City Manager

ATTEST:


J.E. BOCCIGNONE
City Clerk

1500 Warburton Avenue
Santa Clara, CA 95050
Telephone: (408) 615-2210
Facsimile: (408) 241-6771

"SVP"

**ENRON POWER MARKETING, INC.
a Delaware corporation**

By:  C6X
Name: Greg Wolfe
Title: Vice President
Address: Enron North America Corp.
Three World Trade Center
121 S.W. Salmon, 3WTC0306
Portland, Oregon 97204
Telephone: (503) 464-3800
Facsimile: (503) 464-3740

"Enron"

\\DATA\WP\AGREEMNT.A-MENRONCON.LTR

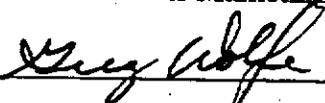
CONFIRMATION LETTER PURSUANT TO
TO THE MASTER ENERGY PURCHASE AND
SALE AGREEMENT AND AMENDMENT NO. 1 THERETO
BY AND BETWEEN THE
CITY OF SANTA CLARA, CALIFORNIA
AND
ENRON POWER MARKETING, INC.

ATTACHMENT "A" - Page 1 of 3

FIRST 25MW BLOCK:

OFFER: Price per MWh: \$47.15
Delivery Location: COB
Term: January 1, 2001 through December 31, 2009
Baseload delivery 7x24
Firm Power WSPP Schedule C Firm Energy as defined in this Confirmation Letter
Other Terms: The rates for service specified herein shall remain in effect for the term of this Confirmation Letter, and shall not be subject to change through application to the Federal Energy Regulatory Commission pursuant to the provisions of Section 205 or 206 of the Federal Power Act absent the agreement of all Parties to this Confirmation Letter.

Offer made by: Enron Power Marketing, Inc.



(signature)

Print Name: Greg Wolfe
Title: Vice President

CBK

ACCEPTANCE BY SVP:

By: 

JENNIFER SPARACINO
City Manager
1500 Warburton Avenue
Santa Clara, CA 95050
Telephone: (408) 615-2184
Facsimile: (408) 261-2717

EXHIBIT 4

**CONFIRMATION LETTER PURSUANT TO
THE MASTER ENERGY PURCHASE AND
SALE AGREEMENT AND AMENDMENT NO. 1 THERETO
BY AND BETWEEN THE
CITY OF SANTA CLARA, CALIFORNIA
AND
ENRON POWER MARKETING, INC.**

This Confirmation Letter ("Confirmation") is made and entered into on the 17th day of April, 2001, ("Effective Date") by and between the City of Santa Clara, California, a chartered California municipal corporation, doing business as Silicon Valley Power ("SVP") and Enron Power Marketing, Inc., a Delaware corporation ("Enron"). Enron and SVP may be referred to herein individually as a "Party" or collectively as the "Parties" or the "Parties to this Confirmation Letter".

RECITALS

- A. The Parties previously entered into an agreement entitled "Master Energy Purchase and Sale Agreement" dated September 10, 1999 (the "Original Agreement");
- B. The Original Agreement was previously amended by Amendment No. 1, dated June 8, 2000 and that Amendment is incorporated herein by this reference as though set forth in full. The Original Agreement and Amendment No. 1 are collectively referred to as the "Master Agreement";
- C. The Parties entered into the Master Agreement for the purpose of enabling the Parties to purchase or sell Energy (as that term is defined in the Master Agreement) to each other on a short-term basis;
- D. SVP is permitted by City Council resolution to enter into the purchase and sale of Energy for short periods of time, not exceeding one year. SVP must obtain City Council approval for the purchase of Energy for a duration of several years;
- E. By an action taken at its regular meeting on April 10, 2001, the City Council approved Resolution No. 6794 which delegated the authority to the City Manager to solicit, negotiate and execute, on behalf of the City, any and all electric power purchase contracts with electric power suppliers of fixed-price power up to a total of 100 MW for delivery between July 1, 2001, and December 31, 2006, or a shorter period, depending on market conditions and contract provisions; and
- F. Parties now wish to enter into an agreement for the long-term purchase of Energy from Enron by SVP, which agreement must be approved by the City Council.

In consideration of the above Recitals and the following mutual covenants and obligations, the Parties agree as follows:

AGREEMENT PROVISIONS

- 1. The terms which appear in initial capital letters in this Confirmation Letter shall have the meaning set forth in the Master Agreement.

2. Paragraph number 1.2 "Transaction Procedures" shall be amended, for the purposes of this Confirmation Letter only, to read as follows:

The Transaction that is the subject of Confirmation Letter is not the result of a telephonic transaction, but rather is the result of a response by Enron to a Request for Proposal issued by SVP. All terms and conditions of this Transaction are contained herein, and will not be the subject of a later Confirmation Letter.

3. Paragraph number 1.3 of the Master Agreement, "Term of Agreement", shall be amended for purposes of this Confirmation Letter only to read as follows:

The term of this Confirmation Letter shall commence at midnight on January 1, 2002 and shall terminate at close of business on December 31, 2006. This Confirmation Letter shall remain in full force and effect regardless of whether the Master Agreement is canceled. If the Master Agreement is canceled, then the Parties agree that the terms and conditions of the Master Agreement are incorporated herein by this reference to the extent that they do not conflict with the terms of this Confirmation Letter.

4. Paragraph number 4.7 of the Master Agreement "Security" is amended for purposes of this Confirmation Letter only, to read as follows:

In order to secure all delivery obligations of Enron to SVP hereunder, Enron shall cause its Guarantor to execute and deliver to SVP an amended guarantee agreement in the amount of Three Hundred and Fifty Million Dollars and No Cents (\$350,000,000.00).

SVP agrees to waive its right to call for margin with respect to this deal.

5. "WSPP Schedule C Firm Energy" means firm power that is or will be scheduled as firm power consistent with the most recent rules adopted by the WSCC for which the only excuses for failure to deliver or receive are if an interruption is (i) due to an event of force majeure as such term is defined under the Master Agreement between the Seller and the Buyer that governs the Transaction that is the subject of this Confirmation Letter; or (ii) where applicable; to meet Seller's public utility or statutory obligations to its customers. Notwithstanding, any other provision in this Confirmation Letter, if Seller exercises its right to interrupt to meet its public utility or statutory obligations, Seller shall be responsible for payment of damages for failure to deliver firm power as provided in the applicable remedy section(s) of the Master Agreement.
6. "CAISO Energy" means with respect to a Transaction, a Product under which the Seller shall sell and the Buyer shall purchase a quantity of energy equal to the hourly quantity without Ancillary Services (as defined in the Tariff) that is or will be scheduled as a schedule coordinator to schedule coordinator transaction pursuant to the applicable tariff and protocol provisions of the California Independent System Operator ("CAISO") (as amended from time to time, the "Tariff") for which the only excuse for failure to deliver or receive is an "Uncontrollable Force" (as defined in the Tariff).

7. SVP shall provide Enron with a copy of Resolution No. 6794 by the City Council of the City of Santa Clara delegating authority to the City Manager to execute the Power Purchase contracts for the purchase of up to one-hundred megawatts (100 MW) of Energy.
8. For purposes of this Confirmation Letter only, Enron is the Seller and SVP is the Buyer. The Contract Price, Delivery Term, Delivery Point, Contract Quantity and whether the Transaction is Firm or Non-Firm, is set forth in Attachment "A", attached hereto and those terms are incorporated herein by this reference. No other terms or conditions set forth in Attachment "A" are made a part of this Confirmation Letter unless specifically agreed to in writing by SVP.
9. SVP and Enron bind themselves, their successors, assigns, executors and administrators to all covenants of this Confirmation Letter. Except as otherwise set forth in this Confirmation Letter, no interest in this Confirmation Letter shall be assigned or transferred, either voluntarily or by operation of law, without the prior written approval of the other Party. However, claims for money due to or to become due to Enron from SVP under this Confirmation Letter may be assigned to a bank, trust company or other financial institutions, or to a trustee in bankruptcy, provided that written notice of any such assignment or transfer shall be first furnished to SVP. Any such assignment shall not relieve Enron from any of its obligations or liability under the terms of this Confirmation Letter.
10. All other terms of the Master Agreement and Amendment No. 1, which are not in conflict with the provisions of this Confirmation Letter shall remain unchanged in full force and effect. In case of a conflict in the terms of the Master Agreement and this Confirmation Letter, the provisions of this Confirmation Letter shall control.
11. Subject to all of the conditions hereof being met, the pricing in Attachment A is valid until 5:00 p.m. P.P.T., April 17, 2001, after which Enron reserves the right, in its sole discretion, to change it. SVP may meet the foregoing requirement by: (1) executing a copy of this Confirmation Letter and sending it by facsimile transmission to Enron by 5:00 p.m. P.P.T., April 17, 2001 (2) executing a copy of Attachment "A" and sending it by facsimile transmission to Enron by 5:00 p.m. P.P.T., April 17, 2001 and (3) sending an executed copy of the Resolution by facsimile transmission to Enron by 5:00 p.m. P.P.T., April 17, 2001. Enron shall make its best effort to place in the Overnight Mail on April 17, two (2) originally signed copies of this Confirmation Letter to SVP, attention Roland D. Pfeifer, Assistant City Attorney, 1500 Warburton Avenue, Santa Clara, California 95050. Enron's pricing in the attached Attachment A shall not be changed if the sole delay is due to the foregoing.

The Parties acknowledge and accept the terms and conditions of this Confirmation Letter as evidenced by the following signatures of their duly authorized representatives. It is the intent of the Parties that this Confirmation Letter shall be operative on the Effective Date first set forth above.

CITY OF SANTA CLARA, CALIFORNIA
a Chartered California Municipal Corporation

APPROVED AS TO FORM:

for Roland D. Heitec

MICHAEL R. DOWNEY
City Attorney

By *Jennifer Sparacino*

JENNIFER SPARACINO
City Manager

ATTEST:

J. E. Boccignone

J.E. BOCCIGNONE
City Clerk

1500 Warburton Avenue
Santa Clara, CA 95050
Telephone: (408) 615-2210
Facsimile: (408) 241-6771

"SVP"

ENRON POWER MARKETING, INC.
a Delaware corporation

By: *Timothy Bolden*

Name: *Timothy Bolden* CBK
Title: *Managing Director*
Address: Enron North America Corp.
Three World Trade Center
121 S.W. Salmon, 3 WTC0306
Portland, Oregon 97204
Telephone: (503) 464-3800
Facsimile: (503) 464-3740

"Enron"

**CONFIRMATION LETTER PURSUANT TO
THE MASTER ENERGY PURCHASE AND
SALE AGREEMENT AND AMENDMENT NO. 1 THERETO
BY AND BETWEEN THE
CITY OF SANTA CLARA, CALIFORNIA
AND
ENRON POWER MARKETING, INC.**

ATTACHMENT "A" – Page 1 of 1

50 MW BLOCK:

OFFER: Price per MWh: \$64.00

Delivery Location: NP-15 as currently defined, until such time that the definition of NP-15 changes or the zone ceases to exist, when the Delivery Point shall be that zone, or any physical location or bus, that reasonably resembles, in terms of liquidity and homogeneity and physical location, PGE3, and specifically excluding the proposed "North Bay and Greater Bay Area Zones" as identified in Figure 1 on page 10 of Appendix H (located at <http://www.caiso.com/docs/09003a6080/06/ec/09003a608006ec61.pdf>) to the document entitled "Congestion Management Reform Recommendations" (Draft Proposal) dated July 28, 2000 issued by the California ISO on its official website: <http://www.caiso.com>.

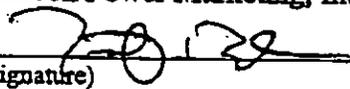
Term: January 1, 2002, through December 31, 2006

Baseload Delivery: 7 x 24

Firm Power: "CAISO Energy" means with respect to a Transaction, a Product under which the Seller shall sell and the Buyer shall purchase a quantity of energy equal to the hourly quantity without Ancillary Services (as defined in the Tariff) that is or will be scheduled as a schedule coordinator to schedule coordinator transaction pursuant to the applicable tariff and protocol provisions of the California Independent System Operator ("CAISO") (as amended from time to time, the "Tariff") for which the only excuse for failure to deliver or receive is an "Uncontrollable Force" (as defined in the Tariff).

Other Terms: The rates for services specified herein shall remain in effect for the term of this Confirmation Letter, and shall not be subject to change through the application to the Federal Energy Regulatory Commission pursuant to provisions of Section 205 or 206 of the Federal Power Act absent the agreement of all Parties to this Confirmation Letter.

Offer made by: Enron Power Marketing, Inc.

 _____ **CB**

(signature)

Print Name: Tim Belden

Title: Managing Director

ACCEPTANCE BY SVP:

By:  _____

JENNIFER SPARACINO

City Manager
1500 Warburton Avenue
Santa Clara, CA 95050
Telephone: (408) 516-2184
Facsimile: (408) 261-2717

EXHIBIT 5

PRESS ROOM

products+services
investors
work at enron

press room
contacts
enron.com home



You are here: >>enron.com >>Press Room >>Press Releases >>2001 >>Enron Corp.

Press Release

**ENRON PROVIDES ADDITIONAL INFORMATION
ABOUT RELATED PARTY AND OFF-BALANCE
SHEET TRANSACTIONS; COMPANY TO RESTATE
EARNINGS FOR 1997-2001**

FOR IMMEDIATE RELEASE: Thursday, November 8, 2001

HOUSTON – Enron Corp. (NYSE: ENE) today provided additional information about various related party and off-balance sheet transactions in which the company was involved. The information was posted today on the company's website at <http://www.enron.com/corp/sec> and also made available in a Form 8-K Report filed today with the Securities and Exchange Commission (SEC).

Specifically, Enron's filing provides information about:

- a required restatement of prior period financial statements to reflect the previously disclosed \$1.2 billion reduction to shareholders' equity, as well as various income statement and balance sheet adjustments required as the result of a determination by Enron and its auditors, based on current information, that certain off-balance sheet entities should have been included in Enron's consolidated financial statements pursuant to generally accepted accounting principles;
- the restatement of its financial statements for 1997 through 2000 and the first two quarters of 2001. As a result, financial statements for these periods and the audit reports relating to the year-end financial statements for 1997 through 2000 should not be relied upon;
- the accounting basis for the above-mentioned reduction to shareholders' equity;
- the special committee appointed by the Enron Board of Directors to review transactions between Enron and related parties;
- information regarding the two LJM limited partnerships formed by Enron's then chief financial officer, his role in the partnerships, the business relationships and transactions between Enron and the partnerships, and the economic results of those transactions as known thus far; and

Elsewhere in
Press Release

Enron Corp.

archive 2001

archive 2001

archive 2001

archive 2001

archive 1999

archive 1999

archive 1999

archive 1999

- transactions between Enron and certain other Enron employees.

"We believe that the information we have made available addresses a number of the concerns that have been raised by our shareholders and the SEC about these matters," said Ken Lay, Enron chairman and CEO. "We will continue our efforts to respond to investor requests for information about our operational and financial condition so they can evaluate, appreciate and appropriately value the strength of our core businesses."

Restatement of Earnings

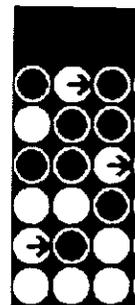
As further described on Enron's website, and its Form 8-K Report, Enron will restate prior years' financial statements to reflect its review of current information concerning the transactions discussed below. After taking into account Enron's previously disclosed adjustment to shareholders' equity in the third quarter of 2001, these restatements have no effect on Enron's current financial position.

Based on this review, Enron has determined that:

- the financial activities of Chewco Investments, L.P. (Chewco), a related party which was an investor in Joint Energy Development Investments Limited Partnership (JEDI), should have been consolidated beginning in November 1997;
- the financial activities of JEDI, in which Enron was an investor and which was consolidated into Enron's financial statements during the first quarter of 2001, should have been consolidated beginning in 1997; and
- the financial activities of a wholly-owned subsidiary of LJM1, which engaged in structured transactions with Enron that were designed to permit Enron to mitigate market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated into Enron's financial statements beginning in 1999.

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, increases of \$17 million for the first quarter of 2001 and \$5 million for the second quarter and a reduction of \$17 million for the third quarter of 2001. These changes to net income 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. The consolidation of JEDI and Chewco also will increase Enron's debt by approximately \$711 million in 1997, \$561 million in 1998, \$685 million in 1999 and \$628 million in 2000. The restatement will have no negative impact on Enron's reported earnings for the nine-month period ending Sept. 2001.

Enron is one of the world's leading energy, commodities and services companies. The company markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is www.enron.com. The stock is traded under the ticker symbol "ENE."



This press release includes forward-looking statements within the meaning of Section 27A of the Securities Act of

Copyright 1997-2003 Enron. All rights re:

EXHIBIT 6



Harlan E. Murphy
Vice President and
General Counsel
(713) 345-2679
Fax (713) 646-3490
Harlan.Murphy@enron.com

May 30, 2002

VIA FACSIMILE AND U.S. MAIL

Ann Hatcher
Division Manager, Risk Analysis
City of Santa Clara – Silicon Valley Power
1500 Warburton Avenue
Santa Clara, California 95050

Re: Master Energy Purchase and Sales Agreement, dated September 10, 1999 between Enron Power Marketing, Inc. ("EPMI") and City of Santa Clara, California dba Silicon Valley Power ("Silicon Valley"), as amended (the "Agreement")

Dear Ms. Hatcher:

Attached as Exhibit A is EPMI's calculation of the Termination Payment owed by Silicon Valley to EPMI as a result of the termination of the Agreement. In accordance with Section 4.4(a) of the Agreement, such payment is due to EPMI within three Business Days following receipt of this letter.

The prior letters from Silicon Valley notwithstanding, EPMI possessed a clear contractual right to notice an Early Termination Date pursuant to section 5.2 of the Agreement. In a letter dated December 11, 2001, Silicon Valley admitted that it owed \$1,010,439.50 to EPMI with respect to purchases and sales of electricity made during the month of November 2001. In accordance with the terms of Section 6.1 of the Agreement, such amounts were due to be paid on or before December 20, 2001. Despite notice given by EPMI to Silicon Valley on December 21, 2001, Silicon Valley refused to pay such amounts, and, accordingly, an Event of Default occurred pursuant to Section 4.1(a) of the Agreement. In a letter dated December 28, 2002, EPMI terminated the Agreement and specified January 2, 2002 as the Early Termination Date.

We note that in the December 11, 2001 letter, Silicon Valley stated that it was retaining amounts otherwise due and owing to EPMI as security against future EPMI payment obligations. Although you attempt to address Silicon Valley's setoff and recoupment rights, you fail to cite any provision in the Agreement that would justify this action or explain the inconsistency between Silicon Valley holding amounts owed as security and the mechanism provided for obtaining security set forth in Section 4.8.

Silicon Valley's withholding of payments otherwise due and owing to EPMI was not the only Event of Default by Silicon Valley. On November 28, 2001, Silicon Valley refused to post Performance Assurance as required pursuant to Section 4.8 of the Agreement. On December 5,

Endless possibilities.™

May 30, 2002

Page 2

2001, Silicon Valley wrongfully suspended performance of the Agreement. Each of these events constitute an independent ground for termination. Silicon Valley's rationale for failing to post Performance Assurance, as set forth in your letter of November 28, 2001, is fallacious because it assumes that the entire definition of "Early Termination Payment" is set forth in the last sentence of Section 4.8 and virtually ignores the actual definition of "Early Termination Payment", which is in Section 4.3(e). Section 4.3(e) defines "Early Termination Payment" to include Gains, Losses and Costs. Contrary to Silicon Valley's position, the last sentence of Section 4.8 supplements, but does not supplant, that definition. At the time EPMI requested that Silicon Valley post Performance Assurance, the Early Termination Payment (as that term is defined in Section 4.3(e) and the last sentence of Section 4.8) that would be owed to EPMI far exceeded the threshold set forth in Section 4.8. Silicon Valley failed to provide Performance Assurance, which pursuant to Section 4.1(f) is an Event of Default.

Silicon Valley indicates that it was entitled to exercise all remedies available to it under the Agreement pursuant to the safe harbor provisions of the Bankruptcy Code. This is not a correct statement of the law. Section 556 of the Code permits a forward contract merchant to cause the liquidation of a commodity contract because of a condition of the kind specified in section 365(e) of the Code. Even if the Agreement were a forward contract and Silicon Valley were a forward contract merchant, section 556 would only protect the liquidation remedy. It would not permit Silicon Valley to exercise other contractual remedies available to it in the absence of a termination. Moreover, as a governmental unit, Silicon Valley is not a forward contract merchant, as defined in the Code. See 11 U.S.C. § § 101(26) (forward contract merchant definition; must be a "person"), 101(41) (definition of person; excludes any "governmental unit"), 101(27) (definition of governmental unit).

Failure by Silicon Valley to remit the Termination Payment in a timely manner will force EPMI to pursue the remedies available to it under the Bankruptcy Code and the Agreement, including the prompt commencement of an adversary proceeding for the turnover of a matured debt owed to the estate.

We note that in prior correspondence, Silicon Valley has maintained that the Agreement has not been terminated. As an alternative to receipt of a the Early Termination Payment, EPMI would consider the resumption of performance under the Agreement (by both EPMI and Silicon Valley) coupled with an appropriate payment to compensate EPMI for the lost value associated with the Silicon Valley's failure to perform and breach. EPMI has been, and continues to be, able and willing to perform its obligations under the Agreement. Chuck Ward will be contacting you to discuss this alternative shortly.

Sincerely,

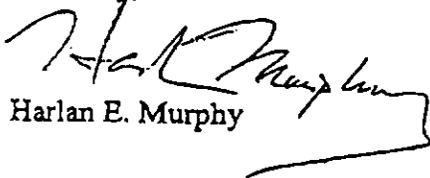

Harlan E. Murphy

Exhibit A:

Amounts owed to (payable by) EPMI

A) EPMI's A/R (A/P) Balance:

Outstanding debit balance in A/P for Sept.	\$ 144,000.00
Month of November [net]	\$ 1,010,439.50
Energy delivered in December [net]	\$ (432,460.00)
Sub-total	<u>\$ 721,979.50</u>

B) LD's:

For the month of December as calculated
by SVP (see letter dated 1/10/02 from
SVP), due to SVP

\$ (1,758,105.00)

C) Early Termination Value for 1/3/02 Termination Date:

\$ 147,297.655

Early Termination Payment: \$ 147,297.655

EXHIBIT 7



FILED
OFFICE OF THE SECRETARY

00 FEB -1 PM 1:00

FEDERAL ENERGY
REGULATORY
COMMISSION

Enron Power Marketing, Inc.

P.O. Box 1188

Houston, TX 77251-1188

(713) 853-7500

January 31, 2000

Mr. David Boergers
Acting Secretary
Federal Energy Regulatory Commission
825 N. Capitol Street, Northwest
Washington, D.C. 20426

Re: Enron Power Marketing, Inc.
Report for the Fourth Quarter 1999
ER94-24-027

Dear Mr. Boergers:

Pursuant to the Commission's letter-order issued December 2, 1993 in Docket No. ER94-24-027, please find below a summary of activity for Enron Power Marketing, Inc. ("EPMI") for the quarter ending December 31, 1999.

The following agreements were signed:

Energy New England, LLC	10/01/99	Evergreen
Energy Transfer Group, LLC	10/01/99	Evergreen
Public Service Company of Colorado	10/26/99	Evergreen
Duke Energy Trading and Marketing, LLC	11/01/99	Evergreen
Florida Power & Light Company	11/30/99	Evergreen
Green Bay Power Corporation	12/01/99	Evergreen
Montana Power Company	12/21/99	Evergreen

The following contracts were received after the September 30, 1999 filing was submitted:

Conoco Pipe Line Company	04/01/99	Evergreen
Valley Electric Association, Inc.	06/01/99	Evergreen
Santa Clara, California, City of, Silicon Valley Power	09/10/99	Evergreen

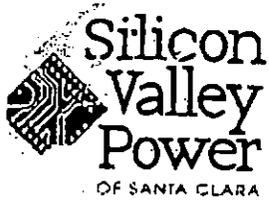
Enron Power Marketing Inc.
4th Quarter 1999
FERC Report

Entity	Product	Quantity	Price	Value	Notes
City of Riverside	P		F		
City of Santa Clara California, Silicon Valley Power	P	10,080	\$23.00	\$233,000	BP-15
	P	238,925	\$23.50	\$5,514,388	COB N/S
					NP-15
City of Tacoma, Department of Public Utilities, dba Tacoma Power	P	188,768	\$15.50	\$2,925,904	PALO VERDE BC Border BPA Busbar John Day MID COLUMBIA Portland General System Tacoma System Border
CLECO Corporation	P	43,200	\$19.25	\$831,600	Energy (into) System Border
CMS Marketing, Services and Trading Company	P	28,000	\$17.25	\$483,000	CINERGY (into) System Energy (into) System Border PJM-Western Hub
Colorado River Commission	P	13,884	(\$0.29)	(\$4,026)	Meed-230KV
Colorado Springs Utilities	P	106	\$35.50	\$3,766	Midway - PSC
Columbia Energy Power Marketing Corporation	P	62,400	\$14.12	\$883,248	COB N/S
					PALO VERDE PJM-Western Hub
Comision Federal De Electricidad	P	184	\$23.50	\$4,308	Tijuana
Commonwealth Edison Company	P	281,879	\$15.25	\$4,297,878	AEP System Border CINERGY (into) System COMED (into) System Border IAEP System Border AEP-MECS Interface Ameren (into) System Border CINERGY (into) System COMED (into) System Border Commonwealth Edison TVA (into) System Border TVA (Out of) System Border TVA System Border UPA System Border
Commonwealth Edison Company	P	7,554	\$10.00	\$75,540	MID COLUMBIA PALO VERDE
ConAgra Energy Services, Inc.	P	134,000	\$27.00	\$3,618,000	PJM-500 Interface (excluding Flamingo) PJM-Branchburg PJM-CONASTONE PJM-CONEMAUGH PJM-IUNIATA PJM-NEWFREEDOM PJM-Reachbottom PJM-SUSQUEHANNA PJM-WAUGHCHAPEL PJM-WESCO8VL PJM-WHITPAIN
Conoco Inc.	P	6,624	\$23.06	\$152,712	Montana System Border
Conoco Pipe Line Company	P	1,731	\$33.73	\$58,388	Hot Springs Montana System Border
Constellation Power Source Inc.	P	1,870,000	\$12.54	\$23,547,000	CINERGY (into) System

Enron Power Marketing Inc.
4th Quarter 1989
FERC Report

Customer Name	Product	Quantity (MWh)	Price (\$/MWh)	Market Price	Point Name
City of McMillinville Water & Light	S	(11,046)	\$23.70	\$23.70	NP-15 PALO VERDE
City of Redding	S	(603)	\$34.00	\$39.00	PJM-Western Hub BC Border 8PA Busbar COB N/S
City of Riverside	S	(415)	\$32.00	\$37.00	NP-15 SP-15
City of Santa Clara California, Silicon Valley Power	S	(184,800)	\$23.00	\$40.00	COB N/S
City of Tacoma, Department of Public Utilities, dba Tacoma Power	S	(108,907)	\$18.72	\$61.13	PALO VERDE
CLECO Corporation	S	(43,200)	\$18.25	\$28.06	Tacoma System Border
CMS Marketing, Services and Trading Company	S	(139,200)	\$17.75	\$33.00	Energy (Info) System Border CINERGY (Info) System Energy (Info) System Border PJM-Western Hub
Colorado River Commission	S	(23,447)	\$6.82	\$60.85	Mead-230KV
Colorado Springs Utilities	S	(13,840)	\$33.75	\$100.00	Midway - PSC
Colorado Springs Utilities	S	(23,886)	\$27.28	\$27.28	Midway - PSC
Columbia Energy Power Marketing Corporation	S	(217,600)	\$24.10	\$34.50	CINERGY (Info) System MID COLUMBIA
Comblon Federal De Electricidad	S	(41,426)	\$2.50	\$154.50	PALO VERDE PJM-Western Hub Imperial Valley (CFE)
Commonwealth Edison Company	S	(646,876)	\$14.00	\$37.16	Tjuana CINERGY (Info) System COMED (Info) System Border IES System Border
Commonwealth Edison Company	S	(14,764)	\$9.00	\$38.00	PJM-Western Hub AEP System Border COMED (Info) System Border Commonwealth Edison IP System Border
ConAgra Energy Services, Inc.	S	(81,666)	\$26.25	\$37.75	Interstate-CE Interface TVA System Border UPA System Border MID COLUMBIA
Conoco Inc.	S	(68,270)	\$22.25	\$30.00	PALO VERDE Tacoma System Border
Canoco Pipe Line Company	S	(37,763)	\$15.88	\$60.18	Colstrip Montana System Border
Constellation Power Source Inc.	S	(1,913,910)	\$14.50	\$65.00	Colstrip Montana System Border CINERGY (Info) System COB N/S
					COMED (Info) System Border Crug
					Energy (Info) System Border MID COLUMBIA
					NEPOOL PTF
					PALO VERDE

EXHIBIT 8



Giving you the power
to change the world.

December 11, 2001

Via Facsimile and U.S. Mail
Facsimile: (713) 646-4818

Enron Power Marketing, Inc
Assistant General Counsel, Trading Group
1400 Smith
Houston, TX 77002-7361

Re: Setoff for November and December Pre-Bankruptcy Transactions

Dear Sir or Madam:

On account of Enron Corporation's filing for bankruptcy on December 2, 2001, and in order to calculate the appropriate setoff for pre petition mutual claims pursuant to 11 U.S.C. §553, we have calculated a Setoff for pre-petition electricity deliveries to EMPI that occurred during the months of November and December up to the date and time of the filing of EMPI's bankruptcy petition.

We will calculate the Setoff pursuant to Section 6.2 Netting/Setoff of the Master Energy Purchase and Sale Agreement (the "Agreement"), specifically, which states in the last sentence:

All outstanding Transactions and the obligations to make payment in connection therewith or under this Agreement or any other agreement between the Parties may be offset against each other, set off or recouped therefrom.

For purchases and sales of electricity made during the calendar month of November 2001, we calculate that Silicon Valley Power (SVP) owes to Enron Power Marketing, Inc. (EMPI) the amount of \$1,010,439.50 after obligations have been netted.

1500 Warburton Ave.
Santa Clara, CA 95050
408) 261-5292
Fax: (408) 249-0217

Jody/k/hatcher/tw/enronPaymentsPO120601



Enron Power Marketing, Inc.
Power Contract Documentation Manager
December 11, 2001

We have calculated the payments (the "Setoff") that would be due to SVP from EPMI for electricity deliveries made starting December 1, 2001, through 3 am PST on December 2, 2001. This Setoff would equal \$445,323.75.

As a result, the total netted payment due to EPMI from SVP for pre-petition transactions will equal \$565,115.75.

SVP will retain that amount as security (i) for EPMI's payment obligations for deliveries made from 3am PST on December 2 through midnight on December 4, 2001, which will result in payment from EPMI to SVP of \$861,046.25 and (ii) for EPMI's payment of liquidated damages to SVP which will be calculated at a later date.

Sincerely,



Ann Hatcher
Division Manager, Risk Analysis

cc: Accounts Receivable, Enron Power Marketing, Inc.
Jennifer Sparacino, City Manager, City of Santa Clara
James H. Pope, Director of Electric Utility, Silicon Valley Power
Ray Camacho, Assistant Director, Silicon Valley Power
John Roukema, Assistant Director, Silicon Valley Power
Chad Wozniak, Division Manager Risk Management
Rol Pfeifer, Assistant City Attorney

EXHIBIT 9



MANUAL NET INVOICE

CUSTOMER INFORMATION	INVOICE INFORMATION	CONTRACT INFORMATION	PAYMENT INFORMATION		
City of Santa Clara California 1500 Warburton Ave Santa Clara, CA 95050-3713 Attn: Betty Sargent Tel: 408-984-3101 Fax: 408-727-9833	INVOICE NUMBER: NTP0101216 INVOICE DATE: 12/10/2001 DUE DATE: 12/20/2001 TERMS: WSPP	CONTRACT NO: Ref. Inv. # F0470001D10014 CONTACT: Amy Clemons PH #: (713) 853-9741 FAX #: (713) 646-4061	WIRE TRANSFER: Remit To: Enron Power Marketing, Inc. Bank: Citibank, N.A. New York Bank Id: 021000089 Acct: 40781075		
TO INVOICE FOR NET SALES November 2001					
FACILITY	START	END	DATES	ENERGY MWHR	TOTAL DOLLARS
Enron Sold	11/1/2001	11/30/2001		445,280	\$16,087,840.00
Enron Purchased	11/1/2001	11/30/2001		(426,420)	(\$15,077,400.50)
					\$1,010,439.50

Net Due Enron Power Marketing, Inc.

RECEIVED

DEC 14 2001

**CITY OF SANTA CLARA
ELECTRIC DEPARTMENT**

**City of Santa Clara California, Silicon Valley Power
ATTN: Betty Sargent
1500 Warburton Ave
Santa Clara, CA 95050-3713**

EXHIBIT 10



Harlan E. Murphy
Asst. General Counsel

Enron North America Corp.
1400 Smith Street
Houston, TX 77002-7361
713-345-2679

P.O. Box 1188
Houston, TX 77251-1188
Fax 713-646-3490
Harlan.Murphy@enron.com

December 21, 2001

The City of Santa Clara – Silicon Valley Power
1500 Warburton Avenue
Santa Clara, California 95050

Attention: Risk Manager Facsimile No.: (408) 247-3730

Re: Master Energy Purchase and Sale Agreement dated September 10, 1999 between Enron Power Marketing, Inc. ("Enron") and City of Santa Clara, California dba Silicon Valley Power ("Silicon Valley") (the "Agreement"; capitalized terms used herein and not defined herein shall have the meanings given to such terms in the Agreement).

Ladies and Gentlemen:

Pursuant to Section 6.1 of the Agreement, a payment of \$1,010,439.50 was due from Silicon Valley to Enron on December 20, 2001. This letter shall serve as Enron's written notice to Silicon Valley that Silicon Valley has failed to make that payment.

If you have any questions about the matters set forth herein, please call me at the telephone number set forth above.

Very truly yours,

A handwritten signature in black ink, appearing to read "Harlan E. Murphy". The signature is written in a cursive, flowing style.

EXHIBIT 11

MCPHARLIN
SPRINKLES &
THOMAS LLP

ATTORNEYS AT LAW

TEN ALMADEN BLVD., SUITE 1460
SAN JOSE, CALIFORNIA 95113
TELEPHONE (408) 293-1900
FACSIMILE (408) 293-1999
WWW.MSTPARTNERS.COM

Writer's Direct Dial: (408) 975-2461
Writer's Email: emseid@aol.com

December 21, 2001

PAUL S. AVILLA
MARY L. MALYSZ
LINDA HENDRIX MCPHARLIN
JANE P. RELTEA
ELAINE M. SEID
CATHERINE C. SPRINKLES
N. DAVID THOMAS

Via Facsimile and U.S. Mail

Harlan E. Murphy
Assistant General Counsel
Enron North America Corp
1400 Smith Street
Houston, TX 77002-7361

Re: Enron, Chapter 11 Bankruptcy

Dear Mr. Murphy:

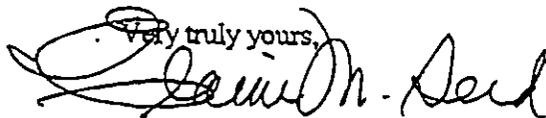
Our firm represents the City of Santa Clara ("the City") and its electrical department, Silicon Valley Power ("SVP"), with respect to Enron's bankruptcy. Your letter of December 21, 2001, a copy of which is attached, has been directed to the undersigned for response. Contrary to your characterization, please be advised that SVP has not failed to make a payment which has become due.

By letter of December 11, 2001, a copy of which is attached for your convenience, SVP notified Enron of SVP's setoff of mutual pre bankruptcy petition claims that SVP is entitled to do under Section 553 of the United States Bankruptcy Code. The setoff of pre petition claims resulted in a net of \$565,115.75 ("Pre Petition Net Amount") owed by SVP to Enron.

Further, on account of doubt as to Enron's ability to perform, SVP has elected to hold the Pre Petition Net Amount as security for Enron's payment for deliveries made from 3am PST on December 2 through midnight on December 4, 2001.

Should you have any questions with regard to this matter, kindly contact the undersigned.

Very truly yours,



ELAINE M. SEID

Encl.

cc: Ann Hatcher, via facsimile & U.S. Mail
Roland Pfeifer, Esq., via facsimile & U.S. Mail

EXHIBIT 12



Harlan E. Murphy
Asst. General Counsel

Enron North America Corp.

1400 Smith Street
Houston, TX 77002-7361
713-345-2679

P.O. Box 1188
Houston, TX 77251-1188
Fax 713-646-3490
Harlan.Murphy@enron.com

December 28, 2001

The City of Santa Clara – Silicon Valley Power
1500 Warburton Avenue
Santa Clara, California 95050
Attention: Risk Manager Facsimile No.: (408) 247-3730

Ms. Elaine M. Seid
McPharlin Sprinkles & Thomas LLP
Ten Almadén Blvd., Suite 1460
San Jose, California 95113
Facsimile No.: (408) 293-1999

Re: Master Energy Purchase and Sale Agreement dated September 10, 1999 between Enron Power Marketing, Inc. ("Enron") and City of Santa Clara, California dba Silicon Valley Power ("Silicon Valley") (the "Agreement"; capitalized terms used herein and not defined herein shall have the meanings given to such terms in the Agreement).

Ladies and Gentlemen:

Enron is in receipt of your letters dated December 11 and 21, 2001. Pursuant to Section 6.1 of the Agreement, a payment was due from Silicon Valley to Enron on December 20, 2001. On December 21, 2001, Silicon Valley received written notice that Silicon Valley failed to make that payment. Silicon Valley failed to cure such failure to pay within the three Business Days allotted therefor by Section 4.1(a) of the Agreement. Accordingly, (i) an Event of Default has occurred; (ii) Silicon Valley is the Defaulting Party; and (iii) Enron hereby declares Wednesday, January 2, 2002 as the Early Termination Date. Enron will notify Silicon Valley of the Early Termination Payment shortly.

If you have any questions about the matters set forth herein, please call me at the telephone number set forth above.

Very truly yours,

A handwritten signature in black ink, appearing to read "Harlan E. Murphy". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

EXHIBIT 13



January 10, 2002

Giving you the power
to change the world.

Via Facsimile and U.S. Mail
Enron Power Marketing, Inc.
1400 Smith Street
P.O. Box 4428
Houston, Texas 77210-4428
Attn: Power Contract Settlements Manager
Facsimile No: (713) 646-4061

Re: Payment due to Silicon Valley Power by Enron Power Marketing, Inc.

Ladies and Gentlemen:

As of January 1, 2002, Enron Power Marketing, Inc. ("EPMI") owes to the City of Santa Clara, California dba Silicon Valley Power ("SVP") the sum of \$2,998,273. The sum is made up of the following charges and setoffs:

From December 2, 2001, 3am PST through December 31, 2001, midnight PST, purchases and sales were made between EPMI and SVP which net pursuant to Section 6.1 of the Master Energy Purchase and Sales Agreement dated September 10, 1999 (the "Agreement") for a total of \$1,805,283.75 owed to SVP. (See Tables A and B for list of all December purchases and sale transactions.)

On November 29, 2001, following EPMI's multiple default of the Agreement and pursuant to Section 4.1(e), SVP requested Performance Assurance from EPMI. When EPMI failed to provide requested Performance Assurance, SVP suspended certain deliveries of energy to EPMI under the Agreement and for mutual benefit of scheduling. (See Table B for list of suspended energy transactions.) Pursuant to section 5.2 Duty to Mitigate, SVP made a commercially reasonable effort to minimize any damages from EPMI's failure to provide Performance Assurance. After mitigating damages and pursuant to Section 3.6, SVP calculates a liquidated damage payment amount equal to \$1,758,105.00 owed to SVP.

On December 11, 2001, and again on December 21, 2001, SVP notified EPMI of SVP's setoff of mutual pre-bankruptcy petition claims that SVP is entitled to do under Section 553 of the United States Bankruptcy Code.

As per the letter dated December 11, 2001, following EPMI's failure to perform physical deliveries or to provide Performance Assurance as stated above, Silicon Valley Power retained payments of \$565,115.75 ("Pre-Petition Net Amount") owed by SVP to EPMI as setoff for deliveries already made pursuant to Section 6.2 of the Agreement.

1500 Warburton Ave.
Santa Clara, CA 95050
(408) 261-5292
Fax: (408) 249-0217



Offsetting the retained Pre-Petition Net Amount against EPMI's current payments due for post-petition energy transactions and liquidated damages, results in EPMI owing to SVP a sum of \$2,998,273.00.

An invoice, separate from this letter, has been sent to EPMI pursuant to Section 8.3 of the Agreement and in the manner that has historically allowed EPMI and SVP to finalize their mutual billing and payment requirements.

Sincerely,



Ann Hatcher
Division Manager, Risk Analysis
Silicon Valley Power

Cc: Harlan E. Murphy, Assistant General Counsel, Enron North America Corp.
Amy Clemons, Accounts Payable, Enron Power Marketing, Inc.
Mike McDonald, Vice President, Enron Power Marketing, Inc.
Jennifer Sparacino, City Manager, City of Santa Clara
James H. Pope, Director of Electric Utility, Silicon Valley Power
Ray Camacho, Assistant Director, Silicon Valley Power
John Roukema, Assistant Director, Silicon Valley Power
Chad Wozniak, Division Manager, Risk Management
Rol Pfeifer, Assistant City Attorney, City of Santa Clara

Enron December 2001 Transactions with Silicon Valley Power

TABLE A - Enron deliveries (buy) and receipts (sell) for the full month

Code	Quantity	Price	Market	Contract	Start	End	Season	Start	End	Hours	Notes	LT	Contract	LT	Contract	LT	Contract	SALES VALUE	PURCHASES
EPMI Buy	50	@ 47.15	COB	COBN-S	11/01	12/31/03	100	12/31/03	100	-100	all hours	Repeat Failures 12/	10/9/01	AAT427	403520			893492.50	
EPMI Buy	25	@ 34.00	MID-C	MID-C	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/9/01	AAQ712	808316			340000	
EPMI Buy	25	@ 29.75	MID-C	MID-C	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/26/01	AA1269	879795			297500	
EPMI Buy	25	@ 35.00	MID-C	MID-C	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/7/01	AAS574	861568			350000	
EPMI Buy	25	@ 42.20	MID-C	MID-C	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/25/01	AAR807	839129			422000	
EPMI Buy	25	@ 34.75	MID-C	MID-C	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/5/01	AAQ558	804532			347500	
EPMI Sell	25	@ 44.00	MID-C	MID-C	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		10/30/01	AAS212	846740	440000			
EPMI Sell	100	@ 45.00	MID-C	MID-C	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		10/29/01	AAS054	845259	1800000			
EPMI Buy	50	@ 23.00	MID-C	MID-C	12/4/01	12/4/01	-700	12/4/01	-700	-2200	on peak		12/3/01	AA7554	883900			18400	
EPMI Buy	25	@ 24.00	MID-C	MID-C	12/4/01	12/4/01	-700	12/4/01	-700	-2200	on peak		12/3/01	AA1560	883901			9600	
EPMI Buy	50	@ 20.00	MID-C	MID-C	12/4/01	12/4/01	-700	12/4/01	-700	-2200	on peak		12/3/01	AA1559	883902			16000	
EPMI Buy	25	@ 31.35	CA	NP15	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/26/01	AA1261	879412			313500	
EPMI Buy	25	@ 34.05	CA	NP15	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/11/01	AAQ860	811906			340500	
EPMI Buy	25	@ 33.30	CA	NP15	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/2/01	AAQ394	799710			333000	
EPMI Buy	25	@ 34.10	CA	NP15	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		10/3/01	AAQ421	802186			341000	
EPMI Sell	25	@ 30.00	CA	NP15	10/1/01	12/31/01	700	12/31/01	700	2200	on peak		6/5/01	AAM206	632804	900000			
EPMI Sell	25	@ 45.15	CA	NP15	10/1/01	12/31/01	700	12/31/01	700	2200	on peak		8/18/01	AAQ357	754287	451500			
EPMI Sell	25	@ 43.00	CA	NP15	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		10/9/01	AA6246	849033	430000			
EPMI Sell	25	@ 84.50	CA	NP15	10/1/01	12/31/01	700	12/31/01	700	2200	on peak		7/10/01	AAN310	680276	845000			
EPMI Buy	25	@ 43.95	SW	PV	11/01	12/31/03	-100	12/31/03	-100	-100	all hours		LT contract	AAL413	404470			817470	
EPMI Sell	25	@ 25.75	SW	PV	12/1/01	12/31/01	100	12/31/01	100	600	off load		10/31/01	AAS248	849158	221450			
EPMI Buy	25	@ 27.15	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/27/01	AA1312	880694			271500	
EPMI Buy	25	@ 27.00	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/15/01	AA1049	872069			270000	
EPMI Buy	25	@ 32.25	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/5/01	AAS450	856612			322500	
EPMI Buy	25	@ 35.25	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		11/2/01	AAS388	854130			352500	
EPMI Buy	25	@ 32.75	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		9/18/01	AAP741	779091			327500	
EPMI Buy	25	@ 33.50	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		9/12/01	AAP513	771079			335000	
EPMI Buy	25	@ 37.25	SW	PV	12/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		8/27/01	AAO864	750280			372500	
EPMI Buy	25	@ 43.00	SW	PV	11/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		7/30/01	AAN718	709285			430000	
EPMI Sell	25	@ 32.00	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		9/5/01	AAR284	761254	320000			
EPMI Sell	25	@ 34.25	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		8/29/01	AAP071	753027	842500			
EPMI Sell	25	@ 30.50	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		11/9/01	AAS500	857884	305000			
EPMI Sell	25	@ 34.75	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		11/1/01	AAS299	851639	347500			
EPMI Sell	25	@ 35.40	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		10/31/01	AAS247	849106	354000			
EPMI Sell	25	@ 36.40	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		10/30/01	AAS213	846800	364000			
EPMI Sell	25	@ 33.50	SW	PV	12/1/01	12/31/01	700	12/31/01	700	2200	on peak		9/18/01	AAP745	779888	335000			
EPMI Sell	25	@ 50.50	SW	PV	11/1/01	12/31/01	700	12/31/01	700	2200	on peak		7/15/01	AAM945	674862	690000			
EPMI Sell	25	@ 50.50	SW	PV	11/1/01	12/31/01	700	12/31/01	700	2200	on peak		6/25/01	AAM804	688077	505000			
EPMI Sell	25	@ 127.00	CA	SP15	10/1/01	12/31/01	700	12/31/01	700	2200	on peak		6/29/01	AA1832	624761	1270000			
EPMI Buy	25	@ 127.00	CA	SP15	10/1/01	12/31/01	-700	12/31/01	-700	-2200	on peak		5/29/01	AAL829	624218			1270000	
\$9,820,950.00 \$8,791,462.50																			

EXHIBIT 14



Enron Power Marketing, Inc
 1400 Smith Street, Suite 2835A
 Houston, TX 77002-7361

November 27, 2001

Attn: Jennifer Sparacino
 City of Santa Clara California, Silicon Valley Power

DELIVERED FACSIMILE: (408) 261-8640

Postnet	Date	# of pages
Fax Note R7E73		
To	Ray Canache	
Fax	408-261-2758	
From	408-261-2717	
Phone		

Dear Mr. ~~XXXXXX~~

Enron Power Marketing, Inc. ("EPMI") and City of Santa Clara California ("CSCC") entered into a Master Power Agreement dated September 10, 1999 ("Agreement"). All capitalized terms used in this letter that are not otherwise defined herein shall have the meanings given to them in the Agreement. Our books show that the Net Exposure of CSCC to EPMI is reflected as below results in a call for margin, which is due EPMI. The Net Exposure was calculated as of close of business on November 26, 2001.

Net Exposure Summary

Net Exposure:	\$	94,176,291
Less Threshold & Guaranty:	\$	(15,000,000)
Less Margin Held:	\$	-
Collateral Return Required:	\$	79,176,291
Total Margin Due to Enron:	\$	79,250,000

Pursuant to Annex A of the Agreement, EPMI hereby requests that CSCC provide to EPMI Margin posted at least equal to \$79,250,000 by the close of business on November 28, 2001. Please wire transfer cash to the account of:

Enron North America Corp.
 Bank of America, N.A. ABA# 111-000-012
 Acct #: 375-0494-727

Please contact me at (713) 853-9839 upon receipt of this notification to arrange for the return of Margin.

Sincerely,

Monica Reasoner
 Credit Manager
 Risk Assessment and Control



Enron Power Marketing, Inc
1400 Smith Street, Suite 2835A
Houston, TX 77002-7361

November 27, 2001

Attn: Jennifer Sparacino
City of Santa Clara California, Silicon Valley Power

DELIVERED FACSIMILE: (425) 783-8640

Dear Mr. White

Enron Power Marketing, Inc. ("EPMI") and City of Santa Clara California ("CSCC") entered into a Master Power Agreement dated September 10, 1999 ("Agreement"). All capitalized terms used in this letter that are not otherwise defined herein shall have the meanings given to them in the Agreement. Our books show that the Net Exposure of CSCC to EPMI is reflected as below results in a call for margin, which is due EPMI. The Net Exposure was calculated as of close of business on November 26, 2001.

Net Exposure Summary

Net Exposure:	\$	94,176,291
Less Threshold & Guaranty:	\$	(15,000,000)
Less Margin Held:	\$	-
Collateral Return Required:	\$	79,176,291
Total Margin Due to Enron:	\$	79,250,000

Pursuant to Annex A of the Agreement, EPMI hereby requests that CSCC provide to EPMI Margin posted at least equal to \$79,250,000 by the close of business on November 28, 2001. Please wire transfer cash to the account of:

Enron North America Corp.
Bank of America, N.A. ABA# 111-000-012
Acct #: 375-0494-727

Please contact me at (713) 853-9839 upon receipt of this notification to arrange for the return of Margin.

Sincerely,

Monica Reasoner
Credit Manager
Risk Assessment and Control

MODE = MEMORY TRANSMISSION

START=NOV-27 10:29

END=NOV-27 10:29

FILE NO. = 176

STN NO.	COM	ASBR NO.	STATION NAME/TEL.NO.	PAGES	DURATION
001	OK		914257836640	001/001	00:00'27"

-RISK ASSESSMENT & CONTROL-

***** - ***** - 7136468012- *****



Enron Power Marketing, Inc
1400 Smith Street, Suite 2835A
Houston, TX 77002-7361

November 27, 2001

Attn: Jennifer Sparacino
City of Santa Clara California, Silicon Valley Power

DELIVERED FACSIMILE: (425) 783-8640

Dear Mr. White

Enron Power Marketing, Inc. ("EPMI") and City of Santa Clara California ("CSCC") entered into a Master Power Agreement dated September 10, 1999 ("Agreement"). All capitalized terms used in this letter that are not otherwise defined herein shall have the meanings given to them in the Agreement. Our books show that the Net Exposure of CSCC to EPMI is reflected as below results in a call for margin, which is due EPMI. The Net Exposure was calculated as of close of business on November 26, 2001.

Net Exposure Summary

Net Exposure:	\$	94,176,291
Less Threshold & Guaranty:	\$	(15,000,000)
Less Margin Held:	\$	-
Collateral Return Required:	\$	79,176,291
Total Margin Due to Enron:	\$	79,250,000

Pursuant to Annex A of the Agreement, EPMI hereby requests that CSCC provide to EPMI Margin posted at least equal to \$79,250,000 by the close of business on November 28, 2001. Please wire transfer cash to the account of:

Enron North America Corp.
Bank of America, N.A. ABA# 111-000-012
Acct #: 375-0494-727

Please contact me at (713) 853-9839 upon receipt of this notification to arrange for the return of Margin.

Sincerely,

Monica Reasoner
Credit Manager

EXHIBIT 15



November 28, 2001

Giving you the power
to change the world.

Via Facsimile and U.S. Mail
(503) 464-3740

Ms. Monica Reasoner
Credit Manager
Risk Assessment and Control
ENRON POWER MARKETING, INC.
1400 Smith Street, Suite 2835A
Houston, TX 77002-7361

Dear Ms. Reasoner:

The City of Santa Clara, California, doing business as Silicon Valley Power ("SVP"), is in receipt of your facsimile letter, dated November 27, 2001, in which Enron Power Marketing, Inc. ("EPMI") has made a Margin Call upon SVP pursuant to Section 4.8 of that Master Energy Purchase and Sale Agreement dated September 10, 1999 (the "Agreement"). EPMI has incorrectly interpreted the terms of the Agreement and SVP is not obligated to post any Performance Assurance at this time.

Pursuant to Section 4.8, EPMI is permitted to request Performance Assurance in the event that the Early Termination Payment that would be owed by SVP to EPMI exceeds \$15,000,000. However, we direct your attention to the last sentence of that Section which states:

For purposes of this Section 4.8 the calculation of the "Early Termination Payment" shall include all amounts owed but not yet paid by one Party to the other Party whether or not such amounts are then due, *for performance already provided pursuant to any and all Transactions* [emphasis added].

Therefore, to calculate the Early Termination Payment of Section 4.8, we look at the amount of money SVP owes to EPMI for *performance already provided* by EPMI to SVP. In order for EPMI to have *performed* it must have delivered energy to SVP. As required in Section 6 of the Agreement, SVP and EPMI net the amounts owed to each other on a monthly basis. If SVP owes EPMI more than \$15,000,000 at the end of any one month, then SVP would be required to provide Performance Assurance in accordance with Section 4.8. SVP does not owe EPMI in excess of \$15,000,000.

1500 Warburton Ave.
Santa Clara, CA 95050

(408) 261-5292

Fax: (408) 249-0217

K/sjody/camscho/ltz/HatcherEnronPerformanceAssurance



Page 2 of 2

Ms. Monica Reasoner
ENRON POWER MARKETING, INC.
November 28, 2001

The calculation you have performed, appears to take the value of the contract as a whole, to reach the Early Termination Payment. This method of calculating the Early Termination Payment *only applies* if SVP unilaterally *terminates* the Agreement pursuant to Section 4.2. SVP has not terminated the Agreement.

Therefore, according to our calculations and the terms of the Agreement, SVP is not required to post Performance Assurance at this time.

Sincerely,



Ann Hatcher
Division Manager, Risk Analysis
Silicon Valley Power

cc: Jim Pope, Director of Electric Utility, Silicon Valley Power
Ray Camacho, Assistant Director, Silicon Valley Power
John Roukema, Assistant Director, Silicon Valley Power
Chad Wozniak, Division Manager Risk Management
Rol Pfeifer, Assistant City Attorney

EXHIBIT 16

Monday, 4 February, 2002, 10:37 GMT

Timeline: Enron's rise and fall

BBC News Online chronicles the key moments of the spectacular rise and fall of US energy giant Enron.

July 1985

Houston Natural Gas merges with InterNorth, a natural gas company based in Omaha, Nebraska, to form the modern-day Enron. The firm is an interstate and intrastate natural gas pipeline company with 37,000 miles of pipe.

1989

Enron begins trading natural gas commodities. It soon becomes the largest natural gas merchant in North America and the United Kingdom.

November 1999

Launch of Enron Online, "an internet-based global transaction system which allows Enron's customers to view real-time prices from Enron's traders and transact instantly online". Within two years the platform is averaging 6,000 transactions a day worth about \$2.5bn.

Our corporate culture... is driven by smart employees who continually come up with new ways to grow our business

December 2000

Chief executive Kenneth Lay steps down, but stays on as chairman. Enron's president and chief operating officer Jeffrey Skilling to take over in February.

Kenneth Lay, 6 February 2001, after Enron wins Fortune's 'Most innovative company' award

28 December 2000

Shares hit a record high of \$84.87 - making Enron the country's seventh most valuable company.

14 August 2001

Jeffrey Skilling resigns after just six months; Mr Lay returns to day-to-day management of the company.

The company remains largely impenetrable to outsiders. How exactly does Enron make its money? Details are hard to come by... Analysts don't seem to have a clue

15 August 2001

Enron employee Sherron Watkins sends letter to Kenneth Lay warning of accounting irregularities that could pose a threat to the company.

20 August 2001

Mr Lay exercises Enron share options worth \$519,000.

Fortune reporter, Bethany McLean, 5 March 2001

October 2001

Accounting firm Andersen begins destroying documents relating to the Enron audits.

The destruction continues until November when the company receives a subpoena from the Securities and Exchange Commission.

15 October 2001

Mr Lay calls Commerce Secretary Don Evans, but officials say the call dealt with a troubled Enron energy project in India and did not

We have the strongest and

cover Enron's financial troubles.

21 August 2001

Mr Lay exercises Enron share options worth just under \$1.48m.

16 October 2001

Enron reports losses of \$638m run up between July and September and announces a \$1.2 billion reduction in shareholder equity.

The reduction in company value relates to partnerships set up and run by chief financial officer Andrew Fastow.

22 October 2001

Securities and Exchange Commission opens inquiry into a possible conflict of interest related to the Enron's dealings with the partnerships set up by Mr Fastow.

23 October 2001

In a conference call Mr Lay tries to reassure investors and defends Mr Fastow's work.

24 October 2001

Enron sacks Mr Fastow.

28 October 2001

Enron chief executive Kenneth Lay calls Treasury Secretary Paul O'Neill to inform him of the financial problems facing the company. A second conversation takes place on 8 November.

Mr O'Neill says he declined to help the company, as he could not detect any ripple effects in financial markets from Enron's troubles.

29 October 2001

Mr Lay calls Commerce Secretary Don Evans again, asking him whether he could do anything to influence a decision by Moody's Investors Service to downgrade Enron's credit rating.

Mr Evans does not intervene, saying it would not be appropriate to influence a decision by a private credit rating agency

31 October 2001

The SEC inquiry is upgraded to a formal investigation.

8 November 2001

Enron revises its financial statements for the past five years. Instead of the massive profits claimed previously, the firm now says it actually lost \$586m.

9 November 2001

Rival energy trader Dynegy announces it will take over the much larger Enron for more than \$8bn in shares.

19 November 2001

deepest talent we have ever had in the organisation, our business is extremely strong, and our growth prospects have never been better

Kenneth Lay, 14 August 2001

My personal belief is that Enron stock is an incredible bargain at current prices and we will look back a couple of years from now and see the great opportunity that we currently have

Kenneth Lay, reported comments on Enron's intranet chat site, 26 September 2001

We have decided to take these [\$1bn] charges to clear away issues that have clouded the performance and earnings potential of our core energy businesses

Kenneth Lay, 16 October 2001

I cannot imagine Enron's attorneys or accountants would allow it to do something illegal.

Enron says its third-quarter losses are higher than originally stated, and warns it needs to find financing for a \$690m debt due by the end of the month. **These challenges do not last for a solid company, and we think Enron is one**

20 November 2001

Enron's share price drops to its lowest level in 10 years - shedding nearly 23% in one day - as investors worry whether the company can survive its financial troubles.

Merrill Lynch analyst Donato Eassey, 22 October 2001

21 November 2001

Enron secures an extension of its \$690m debt payment.

26 November 2001

Enron shares fall a further 15% to \$4.01.

28 November 2001

Dynegy pulls out of the takeover deal after Enron's credit rating is downgraded to junk bond status.

Enron shares plunge below \$1 - the stock experiences the heaviest single-day trading volume in history for firm listed on the New York Stock Exchange and the Nasdaq

2 December 2001

Enron files for Chapter 11 bankruptcy protection and sues Dynegy for wrongful termination of the merger.

As the collapse unfolds the company bars its employees from selling the company shares locked into their retirement plans.

9 January 2002

The US Justice Department confirms it has begun a criminal investigation of Enron.

10 January 2002

The White House confirms that Enron boss Kenneth Lay lobbied for government support shortly before the company collapsed.

The company's auditor Andersen acknowledges that its employees destroyed some Enron documents.

Attorney General John Ashcroft, who received campaign funds from the company for his 2000 Senate race, excludes himself from the investigation - as does the 100-strong team of federal investigators in Houston, where Enron is based.

12 January 2002

The Justice Department names Joshua Hochberg, head of its fraud division, as acting attorney to oversee the criminal investigation into Enron.

15 January 2002

Andersen fires executive David Duncan who was in charge of auditing Enron and places three other employees on administrative leave.

16 January

Enron shares delisted on New York stock market.

23 January

Enron chairman and chief executive Kenneth Lay resigns.

24 January

Congressional hearings into the Enron affair begin

25 January

Clifford Baxter, Enron's former vice chairman and chief strategy officer, commits suicide. He had left the firm abruptly in May 2001, after reportedly clashing with Jeff Skilling over the firm's accounting practices.

27 January

US Vice President Dick Cheney says he is willing to go to court, in order to keep secret details of meetings with Enron officials. He had been asked to disclose documents, amid suspicion that Enron had been able to influence government energy policy.

28 January

Some 400 current and former staff launch a lawsuit against Mr Lay, Mr Skilling, Andersen and others, claiming damages for the money they lost in Enron's employee share ownership scheme.

29 January

Stephen Cooper, from the US restructuring firm Zolfo Cooper, is named as interim chief executive. He is joined by new chief operating and financial officers.

4 February

At the start of a jam-packed week for Congressional hearings, the firm's former chief executive and chairman Kenneth Lay refuses to testify because of what his lawyer calls a "prosecutorial climate".

November 29, 2001

Page One Feature

Enron Faces Collapse as Dynegy Bolts And Stock Price, Credit Standing Dive

By REBECCA SMITH and JOHN R. EMSWILLER

Staff Reporters of THE WALL STREET JOURNAL

Enron Corp., the once-mighty energy trader at the center of the nation's vast deregulated market for electricity and natural gas, wobbled on the brink of collapse Wednesday after credit-rating agencies downgraded its debt to junk status.

Following the ratings announcements -- which force Enron to accelerate repayment of billions of dollars of debt from cash it doesn't have -- its smaller cross-town rival in Houston, Dynegy Inc., called off a planned merger. The \$9 billion all-stock deal had been aimed at rescuing Enron after questions about a series of financial transactions involving company insiders shook investors and sent Enron's stock plunging. Dynegy Wednesday accused Enron of "misrepresentations" -- an allegation Enron denied and is expected to contest in court.

In a day that brought a series of devastating rapid-fire blows to Enron, its energy-trading business -- the nation's biggest, having handled \$1 trillion in transactions since November 1999 -- shut down for two and a half hours. Soon after the downgrade announcements, price quotes on Enron's widely used online trading system went blank, as one trader after another at the company's Houston headquarters walked away.

Enron's breathtaking fall will reshape the U.S. energy business, casting doubt on the belief that gas and electricity markets should be lightly regulated, with their management largely left to freewheeling traders. The fiercest industry proponent of free markets, Enron was vilified by California officials earlier this year, when the state's deregulated market careened off course. California's largest utilities lurched toward insolvency, leaving the state saddled with billions of dollars of debt.

No Access

With no access to credit and its only potential savior on the fly, it now appears that Enron may well be joining PG&E Corp.'s Pacific Gas and Electric unit in U.S. bankruptcy court. That would be a striking irony, since Enron once was regarded as being in the vanguard of a new way of doing business that would relegate old-line utilities like Pacific Gas and Electric to second-class status.

On its books, Enron has assets worth \$62 billion. But investors have little confidence in that number or in the company's accounting of its sizeable liabilities. Enron has recently been adjusting its financial figures, and many of its dealings are still poorly understood by outsiders. A week ago, the company said it had about \$1.6 billion in cash -- a surprise to many analysts who thought it had \$1 billion more than that.

The bottom line: Enron doesn't appear to have enough profitable assets to survive in its current form.

Under Chairman and Chief Executive Kenneth Lay, the company embarked on a revolutionary transformation, moving away from the business of running hard energy assets, such as power plants, and into the field of buying and selling contracts for energy. The crown jewel sought by Dynegy wasn't Enron's handful of power plants and pipelines around the globe, but its EnronOnline trading system.

Limiting Exposure

Since its start in November 1999, the system had become the dominant forum for U.S. electricity and natural-gas trading. As Enron's problems mounted in recent weeks, other trading firms began limiting their exposure to the company, causing its trading volume -- and hence, cash flow -- to dry up.

See full coverage of the rise and fall of Enron

See a chronology of Enron's recent woes

See a timeline detailing the rise and fall of Enron.

See a map of where Enron's major assets, operations and interests lie.

The sudden decline of Enron's once-potent trading business is one big reason Standard & Poors Ratings Group, Moody's Investors Service Inc. and Fitch Inc. pulled the trigger Wednesday. Noting that the Dynegy merger probably wouldn't go through, S&P also said Enron's woes in recent weeks had caused "significant damage" to its trading and marketing operations. The company's market capitalization has fallen from a peak of about \$70 billion in 2000 to less than \$1 billion.

S&P said that a voluntary filing by Enron under Chapter 11 of the U.S. Bankruptcy Code is "a distinct possibility." Chapter 11 gives a company protection from its creditors while it reorganizes.

Unwilling to concede defeat, Enron's chief financial officer, Jeff McMahon, said the firm is "reviewing all our options" but isn't contemplating liquidation.

Enron's stock and bond prices fell hard Wednesday. Its shares, which had been hovering at about \$4 as Dynegy and Enron worked to resuscitate the deal, closed at 61 cents in New York Stock Exchange composite trading. Enron's benchmark bonds fell to 20 cents on the dollar, down from their already-depressed level of 50 cents. Dynegy shares fell \$4.92, to close at \$35.97 in NYSE trading.

Enron, which has 21,000 employees, was dropped from the S&P 500 Index after the markets closed Wednesday.

The company's crash is likely to push regulators to keep a closer eye on such asset-light

energy traders that have reported huge profits while generating relatively little cash from operations. The Federal Energy Regulatory Commission is considering applying tougher rules to wholesale-energy markets, while other regulators will look more closely at accounting practices used by trading firms. "If you don't have the Ten Commandments, it's hard to find a sinner," said Nora Brownell, a Republican FERC commissioner.

It was Enron's habit of opening new markets, using imaginative financial structures and employing aggressive accounting methods that first brought it great success -- and then contributed to its downfall. Enron became a bold player in everything from commodities, such as electricity, to exotic financial instruments, such as "weather derivatives," a form of insurance used to cover weather-related losses.

The company made much of its profit by buying and selling energy many times over, capturing the difference between buyers' bids and sellers' offers. Unlike a traditional commodities exchange, open to all, natural gas and electricity are traded privately, with many transactions involving just two players.

The company also borrowed heavily, sometimes recording the debt on separate operations off Enron's balance sheets, meaning that debt wasn't immediately apparent to many investors. Enron poured a lot of this money into building its new markets. Wall Street analysts and, in private, some company executives now say the company also priced some of the assets it kept on its books at inflated levels. The company repeatedly has said its accounting has been entirely proper.

By last year, Enron was in the middle of about one quarter of the electricity and natural-gas deals done by energy producers, traders and utilities. It had big operations as far afield as Bolivia and India, and it had a seemingly unstoppable ability to produce ever-higher quarterly earnings. Fortune magazine called it the most innovative company in America and ranked it No. 7 on the Fortune 500. With annual revenue of \$100 billion, Enron had eclipsed International Business Machines Corp. and AT&T Corp.

Enron came unglued last month, after it disclosed a big quarterly loss and The Wall Street Journal reported that the company's chief financial officer and other executives had profited personally from partnerships that Enron used to move assets on and off its books. These profits apparently came at the expense of the company and its shareholders. The Journal also reported that the company was forced to shrink its equity base by \$1.2 billion. The Securities and Exchange Commission launched an investigation.

Previously, even though Enron's practices had worried some regulators, the Bush administration had kept its distance. Over the last decade, the company and its chairman, Mr. Lay, have been Mr. Bush's biggest financial backers, donating nearly \$2 million to his campaigns. Before the company's recent problems came to light, Mr. Lay enjoyed unusually good access to top administration officials, including Vice President Dick Cheney, who earlier this year drafted a new national energy plan that seemed to lean heavily on Mr. Lay's suggestions.

More recently, the White House hasn't stepped forward to defend Mr. Lay or Enron. And few

members of the energy-trading fraternity, who have always seen Enron as sharp-elbowed, did anything to help the company.

Dynegy saw an opportunity, though, to acquire the company against which it had always been compared. Dynegy Chairman Chuck Watson agreed to buy Enron in an all-stock transaction that valued the firm at \$9 billion, a pittance compared with its \$70 billion peak market value.

But Enron's stock price fell further after more disclosures that future profits weren't likely to be as strong as expected and volume started to dry up at the company's trading desk. Dynegy sought to renegotiate the price downwards.

Executives of the two companies had huddled since Sunday, first in Westchester County, N.Y., and then in Houston, trying to come up with a formula that would allow Enron to survive until a merger could be completed. The talks fell apart when it became clear that even a proposed additional \$1 billion investment from Dynegy and bankers J.P. Morgan Chase & Co. and Citigroup Inc.'s Citibank wouldn't be enough to see it through regulatory and shareholder approvals.

The disintegration of the Dynegy-Enron deal is a blow to the two huge banks, which were the leading cheerleaders and financiers behind the transaction. They had invested hundreds of millions of dollars to help get the deal done. Not only will the failure tarnish their status as merger-and-acquisition advisors, but they will also be on the hook, along with some 800 other creditors, in trying to recover several hundred million dollars in unsecured loans to Enron. J.P. Morgan shares were down \$2.30, to \$37.50, while Citigroup shares were down \$2.75, to \$47.80, in NYSE composite trading.

The breakdown of the talks will probably produce litigation. Dynegy used \$1.5 billion of funding provided by its part-owner, ChevronTexaco Corp., to help provide liquidity to Enron. As a result of the collapse of the merger agreement, Dynegy said it planned to claim the collateral on that investment -- all of the preferred stock of an Enron subsidiary, Northern Natural Gas, which owns 16,500 miles of interstate natural-gas pipelines between Texas and the Great Lakes.

Enron isn't likely to let that go without a fight. Neither Dynegy's Mr. Watson nor the company's president, Steve Bergstrom, attended the Westchester meeting. Mr. Watson was at the Mexican resort of Cabo San Lucas. As Enron's Mr. Lay flew back to Texas on Monday, believing he had an agreement to preserve the merger, he received a phone call saying that Mr. Watson wasn't happy with the terms. Enron executives asserted that they didn't breach any of the covenants of the merger agreement and didn't make any material misrepresentations to Dynegy.

Mr. Watson said he told Mr. Lay in a phone conversation early Wednesday that the deal was off. "I told him I was very disappointed we couldn't put this together," said Mr. Watson. "We part as friends," he added.

Mr. Watson said, "We worked our butts off to make this thing work." But he said Enron's "sharp deterioration" couldn't be ignored. "I wasn't about to put our balance sheet in

jeopardy," he said.

Natural gas prices on the New York Mercantile Exchange surged about 25 cents Wednesday morning on the Enron news, above \$3 per million British thermal units, then dipped back into negative territory because of other factors.

Another big worry for Enron is keeping its bankers at bay. Enron's fall isn't expected to rattle credit markets in the fashion of the 1998 collapse of another financial high-flyer, hedge-fund Long Term Capital Management. But Enron has an estimated \$13 billion in debt on its balance sheet and a further \$7 billion in off-balance-sheet financings. It may be on the hook for additional debt in connection with four dozen investment partnerships.

Bankers and regulators said the risk of Enron's debt problems having a broader impact is limited by the fact that many lenders to the firm have syndicated the debt, spreading smaller chunks of it among many institutions.

Still, the credit downgrade brings immediate pressure. An estimated \$3.9 billion of liabilities associated with two of those investment partnerships now will be triggered for repayment. Analysts estimate that even with the recent cash infusion from Dynegy and Enron's decision last month to draw down its remaining available credit lines, the company has less than \$2 billion in available cash.

So far, it doesn't appear that Enron has started negotiations with lenders over a "prepackaged" bankruptcy-reorganization plan that could limit litigation. The company has hired Weil Gotshal & Manges, a New York-based law firm well-known for its bankruptcy practice. Wednesday, Enron engaged investment bankers with the Blackstone Group to come up with a restructuring plan.

As soon as word came Wednesday that the Dynegy deal had fallen apart, a "war room" staffed by lawyers was set up on Enron's massive trading floor in Houston, with the goal of trying to stop suppliers and customers from trying to get out of pending contracts. Other traders struggled to meet Enron's delivery obligations.

"The utilities are all calling and want to make sure that the customers still want to take our gas, and the suppliers are wondering if we will pay for their gas," said one Enron trader. "We are going to have to be very innovative."

In the short term, there are fears that Enron's crippled state will, in the words of Merrill Lynch analyst Steve Fleischman, cast a "cloud of uncertainty" over all of the energy traders that do business with Enron. Other big traders, such as El Paso Corp., Mirant Co., Entergy Inc. and Duke Energy Corp., were busy yesterday, trying to calculate what exposure they still have to Enron.

In recent weeks, many of those companies, including Dynegy itself, have been cutting back on their trades with EnronOnline, fearing the company would fail. They have shifted their business to the rival Intercontinental Exchange and other trading systems. Most big energy-trading companies saw their stocks fall Wednesday.

Some predict the energy-trading business will now shrink, with no clear successor to Enron's throne. They point out that stocks of competitors haven't moved up in anticipation of seizing market share from Enron. If anything, Enron's demise as a major trader will reduce the number of transactions possible -- not only for energy products, but also for such commodities as metals and pulp and paper.

Enron's Recent Woes

Oct. 16: Enron takes \$1.01 billion charge related to write-downs of investments. Of this, \$35 million is attributed to partnerships until recently run by CFO Andrew Fastow. Enron also discloses it shrank shareholder equity by \$1.2 billion, as a result of several transactions including ones undertaken with Mr. Fastow's investment vehicle.

Oct. 19: The Wall Street Journal discloses that general partners of Fastow partnership realized more than \$7 million last year in management fees and about \$4 million in capital increases on an investment of nearly \$3 million in the partnership, set up principally to do business with Enron, according to an internal partnership document.

Oct. 22: Enron announces SEC will begin a probe of company's "related party transactions," including those with Fastow partnerships. Enron says it will fully cooperate.

Oct. 23: Enron's treasurer acknowledges the company may have to issue additional shares to cover potential shortfalls in investment vehicles it created, although he says the company believes it can repay about \$3.3 billion in notes that were sold by those investment vehicles without having to resort to issuing more stock.

Oct. 24: Enron replaces Mr. Fastow as CFO with Jeffrey McMahon, the 40-year-old head of the company's industrial-markets division.

Oct. 25: The company draws down about \$3 billion, the bulk of its available bank credit lines. The Fitch rating agency puts Enron on review for a possible downgrade, while another, Standard & Poor's, changes Enron's credit outlook to negative from stable. A noninvestment-grade rating would throw the company into default on obligations involving billions of dollars of borrowings.

Oct. 29: Moody's lowers its ratings by one notch on the Enron's senior unsecured debt and kept the company under review for a possible further downgrade.

Oct. 31: The SEC elevates to a formal investigation its inquiry into Enron's financial dealings.

Nov. 1: Enron says it has secured commitments for \$1 billion in financing from units of J.P. Morgan and Citigroup.

Nov. 5: Enron has held talks with private-equity firms and power-trading companies for a capital infusion of at least \$2 billion as it faces an escalating fiscal crisis.

Nov. 8: Enron reduces its previously reported net income dating back to 1997 by \$586 million, or 20%, mostly due to improperly accounting for its dealings with the partnerships run by some company officers.

Nov. 9: Dynegy announces a deal to buy Enron for about \$7 billion in stock. ChevronTexaco will inject \$1.5 billion into the deal immediately, and an additional \$1 billion upon closing.

Nov. 13: Enron Chairman Kenneth Lay decides to forgo a severance payment of \$60.6 million that could be triggered by Dynegy's planned acquisition of Enron.

Nov. 20: Enron warned that continuing credit worries, a decline in the value of some of its assets and reduced trading activity could hurt its fourth-quarter earnings.

Nov. 23: The Wall Street Journal reports that Enron is being sued by members of its employee-retirement plan, which has suffered losses because of its plunging stock price. Separately, the slide in its share price and mounting financial problems puts increasing pressure on Dynegy to renegotiate or walk away from its deal to acquire the firm.

Nov. 26: Enron has advanced talks to cut the price of the all-stock acquisition by Dynegy by more than 40% to about \$5 billion. Enron stock fell 70 cents to \$4.01, its lowest level in over a decade.

-- Alexei Barrionuevo contributed to this article.

Write to Rebecca Smith at rebecca.smith@wsj.com and John R. Emshwiller at john.emshwiller@wsj.com

Copyright © 2001 Dow Jones & Company, Inc. All Rights Reserved.
Copyright and reprint information.

Home > Business > Companies

Top Of The News

While Enron Burned, Wall Street Fiddled

Dan Ackman, Forbes.com, 11.29.01, 9:17 AM ET

NEW YORK - Question: What's an **Enron**?

Answer: An Enron is a company that markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services.

Next question: Delivering energy, that's good. But what's all this about marketing electricity and "risk management services?"

Answer: Good question, can we get back to you? But first let's talk about the numbers: Enron has great numbers.

This was essentially the dialogue between Wall Street and Enron (nyse: ENE - news - people) investors for the past few years, at least until yesterday when the **Dynegy** (nyse: DYN - news - people) pulled its offer to buy the company. Enron was involved in barely understood activities--mostly under the rubric of trading energy--and reported its results in mysterious ways, but it announced larger and larger revenue with each passing quarter. The modus operandi was: Ask no questions and we'll tell no lies.

More on Enron

[Tear Sheet](#)

[400 Best Big Cos](#)

[Special Report: Is Enron Out Of Gas?](#)

But Wall Street knew one thing: Enron made its numbers and the numbers were beautiful. In the four quarters of 2000, Enron reported sales of \$13 billion, \$16 billion, \$30 billion and \$41 billion. In the past four years, its revenue grew fivefold from \$20 billion to \$101 billion.*

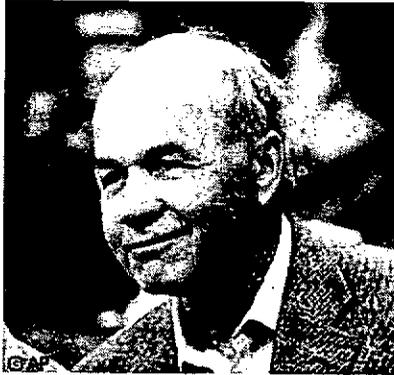
It grew by inventing and then dominating the energy trading business, still a relatively recent phenomenon. Other trading companies--Wall Street firms like Goldman Sachs (nyse: GS - news - people), Merrill Lynch (nyse: MER - news - people), Morgan Stanley (nyse: MWD - news - people) or Lehman Brothers (nyse: LEH - news - people)--rarely trade at more than 20 times earnings. But Enron, based in Houston, at one time traded as high as roughly 70 times earnings.

The celestial valuation may seem to have been justified by the booming revenue. But profits were growing at a much more ordinary rate. Enron's net income grew mightily after a down year in 1997, but then it inched up from \$1.01 per share in 1998 to \$1.12 per share in 2000. This profit growth is using the old numbers--before Enron was forced to restate its profit and loss statement earlier this month.

Meanwhile, the share price (adjusted) climbed from \$19 at the beginning of 1997 to \$82 at the end of 2000.

If Enron's profits were less spectacular and largely based on an increasing volume of paper transactions, not actual delivery of

oil or gas, its story was quite good. Enron would do for telecommunications what it had done already for energy; it would get into "broadband" and the Internet; it would team with **Blockbuster** (nyse: BBI - news - people) and deliver movies on demand. While its achievements were real, the fantasy is what sold.



Kenneth Lay, Enron's CEO and chairman

Major Wall Street analysts listened intently to the story and few questioned it. As of last month, 13 analysts covered the company. Eleven recommended it as a "buy" or "strong buy." Just one said "sell" and the other said "hold." This was just one week before the roof fell in, and Enron announced it would sell itself to Dynegy, its crosstown rival.

But the Dynegy deal has collapsed, its main business has shut down, and Enron seems likely to file for bankruptcy. How did it all collapse so quickly? Even when **Jeffrey Skilling**, the company's chief executive officer, resigned in August for "personal reasons" after just six months at the helm, no one on Wall Street responded to the red flag. Like other Enron executives, Skilling had exercised millions in stock options and sold shares while the company was flying high.

In October, the company disclosed \$1 billion in writedowns and a \$1.2 billion reduction in shareholder equity. The reduction in equity arose from "related party" transactions that turned out to be with investment partnerships involving Chief Financial Officer Andrew Fastow and other Enron executives. The debt issued by these partnerships, it turned out, was really Enron's. Fastow was forced to resign on Oct. 24. Enron's new disclosure itself left a lot of questions.

For Enron, the crisis snowballed. "The problem with Enron is their trading operation needed credibility to sustain itself," says Sean Egan, a managing director of Egan-Jones Ratings. "People will not make trades with a firm with significant credit problems." The partnerships owed as much as \$6 billion, Egan says, which the company had not disclosed.



Jeffrey Skilling resigned as CEO of Enron in August.

Christopher Ellinghaus, an analyst at Williams Capital Group, who covers Dynegy, but not Enron, says the principal business was sound and the revenue was real. But "the fundamental business was built on trust, like Wall Street." Enron's secondary businesses like trading broadband and its international energy business never did well. The collapse of the share price

undermined the value of Enron's collateral and its ability to borrow, he says.

Enron's last straw came when the major debt rating agencies downgraded its debt to junk status. This new designation meant that much of the money Enron borrowed was due right away, causing an even greater credit crisis. It is one of the most spectacular corporate flameouts in U.S. history.



PRESS ROOM

products+services
investors
work at enron

press room
contacts
enron.com home

You are here: >>enron.com >>Press Room >>Press Releases >>2001 >>Enron Corp.

Press Release

ENRON ANNOUNCES PROGRESS IN EFFORTS TO BOOST LIQUIDITY; REAFFIRMS COMMITMENT TO MERGER WITH DYNEGY; WORKING WITH MAJOR LENDERS TO RESTRUCTURE DEBT OBLIGATIONS

FOR IMMEDIATE RELEASE: Wednesday, November 21, 2001

HOUSTON – Enron Corp. (NYSE:ENE) announced today that it has closed on the remaining \$450 million of a previously announced \$1 billion in secured credit lines from JP Morgan, the investment-banking arm of JP Morgan Chase & Co., and Salomon Smith Barney, the investment-banking arm of Citigroup Inc. The \$450 million credit facility is secured by the assets of Enron’s Northern Natural Gas Company. A \$550 million credit facility, secured by the assets of Enron’s Transwestern Pipeline Company, closed on Nov. 16. Proceeds are being used to supplement short-term liquidity and to refinance maturing obligations.

> A

Enron also reaffirmed today its commitment to the merger with Dynegy Inc. “We continue to believe that this merger is in the best interests of our shareholders, employees, and lenders,” said Kenneth L. Lay, chairman and CEO of Enron. “It offers the opportunity to create a formidable player in the merchant energy business with substantial growth prospects and a strong financial position.”

Enron also announced that it is in active discussions with its primary lenders on a restructuring of its debt obligations to further enhance liquidity. “We have been in continuous contact with our banks and believe we can identify a mutually beneficial restructuring to enhance our cash position, strengthen our balance sheet and address upcoming maturities,” said Jeffrey McMahon, executive vice president and chief financial officer of Enron. “For example, we have been informed by the lead bank on the facility that the maturity on our \$690 million note payable obligation, disclosed on Nov. 19 in a Form 10-Q filed with the Securities and Exchange Commission, will be extended to mid-December, providing the time necessary to restructure the facility. We expect that extension to be formalized shortly.”

“We believe the interests of Chase and Enron’s other primary lenders are aligned in this restructuring effort,”

Elsewhere in
Press Release
Enron Corp.:
archive 200:
archive 200:
archive 200:
archive 200:
archive 199:
archive 199:
archive 199:
archive 199:
archive 199:

said James B. Lee, vice chairman of JP Morgan Chase & Co. "We will work with Enron and its other primary lenders to develop a plan to strengthen Enron's financial position up to and through its merger with Dynegy."

Enron is one of the world's leading energy, commodities and services companies. The company markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is www.enron.com. The stock is traded under the ticker symbol "ENE."

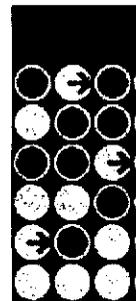
This press release includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Although Enron believes that its expectations are based on reasonable assumptions, it can give no assurance that its goals will be achieved. Important factors that could cause actual results to differ materially from those in the forward looking statements herein include Enron's ability to restructure scheduled maturities of debt; success in marketing natural gas and power to wholesale customers; and conditions of the capital markets and equity markets during the periods covered by the forward looking statements.

In connection with the proposed transactions, Dynegy and Enron will file a joint proxy statement/prospectus with the Securities and Exchange Commission. Investors and security holders are urged to carefully read the joint proxy statement/prospectus regarding the proposed transactions when it becomes available, because it will contain important information. Investors and security holders may obtain a free copy of the joint proxy statement/prospectus (when it is available) and other documents containing information about Dynegy and Enron, without charge, at the SEC's web site at www.sec.gov. Copies of the joint proxy statement/prospectus and the SEC filings that will be incorporated by reference in the joint proxy statement/prospectus may also be obtained for free by directing a request to either: Investor Relations, Dynegy Inc., 1000 Louisiana, Suite 5800, Houston, TX 77002, Phone: (713) 507-6466, Fax: (713) 767-6652; or Investor Relations, Enron Corp., Enron Building, 1400 Smith Street, Houston, TX 77002, Phone: (713) 853-3956, Fax: (713) 646-3302.

In addition, the identity of the persons who, under SEC rules, may be considered "participants in the solicitation" of Dynegy and Enron shareholders in connection with the proposed transactions, and any description of their direct or indirect interests, by security holdings or otherwise, are available in an SEC filing under Schedule 14A made by each of Dynegy and Enron.

###

Click [here](#) to download this press release in Adobe Acrobat



4.0 format.

Click [here](#) to download Adobe Acrobat 4.0.

For additional information please contact:

Karen Denne

(713) 853-9757

Copyright 1997-2003 Enron. All rights reserved.

PRESS ROOM

products+services
investors
work at enron

press room
contacts
enron.com home



You are here: >>enron.com >>Press Room >>Press Releases >>2001 >>Enron Corp.

Press Release

**ENRON ANNOUNCES NOTIFICATION BY DYNEGY
OF MERGER TERMINATION; CREDIT RATING
DOWNGRADED; TAKES ACTION TO PRESERVE
CORE FRANCHISE**

FOR IMMEDIATE RELEASE: Wednesday, November 28,
2001

HOUSTON – Enron Corp. (NYSE: ENE) announced today that it has received a notice from Dynegy Inc. that, effective immediately, it is terminating the merger agreement between it and Enron. In addition, Standard & Poor's, Moody's Investors Service and Fitch, Inc. have downgraded Enron's long-term debt to below investment grade.

In response to these developments, Enron is taking actions designed to preserve value in the company's core trading and other energy businesses. Chief among these is a temporary suspension of all payments other than those necessary to maintain core operations.

"Uncertainty during the past few weeks with respect to the merger has dramatically lowered the market's confidence in Enron and its trading operations. With Dynegy's termination of the merger and the ratings agency downgrades, we are evaluating and exploring other options to protect our core energy businesses," said Kenneth L. Lay, Enron chairman and CEO. "To do this, we will work to retain the employees necessary to the continuing operations of our trading and other core energy businesses."

Enron is reviewing Dynegy's actions today, including its assertion that it is entitled to exercise an option to purchase Enron's interest in Northern Natural Gas Company.

Enron is one of the world's leading energy, commodities and services companies. The company markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is www.enron.com. The stock is traded under the ticker symbol "ENE."

###

Elsewhere in
Press Rel

Enron Corp

archive 2001

archive 2001

archive 2001

archive 2001

archive 1999

archive 1999

archive 1999

archive 1999

Click [here](#) to download this press release in Adobe Acrobat 4.0 format.

Click [here](#) to download Adobe Acrobat 4.0.

For additional information please contact:

Mark A. Palmer

(713) 853-4738



Copyright 1997-2003 Enron. All rights reserved.

EXHIBIT 17



November 29, 2001

Via Facsimile and U.S. Mail

Giving you the power
to change the world.

Enron Power Marketing, Inc.
P.O. Box 4428
Houston, Texas 77210-4428
Attn: Power Contract Documentation Manager
Facsimile: (713) 646-2443

Enron Power Marketing, Inc.
1400 Smith
Houston, Texas 77002-7361
Attn: Assistant General Counsel, Trading Group
Facsimile: (713) 646-4818

Re: Notice of Default, Demand for Performance Assurance
and Notice of Early Termination Date with Regard to
Specific Transactions

Dear Sir or Madam:

Enron Power Marketing, Inc. ("EPMI") entered into a Master Energy Purchase and Sale Agreement (the "Agreement") with the City of Santa Clara doing business as Silicon Valley Power ("SVP") on September 10, 1999. Pursuant to that Agreement, and between June 5 and November 27, 2001, EPMI and SVP entered into a series of Transactions whereby SVP was to both sell to and purchase from EPMI certain Contract Quantities of Energy between and including the months of December 2001 and March 2002.

As you are certainly aware, both EPMI and its guarantor, Enron Corp. are both currently in default of that Agreement pursuant to sections 4.1 (e) and (g) since Enron Corp.'s rating has fallen below BBB- and therefore a Material Adverse Change has occurred:

An "Event of Default" shall mean with respect to a Party ("Defaulting Party"):

(e) the occurrence of a Material Adverse Change with respect to the Defaulting Party; provided, such Material Adverse Change shall not be considered an Event of Default if the Defaulting Party establishes and maintains for so long as the Material Adverse Change is continuing,

1500 Warburton Ave.
Santa Clara, CA 95050
(408) 261-5292
Fax: (408) 249-0217



Performance Assurance to the Non-Defaulting Party in form and amount acceptable to the Non-Defaulting Party; or

(g) with respect to EPMI, at any time, Enron Corp. shall have defaulted on its indebtedness to third parties, resulting in obligations of Enron Corp. in excess of \$100,000,000, being accelerated or capable of becoming accelerated

The term "Material Adverse Change" is defined with respect to EPMI as "Enron Corp. shall have long-term, senior, unsecured debt not supported by third party credit enhancement that is (a) rated by S&P below "BBB-" or (b) is not rated by S&P.

In accordance with paragraph 4.1(e) SVP hereby demands that EPMI provide to SVP a Letter of Credit as that term is defined in the Agreement, in the amount of \$31,750,000. Please provide the Letter of Credit by closed of business on December 3, 2001.

We look forward to receiving from EPMI a Letter of Credit in the amount of \$31,750,000 from a major U.S. commercial bank or a foreign bank with a U.S. branch office, and a credit rating of at least "A-" from S&P.

Sincerely,



Ann Hatcher
Division Manager, Risk Analysis
Silicon Valley Power

Cc: Mike McDonald, Vice President, Enron Power Marketing, Inc.
Jim Pope, Director of Electric Utility, Silicon Valley Power
Ray Camacho, Assistant Director, Silicon Valley Power
John Roukema, Assistant Director, Silicon Valley Power
Chad Wozniak, Division Manager Risk Management
Rol Pfeifer, Assistant City Attorney

EXHIBIT 18



December 3, 2001

Via Facsimile and U.S. Mail

Giving you the power
to change the world.

Enron Power Marketing, Inc.
P.O. Box 4428
Houston, Texas 77210-4428
Attn: Power Contract Documentation Manager
Facsimile: (713) 646-2443

Enron Power Marketing, Inc.
1400 Smith
Houston, Texas 77002-7361
Attn: Assistant General Counsel, Trading Group
Facsimile: (713) 646-4818

Re: Notice of Excuse of Performance, and Suspension of Performance,
by City of Santa Clara Due to Default by EPMI and Enron Corp.

Dear Sir or Madam:

As you are aware, on November 29, 2001 the City of Santa Clara doing business as Silicon Valley Power ("SVP") made a written demand on Enron Power Marketing, Inc. ("EPMI") that it provide Performance Assurance no later than 5:00 p.m. Pacific Standard Time today, December 3, 2001 as a result of certain breaches by EPMI of that Master Energy Purchase and Sale Agreement (the "Agreement") entered into by the parties on September 10, 1999 (See copy of SVP's November 29, 2001 letter attached). EPMI failed to provide Performance Assurance in any form to SVP by the deadline set.

Pursuant to sections 4.1 (b) (c) (d) (e) (f) and (g) of the Agreement, EPMI is currently in default of the Agreement. SVP hereby places EPMI on notice that SVP will suspend deliveries of energy to EPMI under the Agreement until EPMI provides the Performance Assurance demanded. Due to the fact that certain deliveries of energy have already been scheduled through December 4, SVP's suspension of deliveries cannot commence until 12:01am on Wednesday, December 5, 2001. Once EPMI provides Performance Assurance to SVP in the form of a Letter of Credit (as defined in the Agreement) and in the amount demanded, SVP will commence scheduling deliveries of energy to EPMI as soon as may be

1500 Warburton Ave.
Santa Clara, CA 95050
(408) 261-5292
Fax: (408) 249-0217



reasonably scheduled by SVP. This letter does not constitute a Termination of the Agreement pursuant to Section 4.2 of the Agreement.

We look forward to receiving from EPMI a Letter of Credit in the amount of \$31,750,000 from a major U.S. commercial bank or a foreign bank with a U.S. branch office, and a credit rating of at least "A-" from S&P.

Very truly yours,

Ann Hatcher
Division Manager, Risk Analysis

Cc: Stewart Rosman, Enron Power Marketing, Inc.
Mike McDonald, Vice President, Enron Power Marketing, Inc.
Jim Pope, Director of Electric Utility, Silicon Valley Power
Ray Camacho, Assistant Director, Silicon Valley Power
John Roukema, Assistant Director, Silicon Valley Power
Chad Wozniak, Division Manager Risk Management
Rol Pfeifer, Assistant City Attorney

EXHIBIT 19

Yoder, Christian

From: Yoder, Christian
Sent: Friday, November 30, 2001 12:48 PM
To: Choi, Paul; Rosman, Stewart; Lackey, Chris; Buerkle, Jim
Cc: Hail, Steve C. (Legal); Rasmussen, Dale; Beiden, Tim
Subject: Arguments for termination now

Hey Guys, here are the legal arguments for trying to get reluctant counterparties to settle with us pre-bankruptcy:

After Bankruptcy we have a number of options that all favor us and all potentially hurt them:

1. Option to keep performing and collecting money. (they can't lock in term replacement power)
2. The Trustee can elect to terminate and enforce the two way payments (predominant view of hordes of Houston and New York lawyers)
3. The Trustee can assign the contract (to the worst f...ing credit counterparty we can find if you don't settle now).
4. If the market changes and the contract is out of the money to us, the Trustee can terminate it and, you will get a penny on the dollar for your in the money two way payment.

When confronted with these reasons, the vast majority of counterparties always elect to terminate before bankruptcy. Let's gear up our efforts and try to drag money in. ---cgy

ORP0000617

EXHIBIT 20

1 Q. Was one side or the other paid?

2 A. I'm not sure who, if anyone, paid.

3 Q. Were you instructed to attempt to terminate all
4 the term power contracts that you were involved in?

5 A. No.

6 Q. I want to mark something as Exhibit 5 to your
7 deposition. It's an e-mail that was addressed to you
8 that's dated November 30th of 2001, if you'll take a look
9 at that and just tell me if you've seen that one before.

10 (EXHIBIT 5, 11/30/01 Email, Bates ORP0000617,
11 marked.)

12 A. I don't recall the e-mail, but it is addressed
13 to me.

14 BY MR. COOK: (Continuing)

15 Q. And did you receive instructions consistent
16 with this e-mail at or about this time, November of 2001?

17 A. I may have. I may have.

18 Q. And so did you receive instructions at or about
19 November of 2001 that Enron was attempting to terminate
20 all of its power -- term power contracts?

21 A. I don't recall if I did.

22 Q. Is that your best judgment, though, that you
23 received such instructions?

24 A. There was -- there was influence to want to
25 bring cash in the door, and so that may have -- I

MOORE HENDERSON ALLEN & THOMAS - (503) 226-3313

107

1 remember them scrambling around for cash. And that may
2 have been the reason why they were looking at terminating

3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

contracts that were valuable.

Q. Did they only want to terminate some contracts or did they want to terminate all of the contracts?

MR. ADAMS: Well, his memory or --

MR. COOK: I'm asking what he remembers, his best judgment as to what you remember.

A. Could you repeat the question, please.

MR. COOK: Would you repeat the question, please.

(Reporter read back as requested.)

A. I think they wanted -- my best judgment is I think they wanted to terminate contracts that was in the money.

BY MR. COOK: (Continuing)

Q. Well, at this time was Enron preparing to go to bankruptcy?

A. The 30th? I think right around that time bankruptcy was looming.

Q. And did you understand that Enron was going to get out of the power business?

A. Yes.

Q. And so they wanted to terminate all of the contracts, right?

MOORE HENDERSON ALLEN & THOMAS - (503) 226-3313

108

1
2
3
4
5

MR. ADAMS: Objection; calls for speculation.

A. I'm not sure.

BY MR. COOK: (Continuing)

Q. You just can't remember?

A. I just can't remember.

- 6 Q. Okay. when did you find out that Enron was
7 planning to get out of the power business?
8 A. what specific date?
9 Q. Yes, sir.
10 A. I think I saw the writing on the wall probably
11 two to three weeks before Enron filed for bankruptcy.
12 Q. which was when? when did Enron file for
13 bankruptcy?
14 A. I'm not -- I think sometime in December of
15 2001.
16 Q. So you think that sometime slightly before this
17 e-mail is when you saw the writing on the wall?
18 A. Yes.
19 Q. what made you see the writing on the wall?
20 A. Just the impending -- just the -- a lot of the
21 scandals that were coming to a front, the stock price was
22 a pretty good indication because the stock market is a
23 good indication of that.
24 Q. Did Enron up here in Portland have a
25 fundamentalist area?

MOORE HENDERSON ALLEN & THOMAS - (503) 226-3313

109

- 1 A. Yes.
2 Q. what are fundamentalists?
3 A. Fundamentalist group was a group that would try
4 to fail to supply demand stacks in various parts of the
5 west to predict what the pricing, predict what type of
6 demand versus supply; pretty much figure out what the
7 supply and demands curve meets.
8 Q. So they were like a research group?

EXHIBIT 21

From: Belden, Tim
Sent: Wednesday, November 28, 2001 12:26 PM
To: DL-Portland World Trade Center
Subject: Update

This morning Enron's credit rating was downgraded to junk status which is below investment grade. This is very bad news for Enron's future prospects.

The flurry of activity that you see from the trading and scheduling team is a direct result of our credit downgrade. Many of our contracts have provisions that allow our customers to stop performing on their contracts with us if Enron's credit rating falls below investment grade and if we are unable to post sufficient collateral. The trading, scheduling, and legal team are working together to figure out how to meet our physical delivery obligations over the next several weeks. This is our number one priority right now.

I will still be holding the floor meeting at 1 PM today. I would like to hold the meeting earlier but am not sure that I will be able to do so. I know that people are very concerned about our ever-worsening status. I know that you want information as soon as possible. If I am able to meet before 1 PM I will send out an e-mail announcing an earlier meeting.

Tim

EXHIBIT 22

You are viewing document 57,650 (57650) of 1,368,775

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 59431
BOX_NO = WAS098
MEDIA_LABEL : Mailboxes (Green List); Bates No. ECF001382012
FILENAME : louise kitchen 2-7-02.pst
FROM : Bradford, William S.
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=WBRADFO>
TO : Kitchen, Louise
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Lkitchen>
DATE = 11/07/2001
TIME : 20:30:03 -0600
ORIGIN : KITCHEN-L
SUBJECT : RE: FW: Update on SRP Margin Call
FOLDER : \ExMerge - Kitchen, Louise\Americas\ESVL
HEADER : Microsoft Mail Internet Headers Version 2.0
 Received: from NAHOU-MSMBX01V.corp.enron.com
 ([192.168.110.38]) by NAHOU-MSMBX03V.corp.enron.com with
 Microsoft SMTPSVC(5.0.2195.2966);
 Wed, 7 Nov 2001 20:30:03 -0600
 X-MimeOLE: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: RE: FW: Update on SRP Margin Call
 Date: Wed, 7 Nov 2001 20:30:03 -0600
 Message-ID:
 <DD62A2580388DD40840E3C5782D6898E585173@NAHOU-
 MSMBX01V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <DD62A2580388DD40840E3C5782D6898E585173@NAHOU-
 MSMBX01V.corp.enron.com>
 Thread-Topic: Update on SRP Margin Call
 Thread-Index:
 AcFn9NVmmMias4YvRb6t7EPL3heAgAAAL7+AAAG+9s0AAB33c
 A==
 From: "Bradford, William S." <William.S.Bradford@ENRON.com>
 To: "Kitchen, Louise" <Louise.Kitchen@ENRON.com>
 Return-Path: William.S.Bradford@ENRON.com
 X-OriginalArrivalTime: 08 Nov 2001 02:30:03.0287 (UTC)
 FILETIME=[45769270:01C167FD]

MESSAGEID : dd62a2580388dd40840e3c5782d6898e585173@nahou-
msmbx01v.corp.enron.com

BODY : I talked with Despain. They are still in committee. Tim has told
them we need a response before early Houston time for the
market to digest any announcement.

-----Original Message-----

From: Kitchen, Louise

Sent: Wednesday, November 07, 2001 8:25 PM

To: Bradford, William S.
Subject: Re: FW: Update on SRP Margin Call
Importance: High

Any news from Despain?

Sent from my BlackBerry Wireless Handheld

-----Original Message-----

From: Bradford, William S. <William.S.Bradford@ENRON.com>
To: Kitchen, Louise <Louise.Kitchen@ENRON.com>
Sent: Wed Nov 07 19:35:07 2001
Subject: FW: Update on SRP Margin Call

-----Original Message-----

From: Hall, Steve C. (Legal)
Sent: Wednesday, November 07, 2001 7:30 PM
To: Belden, Tim
Cc: Sager, Elizabeth; Bradford, William S.; Ngo, Tracy
Subject: Update on SRP Margin Call
Importance: High

Tim,

As you know, SRP made a margin call to EPMI on Monday, by letter, seeking \$5.5 million in margin under a "one-off" contract. Tracy and I sent a letter back on Tuesday, arguing that the contract does not permit SRP to call for additional margin unless ENE is downgraded to junk status. SRP responded to our letter this afternoon. Predictably, SRP disagrees with our view of the contract and demands its margin. SRP says that it will treat our failure to post \$5.5 million by Monday, November 12, in either cash or an irrevocable letter of credit, as an event of default and will terminate the contract. If this happens, EPMI would have to make a payment of \$5.5 million within 10 days of receipt of an invoice from SRP.

As you know, Tracy and I strongly believe that the contract does not support SRP's right to call for margin at this time. However, the contract is not perfect (they drafted it, after all) and there is a sentence fragment that supports their position.

I recommend that we treat the SRP-EPMI dispute regarding the margining criteria under this Agreement as a "Dispute" under Section 17. Disputes are first submitted to Authorized Representatives (each company designates an Authorized Representative) to resolve. If the Authorized Representatives cannot reach agreement within 30 days, then the dispute is forwarded to you and your equivalent at SRP (the "Executives"). The Executives have to meet within 30 days to resolve the issue. If the Executives cannot resolve the issue within 30 days, then both parties can choose arbitration, or either party can take the matter to court. In summary, best case, this option gets us up to 90 days before we have to arbitrate/litigate the issue. Otherwise, we better prepare to post collateral Monday.

If you want to handle this matter by taking the "Dispute" route, I should send a letter out tomorrow to SRP giving notice that we

wish to try to resolve this through the contract's "Dispute" provisions.

Steve

(I should also mention that Tracy has informed me that SRP plans to issue a margin call on our WSPP contracts (approximately \$4.5 million) as soon as it calculates the amount due.)

Mr. Russell:

By this letter I confirm this morning's receipt of your letter dated November 2, 2001 and our conversation this afternoon.

In your letter, SRP requested that EPMI provide, pursuant to Section 14.1.3 of the Firm Wholesale Power Agreement dated October 30, 1998 ("Agreement"), "a cash margin or an irrevocable standby letter of credit in a form acceptable to SRP in the amount of \$5.5 million."

During our conversation I explained that EPMI was not obligated under the Agreement to provide a new form of security, but that EPMI was amenable to increasing the Enron Corporate guarantee by a mutually agreeable amount.

Section 14.1.3, upon which SRP relies, allows a Party to request a "guarantee or other form of security" to "*establish* creditworthiness." (Emphasis added.) Under this section, a Party may require another Party to (1) provide certain financial statements, (2) have an investment-grade credit rating, and/or (3) provide a guarantee or other form of security acceptable to the requesting Party. EPMI has already established its creditworthiness under the Agreement.

In contrast, SRP is now asking EPMI to post a new form of security (an irrevocable letter of credit or cash) to *maintain* its creditworthiness. Section 14.1.3 does not entitle either Party to request new forms of security. In fact, section 14.1.3 only gives a Party the right to "waive, release, increase, decrease, or reinstate" any guarantee requirement. Absent the occurrence of a Material Adverse Change, SRP cannot require EPMI to post new and different forms of security. *See* Section 27.5 of the Agreement.

Accordingly, because EPMI established its creditworthiness at the outset of this Agreement, and Enron Corporation's credit rating is still at investment grade, EPMI is not required to post a new and different form of security.

If you believe that another provision of the Agreement supports your request, or have a different interpretation of the Agreement, please send me a letter or e-mail setting out your analysis. Otherwise, please contact me at your convenience to discuss other mutually agreeable arrangements for reducing your credit exposure.

Very truly yours,

Tracy Ngo

You are viewing document 57,590 (57590) of 1,368,775



Select
This
Record

VIEW ALL
SELECTIONS

SELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 59368
 BOX_NO = WAS098
 MEDIA_LABEL : Mailboxes (Green List); Bates No. ECF001382012
 FILENAME : louise kitchen 2-7-02.pst
 FROM : Bradford, William S.
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=WBRADFO>
 TO : Kitchen, Louise
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Lkitchen>
 DATE = 11/14/2001
 TIME : 14:49:32 -0600
 ORIGIN : KITCHEN-L
 SUBJECT : FW:
 FOLDER : \ExMerge - Kitchen, Louise\Americas\ESVL
 HEADER : Microsoft Mail Internet Headers Version 2.0
 Received: from NAHOU-MSMBX01V.corp.enron.com
 ([192.168.110.39]) by NAHOU-MSMBX03V.corp.enron.com with
 Microsoft SMTPSVC(5.0.2195.2966);
 Wed, 14 Nov 2001 14:49:32 -0600
 X-Mimeole: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: FW:
 Date: Wed, 14 Nov 2001 14:49:32 -0600
 Message-ID:
 <DD62A2580388DD40840E3C5782D6898E5851A2@NAHOU-
 MSMBX01V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <DD62A2580388DD40840E3C5782D6898E5851A2@NAHOU-
 MSMBX01V.corp.enron.com>
 Thread-Topic:
 Thread-Index:
 AcFsb7P/tJxbYNhgEdWxlwBQi+MJ2QAAIVCAADdnqLA=
 From: "Bradford, William S." <William.S.Bradford@ENRON.com>
 To: "Kitchen, Louise" <Louise.Kitchen@ENRON.com>
 Return-Path: William.S.Bradford@ENRON.com
 X-OriginalArrivalTime: 14 Nov 2001 20:49:32.0875 (UTC)
 FILETIME=[DCE159B0:01C16D4D]

MESSAGEID : dd62a2580388dd40840e3c5782d6898e5851a2@nahou-
 msmbx01v.corp.enron.com

BODY :

-----Original Message-----
 From: Bradford, William S.
 Sent: Tuesday, November 13, 2001 4:39 PM
 To: 'fhillon@aep.com'
 Subject: RE:

Frank,

We have already done a number of things to help reduce AEP's exposure to Enron, none of which were required contractually. We made a margin payment of \$50,000,000. We arranged ring-trades with Allegheny which reduced your exposure by over \$90,000,000. We have proposed a number of assignments which would reduce your exposure to Enron incrementally.

Conversely, pursuant to our contracts AEP has failed to pay a \$1,311,625.46 swap settlement that was due on 11/8/01. Additionally, a margin call which was due to Enron on 11/8/01 in the amount of \$19,250,000 and remains unpaid. Additionally, AEP has failed to continue to trade with Enron which was not our understanding of the agreement.

Enron maintains its investment grade credit rating and is receiving \$1.5 billion of additional funded equity capital from Dynegy as announced on Friday. We are more than happy to continue helping you to reduce exposures in mutually agreeable manners but do not agree to the below list of requests. We need you to address these above issues before we can progress on these exposure reductions.

Regards,
Bill

-----Original Message-----

From: ksbrown1@aep.com@ENRON On Behalf Of fhilton@aep.com

Sent: Tuesday, November 13, 2001 12:19 PM

To: wbradfo@ect.enron.com

Subject:

Per our conversation on November 12, 2001, AEP has reassessed its risk tolerance for Enron Corporation. In light of the current status, we propose the following things to be done to allow for normal trading and other business activity to commence:

- A fully executed Master Set Off Agreement (MSA) with an Adequate Assurance provision and no MAC clauses.
- An agreement that allows for same day margining
- Cash collateral or Letter of Credit to bring exposure down to zero
- Work towards executing an EEI Agreement
- HPL post closing settlement payment must be paid as agreed by both parties
- Settlement of all payments due and past due

These are the critical issues we feel must be addressed to get things back to normal. We appreciate all that has been done thusfar in working to mitigate our exposure, however, we now feel that more should be done to protect what we have at risk.

I look forward to your reply, should you have any questions, comments or otherwise, please give me a call.

Best Regards,

Frank Hilton
Managing Director,
Chief Credit Officer

You are viewing document 1,131,652 (1131652) of 1,368,775



Select
This
Record

VIEW ALL
SELECTIONS

SELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 1176829
 BOX_NO = WAS122
 MEDIA_LABEL : Elizabeth_Sager_Jan2002
 FILENAME : esager (Non-Privileged).pst
 FROM : St. Clair, Carol
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=CSTCLAI>
 TO : Smith, Mike
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Notesaddr/cn=2ee97
 f18-211e482a-862564ff-5a6314>, Harris, Molly
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Mharris6>
 CC : Keller, James
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Notesaddr/cn=e323b
 9cf-f1eda68d-8625650e-5329b7>, Bradford, William S.
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Wbradfo>, Sager,
 Elizabeth </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Esager>,
 Black, Don </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Dbblack>,
 Castano, Marianne
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Notesaddr/cn=e1a26
 e0c-defe690-862564c6-6a59f0>
 DATE = 11/21/2001
 TIME : 18:48:21 GMT
 ORIGIN : Sager-E
 SUBJECT : RE: NIMO/Notice RE: Posting of Additional Security
 FOLDER : \Elizabeth_Sager_Jan2002\Sager, Elizabeth\Deleted Items
 MESSAGEID : 053c29cc8315964cb98e1bd5bd48e3082a7ee2@nahou-
 msmbx07v.corp.enron.com
 BODY : Mike and Molly:
 If we do post margin, what agreement will govern our rights and
 their rights with respect to such margin? Also, how important is
 this program to EES?

Carol St. Clair
 EB 4539
 713-853-3989 (phone)
 713-646-8537 (fax)
 281-382-1943 (cell phone)
 8774545506 (pager)
 281-890-8862 (home fax)
 carol.st.clair@enron.com

-----Original Message-----

From: Smith, Mike
 Sent: Wednesday, November 21, 2001 11:51 AM
 To: Harris, Molly
 Cc: St. Clair, Carol; Keller, James; Bradford, William S.; Sager,
 Elizabeth; Black, Don; Castano, Marianne
 Subject: RE: NIMO/Notice RE: Posting of Additional Security

Please keep marianne castano in the loop on this--she is the EES
 lawyer handling. MDS

From: Molly Harris/ENRON@enronXgate on 11/21/2001 11:10 AM

To: Carol St Clair/ENRON@enronXgate
cc: James E Keller/HOU/EES@EES, Mike D
Smith/HOU/EES@EES, William S
Elizabeth Sager/ENRON@enronXgate, Don
Black/ENRON@enronXgate
Subject: RE: NIMO/Notice RE: Posting of Additional Security

I received the margin letter this morning via Fax. However, it is backdated to Nov 19th for my phone call with Richard Ott at NIMO. We have 5 days to deliver (some flexibility to view it as 5 business days). The margin call is for \$4,283,512. It is to cover NIMO for settlement and imbalance risk for EES participation in their "Supplier Select" program.

Molly

-----Original Message-----
From: St. Clair, Carol
Sent: Wednesday, November 21, 2001 10:33 AM
To: Harris, Molly
Cc: Keller, James; Smith, Mike; Bradford, William S.; Sager, Elizabeth
Subject: RE: NIMO/Notice RE: Posting of Additional Security

What is the next step on this?

Carol St. Clair
EB 4539
713-853-3989 (phone)
713-646-8537 (fax)
281-382-1943 (cell phone)
8774545506 (pager)
281-890-8862 (home fax)
carol.st.clair@enron.com

-----Original Message-----
From: Harris, Molly
Sent: Tuesday, November 20, 2001 3:41 PM
To: St. Clair, Carol
Subject: FW: NIMO/Notice RE: Posting of Additional Security

FYI - Let's discuss. Thanks Molly

-----Original Message-----
From: Castano, Marianne
Sent: Tuesday, November 20, 2001 11:16 AM
To: Harris, Molly
Cc: Keller, James; Smith, Mike
Subject: NIMO/Notice RE: Posting of Additional Security

Molly:

Per your request, we did a bit of research regarding whether NIMO, pursuant to its gas tariff, can request additional security from us in light of the recent credit downgrades experienced by Enron Corp.

Under NIMO's "Supplier Select" program, credit appraisals and security requirements are reviewed by NIMO annually and

adjusted "as financial evaluations dictate". See PSC No. 218 - Gas, Leaf No. 186, Revision 3, effective August 1, 2000. NIMO may require a supplier to post security for the full amount of the supplier's credit exposure if (i) the supplier or its guarantor is at the minimum rating (listed as "BBB" from S&P or Fitch or "Baa2" from Moody's) and is placed on credit watch with negative implications by S&P, Fitch or Moody's or NIMO receives information that the supplier or its guarantor's credit rating could be downgraded below such minimum rating; or (ii) the supplier's status as a billing agent is terminated by another New York utility for failing to render timely bills to customers or to make timely payments to the utility. If in (i) the supplier's or guarantor's credit rating is not downgraded during the next 60 days, the security requirement will be lifted. See PSC No. 218 - Gas, Leaf No. 186.2.

In the event of (i) or (ii) above, the supplier may satisfy its security requirement by providing one of the following forms of security, as mutually agreed by NIMO and the supplier: (i) prepayment or an advance cash deposit which will accumulate interest at the applicable rate per annum approved by the NYPSC; (ii) a stand-by irrevocable letter of credit or surety bond issued by a financial institution with at least an "A" bond rating; (iii) a security interest in collateral found to be satisfactory to NIMO; (iv) a guarantee, acceptable to NIMO, by another party with a satisfactory credit rating of at least "BBB" by S&P or Fitch or "Baa2" by Moody's; (v) payments made by the supplier into a lockbox administered by a third party (which will reduce any security requirements to 50% of what would otherwise be required); or (vi) other mutually agreed means of providing or establishing adequate security. See PSC No. 218 - Gas, Leaf No. 186.4. For your information, NIMO may only call on the posted security in the following events: (i) after providing 5 day's notice to the supplier whenever the supplier fails to pay NIMO charges when due, unless the supplier makes full payment within the 5-day notice period; or (ii) if supplier files a petition in bankruptcy (or the equivalent, including an involuntary petition against the supplier) or if for any reason the supplier ceases to provide service to its customers under NIMO's Supplier Select program. See PSC No. 218 - Gas, Leaf No. 186.7. No prior notice is required under (ii).

Please call me re: the above if you have questions/need additional information.

MLC

You are viewing document 57,533 (57533) of 1,368,775

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 59305
 BOX_NO = WAS098
 MEDIA_LABEL : Mailboxes (Green List); Bates No. ECF001382012
 FILENAME : louise kitchen 2-7-02.pst
 FROM : Black, Don
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=DBLACK>
 TO : Lavorato, John
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Jlavora>, Kitchen,
 Louise </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Lkitchen>,
 Bradford, William S.
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Wbradfo>
 DATE = 11/21/2001
 TIME : 09:43:07 -0600
 ORIGIN : KITCHEN-L
 SUBJECT : FW: Performance / Surety Bonds
 FOLDER : \ExMerge - Kitchen, Louise\Americas\ESVL
 HEADER : Microsoft Mail Internet Headers Version 2.0
 X-MimeOLE: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: FW: Performance / Surety Bonds
 Date: Wed, 21 Nov 2001 09:43:07 -0600
 Message-ID:
 <F8150FDD08B515448433E03F4FFCD0BD6BADBB@NAHOU-
 MSMBX03V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <F8150FDD08B515448433E03F4FFCD0BD6BADBB@NAHOU-
 MSMBX03V.corp.enron.com>
 Thread-Topic: Performance / Surety Bonds
 Thread-Index:
 AcFxzjmRjL5tyvHRt+MgRgIN+JptgAAKXBgABRoTkAAHgPywAA
 AjtwwAAFAHBAAAM1IAA==
 From: "Black, Don" <Don.Black@ENRON.com>
 To: "Lavorato, John" <John.J.Lavorato@ENRON.com>,
 "Kitchen, Louise" <Louise.Kitchen@ENRON.com>,
 "Bradford, William S." <William.S.Bradford@ENRON.com>

MESSAGEID : f8150fdd08b515448433e03f4ffcd0bd6badbb@nahou-
 msmbx03v.corp.enron.com

BODY : FYI - Plenty of focus on limiting bonds and collateral to the LDC's

-----Original Message-----

From: Fite, Rebecca

Sent: Wednesday, November 21, 2001 9:27 AM

To: Kingerski, Harry; Steffes, James D.; Leff, Dan; Hughes, Evan

Cc: Ogenyi, Gloria; Sharp, Vicki; Herndon, Rogers; Black, Don;

Richter, Jeff; Mihalik, Teresa

Subject: RE: Performance / Surety Bonds

One more.

- Washington Gas: EES has parental guaranty. Due to current financial status, Washington Gas has requested Bond instead. RAC contact indicated no bond available - EES has 30 days to respond.

A note on the Con-Ed - Services/Operations has a work around for the few Mid-market deals origination is closing which will prevent us from increasing our security (Straight Dual Billing). Mass Market volume increase will drive any security increase in this market.

Thanks,
Rebecca

-----Original Message-----

From: Kingerski, Harry
Sent: Wednesday, November 21, 2001 9:17 AM
To: Steffes, James D.; Leff, Dan; Hughes, Evan
Cc: Fite, Rebecca; Ogenyi, Gloria; Sharp, Vicki; Herndon, Rogers; Black, Don; Richter, Jeff; Mihalik, Teresa
Subject: RE: Performance / Surety Bonds

... and just to be clear, here are the recent or current issues I am aware of and their status:

Con Ed, request for \$1 million security in lieu of parental guaranty: complete. \$1 million sent prior to 11/14 deadline. Request for additional security likely to come when Con Ed sees our increasing load.

SoCal Gas, request for margin sharing agreement in lieu of parental guaranty: complete. New contract signed and delivered 11/16. Retail and wholesale gas desks to work together to avoid occurrence of margin call for credit over \$5 million daily.

Peoples Gas of IL, request for letter of credit for \$40k in lieu of parental guaranty: deferred. Peoples agreed to suspend demand for l/c if further downgrade does not occur.

Virginia license for EES gas: complete, for now. Services served copy of application to other parties. Their comments due back to VA SCC by Dec 7.

Maryland license for EEMC gas: scheduled to be approved on provisional basis today. MD PSC will be reviewing generic requirement that parental guarantees be unconditional, unlimited, and unrestricted.

Pennsylvania, request for update to EES and EPMI bonds and request for increase in EES bond from \$250k to \$3.8m: Under review. New bond language has been sent to Mary Grisaffi. Trying to whittle down (or eliminate) increase.

CG&E, request for deposit associated with Transmission Service Agreement: being processed. Service request reduced from 100 MW to 25 MW to reduce cash outlay.

First Energy, requested new security in lieu of parental guaranty. deferred. First Energy agreed to continue accepting parental guaranty in absence of further downgrade.

If there are others we should know about, please let me know.

-----Original Message-----

From: Steffes, James D.

Sent: Wednesday, November 21, 2001 8:31 AM
To: Leff, Dan; Hughes, Evan; Kingerski, Harry
Cc: Fite, Rebecca; Ogenyi, Gloria; Sharp, Vicki; Herndon, Rogers;
Black, Don; Richter, Jeff
Subject: RE: Performance / Surety Bonds

After talking with Dan, I intend to set up a meeting to provide complete matrices on licensing and utility contracts sometime early during the week beginning Dec 3.

Also, just to make sure everyone is clear, Harry, Gloria, and Rebecca are on point during the next few weeks to ensure that EES and/or EPMI responds timely to any request for info, additional security, or other utility matters. This, of course, will continue to require help from legal, credit, and operations.

If anyone has any other questions, please give me a call.

Thanks.

-----Original Message-----

From: Leff, Dan
Sent: Tuesday, November 20, 2001 6:08 PM
To: Steffes, James D.; Hughes, Evan; Kingerski, Harry
Subject: RE: Performance / Surety Bonds

when can we discuss this?

thanks

-----Original Message-----

From: Steffes, James D.
Sent: Tuesday, November 20, 2001 8:24 AM
To: Leff, Dan; Hughes, Evan; Kingerski, Harry
Subject: RE: Performance / Surety Bonds

Dan --

I will get with Evan and his team and pull this together. Of course, much of the activity with Utilities is driven by their requirements and judgements (which change over time).

Jim

-----Original Message-----

From: Leff, Dan
Sent: Tuesday, November 20, 2001 8:19 AM
To: Hughes, Evan; Steffes, James D.
Subject: Performance / Surety Bonds

Jim / Evan -

As you are probably aware, the performance and surety bond market is difficult for us to navigate in and around in our current situation. As an example, EFS has been shut out of getting access to new bid and performance / payments bonds for its business that requires these. We are addressing this with the bonding companies now. All of their existing bonds are in place and in force.

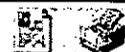
In light of this, I wanted to make sure that we are absolutely

current in all aspects of all bonding requirements with UDC's and LDC's.

Please send me the most current copy of your matrix that illustrates where we have existing bonds in place, what drives the capacity requirements, status, renewal / expiration date, current payment status, etc. I would like to make sure that we are all clear on how these work, what triggers increases / decreases in capacity, and other issues impacting our ability to continue to flow electricity and natural gas to our clients.

Thanks - Dan

You are viewing document 33,762 (33762) of 200,871

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

FIRSTBATES = ECD-000385793
LASTBATES = ECd-000385794
BEGIN_ATTACH = ECd-000385792
END_ATTACH = ECd-000385794
TITLE : CREDIT_GAS&ELECTRIC.XLS
EDOC_CREATED = 11/28/2001 21:49:15
EDOC_CRDATE = 11/28/2001
EDOC_MODIFY = 12/03/2001 18:04:37
EDOC_MODATE = 12/03/2001
EDOCFILENAME : CREDIT_GAS&ELECTRIC.XLS
EDOCFILEPATH : \EXMERGE - HKINGERS\SENT ITEMS
EDOC_SOURCE : HARRY-KINGERSKI.PST
FOLDER_LOC : \ExMerge - hkingers\Sent Items
CUSTODIAN : HARRY-KINGERSKI
ORIGIN : KINGERSKI-H
SOURCE : ENRON_HD1
OCR_TEXT : CREDIT FOR GAS RETAIL MARKETS
 Form of Requested New
 Utility Collateral Form of Utility
 (11/30/01)Collateral Status Next Steps Contact
 (post filing)
 SoCal Gas Margin call on None. Managing volumes to threshold
 tolerance.
 Imbalances & Revised contract
 Receivables recently put Company has informed us core accounts
 Mark Gaines
 in excess of in place switched to dual billing, 11/30.213 244-2824
 \$3 million
 SDG&E SDGE has terminated ESP consolidated Check for and
 retrieve Paul Szymanski
 billing for core accounts effective 11/30.collateral 619 6995078
 PG&E\$2 million bond\$5 million bond In negotiation. Waiting for
 correspondence Ken Bohn
 documenting demand. Existing bond good
 through 6/02..Jack Foley
 BGE\$250,000 Letter None, if gas flows Mark Valvanis
 EES of Credit to City Gate. No 410 291-4642
 new customers Tony Evering
 accepted 410 209-1613
 EEMC EEMC has provisional license for 90 days from
 11/21. PSC doing generic investigation on credit
 requirements for marketers.
 NIMO Corp Guaranty\$4.3 million cash Deadline for posting was
 11/29.Review progress
 Dave Draper negotiating lower collateral.
 Washington Gas Corp Guaranty\$1.0 million cash 11/30 deadline
 passed. Book does not warrant WGL says it will switch Frank
 Donnelly
 Light (MD)posting of collateral.customers to utility. Verify.202 624-
 6062
 Inform PSC.
 Washington Gas VA SCC has requested status report on pilot
 Tom Oliver

Light (VA)customers, 12/3.804 371-9358
License application is pending. Parties'
comments due at SCC 12/7
PSEG\$1.0 million cash Deadline for posting is 12/6. Martha
Savage
973 4307115

Peoples Gas (IL)Corp Guaranty\$40,000 cash Deadline for posting
is 12/3. Will not post Deb Egelhoff
EES for EES book.since deadline will occur after filing.312 240-
7546

EEMC I/c for EEMC book Set to expire Co. has requested
clarification of intention. Follow-up w/ answer.Josephine Lewis
12/31.Will pools be dissolved?312 240-4124

Rochester G&E Corp Guaranty\$0.7 million cash
Con Ed\$261,000\$425,000 Additional security has been
requested.Hollis Kreger

Need to respond.212 460-2079

Lone Star Gas Corp Guaranty\$0.2 million cash
(inter & intrastate)

CREDIT FOR ELECTRIC RETAIL MARKETS

Form of Requested New

Utility/State/Pool)Collateral Form of Utility

(11/30/01)Collateral Status Next Steps Contact

(post filing)

First Energy Parental Guaranty Have asked for clarification of our
plans and Doug Burnall

whether we intend to make payments, 11/30 330 437-1301

IL ICC Have requested evidence demonstrating Alan Pregozen
financial resources to remain an ARES, 11/30, Finance Dept.
due 12/28.

Must file in 1/02 for recertification, under normal
process.

SCE EES Parental Guaranty\$23.2 million Credit trying to get both
accounts covered under

EEMC\$31 million bond\$12.4 million existing EEMC bond. 12/5
deadline to resolve.

Dual billing will be default.

You are viewing document 33,800 (33800) of 200,871

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS

WORD FINDER:

go

FIRSTBATES = ECD-000385991
LASTBATES = ECd-000385991
TITLE : RE: Washington Gas Credit Policy
SUBJECT : RE: Washington Gas Credit Policy
EDOC_CREATED = 11/28/2001 15:46:35
EDOC_CRDATE = 11/28/2001
EDOC_MODIFY = 11/28/2001 15:46:36
EDOC_MODATE = 11/28/2001
EDOCFILENAME : 00003600.MSG
EDOCFILEPATH : \EXMERGE - HKINGERS\SENT ITEMS
EDOC_SOURCE : HARRY-KINGERSKI.PST
SENT = 11/28/2001 15:46:35
DATE_SENT = 11/28/2001
RECD = 11/28/2001 15:46:35
DATE_RECD = 11/28/2001
FOLDER_LOC : \ExMerge - hkingers\Sent Items
CUSTODIAN : HARRY-KINGERSKI
ORIGIN : KINGERSKI-H
SOURCE : ENRON_HD1
TO : SHIELDS, CRAIG
 HARRIS, MOLLY
 MIHALIK, TERESA
FROM : KINGERSKI, HARRY
CC : STEFFES, JAMES D.
 BLACK, DON
 VANDERHORST, BARRY

OCR_TEXT :

From:Kingerski, Harry
 Sent:Wednesday, November 28, 2001 3:47 PM
 To:Shields, Craig
 Harris, Molly
 Mihalik, Teresa
 Cc:Steffes, James D.
 Black, Don
 Vanderhorst, Barry
 Subject:RE: Washington Gas Credit Policy
 Molly - WGL's tariff allows them to demand collateral acceptable to them (cash, l/c, bonds) if we do not meet their credit qualifications (pp. 42-43 of MD tariff), which we don't. The security requirement they have calculated (contained in Craig's earlier e-mail) of \$1.0 million follows a process that is used for all gas marketers and was approved through the "Gas Roundtable" in MD, a cross-sectional group of industry players in MD. In other words, the MD Commission would uphold this calculation.
 I talked to Frank Donnelly, financing director, and Shelley Jennings, corporate treasurer, of WGL about the calculation. Nearly all of the collateral is related to "delivery risk", which is 60 days of peak day usage, reduced by about 50%,

priced at a forward NYMEX price.

This is not terribly unreasonable, and as I say, it would be acceptable to the MD PSC.

I told Frank and Shelly we'd let them know, one way or another, our response by this Friday. Thanks.

-----Original Message-----

From: Shields, Craig

Sent: Wednesday, November 28, 2001 12:59 PM

To: Harris, Molly

Mihalik, Teresa

Cc: Kingerski, Harry

Subject: FW: Washington Gas Credit Policy

Molly & Teresa,

Harry Kingerski suggested I forward this issue to you. WGL has a \$1.1 bond requirement

due on 11/30. Mary Grisaffi (RAC) tried to obtain a bond last week and was unsuccessful

due to Enron's credit rating.

Below are the attached files describing the bond requirement and calculation. WGL's POC

is Francis

Donnelly at (202) 624-6062. Harry is researching the tariff to determine the validity of this requirement.

Please contact me if you have any questions and/or require further information.

Thanks,

Craig

x55846

-----Original Message-----

From: bclark@washgas.com [mailto:bclark@washgas.com]

Sent: Tuesday, November 13, 2001 3:20 PM

To: cshields@enron.com

Cc: fdonnelly@washgas.com

SJennings@washgas.com

JWagner@washgas.com

Subject: Washington Gas Credit Policy

(See attached file: Enron Revised v2.doc)(See attached file: Enron ES

Security Requirement v2.xls)(See attached file: Enron Revised.doc)

1

You are viewing document 33,798 (33798) of 200,871

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS

WORD FINDER:

go

FIRSTBATES = ECD-000385989
LASTBATES = ECd-000385989
TITLE : RE: BGE credit requirement
SUBJECT : RE: BGE credit requirement
EDOC_CREATED = 11/28/2001 16:50:54
EDOC_CRDATE = 11/28/2001
EDOC_MODIFY = 11/28/2001 16:57:49
EDOC_MODATE = 11/28/2001
EDOCFILENAME : 00003598.MSG
EDOCFILEPATH : \EXMERGE - HKINGERS\SENT ITEMS
EDOC_SOURCE : HARRY-KINGERSKI.PST
SENT = 11/28/2001 16:56:40
DATE_SENT = 11/28/2001
RECD = 11/28/2001 16:56:40
DATE_RECD = 11/28/2001
FOLDER_LOC : \ExMerge - hkingers\Sent Items
CUSTODIAN : HARRY-KINGERSKI
ORIGIN : KINGERSKI-H
SOURCE : ENRON_HD1
TO : MIHALIK, TERESA
 SHIELDS, CRAIG
 HARRIS, MOLLY
FROM : KINGERSKI, HARRY
CC : STEFFES, JAMES D.
 BLACK, DON
 VANDERHÖRST, BARRY

OCR_TEXT :

From:Kingerski, Harry
 Sent:Wednesday, November 28, 2001 4:57 PM
 To:Mihalik, Teresa
 Shields, Craig
 Harris, Molly
 Cc:Steffes, James D.
 Black, Don
 Vanderhorst, Barry
 Subject:RE: BGE credit requirement
 I have confirmed with Mark Valvanis that BGE, for the time being,
 will not insist on an
 increase in collateral from \$250k to \$500k, as they were
 requesting. The caveat is that
 we can not add additional customers. Of course, if we anticipate
 any stop in flow of gas,
 they would like to know ASAP.
 I don't think any further action is needed for BGE as long as we
 flow gas.

1

EXHIBIT 23

You are viewing document 899,800 (899800) of 1,368,775

Select
This
RecordVIEW ALL
SELECTIONSSELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 936578
BOX_NO = WAS122
MEDIA_LABEL : Sara_Shackleton_Jan2002
FILENAME : sshackl (Non-Privileged).pst
FROM : St. Clair, Carol
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=CSTCLAI>
TO : Heard, Marie
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Mheard>, Jones,
 Tana </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Tjones>
CC : Shackleton, Sara
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Sshackl>, Cook,
 Mary </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Mcook>,
 Sager, Elizabeth
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Esager>, Mcginnis,
 Stephanie
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Smcginn>, Bradford,
 William S. </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Wbradfo>
DATE = 11/28/2001
TIME : 15:18:03 -0600
ORIGIN : Shackleton-S
SUBJECT : Contracts For Default Letters
FOLDER : \Sara_Shackleton_Jan2002\Shackleton, Sara\Inbox
HEADER : Microsoft Mail Internet Headers Version 2.0
 Received: from NAHOU-MSMBX07V.corp.enron.com
 ([192.168.110.98]) by NAHOU-MSAPP01S.corp.enron.com with
 Microsoft SMTPSVC(5.0.2195.2966);
 Wed, 28 Nov 2001 15:20:46 -0600
 X-MimeOLE: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: Contracts For Default Letters
 Date: Wed, 28 Nov 2001 15:18:03 -0600
 Message-ID:
 <053C29CC8315964CB98E1BD5BD48E3080C460F@NAHOU-
 MSMBX07V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <053C29CC8315964CB98E1BD5BD48E3080C460F@NAHOU-
 MSMBX07V.corp.enron.com>
 Thread-Topic: Contracts For Default Letters
 Thread-Index: AcF4UipDAxvqXXLJSMqtP9jKCqZ+lg==
 From: "St. Clair, Carol" <Carol.St.Clair@ENRON.com>
 To: "Heard, Marie" <Marie.Heard@ENRON.com>,
 "Jones, Tana" <Tana.Jones@ENRON.com>
 Cc: "Shackleton, Sara" <Sara.Shackleton@ENRON.com>,
 "Cook, Mary" <Mary.Cook@ENRON.com>,
 "Sager, Elizabeth" <Elizabeth.Sager@ENRON.com>,
 "McGinnis, Stephanie" <Stephanie.McGinnis@ENRON.com>,
 "Bradford, William S." <William.S.Bradford@ENRON.com>
 Return-Path: Carol.St.Clair@ENRON.com

X-OriginalArrivalTime: 28 Nov 2001 21:20:46.0386 (UTC)
FILETIME=[8B5CF120:01C17852]

MESSAGEID : 053c29cc8315964cb98e1bd5bd48e3080c460f@nahou-
msmbx07v.corp.enron.com

BODY : Tana and Marie:

We need over here copies of the following agreements so that we can send out default notices to counterparties that have failed to post margin. Margin letters were sent out on November 27 and margin is due by the end of today:

Media General, Inc. - 7-13-2000 ISDA
Societe Generale Paris 12-9-97 Master Swap Agreement
Wabash Valley Power Association 1-10-2001 Master Energy
Purchase and Sale
Agreement

El Paso Electric Company 1-22-2001 Master Power Agreement

Merced Irrigation District 3-25-99 ISDA

Eugene Water & Electric Board (City of Eugene) 10-30-2000 ISDA

City of Shasta Lake 11-21-2000 Master power Agreement

City of Sanata Clara California 9-10-99 Master Power Agreement

Snohomish PUD No. 1 1-26-2001 Master Power Agreement

Valley Electric Association Inc. 2-13-2001 Master power
Agreement

Colorado River Commission 6-6-2000 Master Power Agreement

Each contract needs to be checked to see if the due date for posting was today and to see what rights we have to declare an event of default. All copies of response letters should be sent to Stephanie McGinnis who is in conference room 06736 in EB - South. Sara will coordinate with you.

Carol St. Clair
EB 4539

713-853-3989 (phone)

713-646-8537 (fax)

281-382-1943 (cell phone)

8774545506 (pager)

281-890-8862 (home fax)

carol.st.clair@enron.com

EXHIBIT 24

You are viewing document 899,906 (899906) of 1,368,775



Select
This
Record

VIEW ALL
SELECTIONS

SELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 936685
 BOX_NO = WAS122
 MEDIA_LABEL : Sara_Shackleton_Jan2002
 FILENAME : sshackl (Non-Privileged).pst
 FROM : St. Clair, Carol
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=CSTCLAI>
 TO : Mellencamp, Lisa
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Lmellen>, Sager,
 Elizabeth </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Esager>
 CC : Shackleton, Sara
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Sshackl>
 DATE = 12/19/2001
 TIME : 16:13:18 -0600
 ORIGIN : Shackleton-S
 SUBJECT : Credit issues
 FOLDER : \Sara_Shackleton_Jan2002\Shackleton, Sara\Inbox
 HEADER : Microsoft Mail Internet Headers Version 2.0
 Received: from NAHOU-MSMBX07V.corp.enron.com
 ([192.168.110.98]) by NAHOU-MSAPP01S.corp.enron.com with
 Microsoft SMTPSVC(5.0.2195.2966);
 Wed, 19 Dec 2001 16:13:10 -0600
 X-MimeOLE: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: Credit issues
 Date: Wed, 19 Dec 2001 16:13:18 -0600
 Message-ID:
 <053C29CC8315964CB98E1BD5BD48E3080C462D@NAHOU-
 MSMBX07V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <053C29CC8315964CB98E1BD5BD48E3080C462D@NAHOU-
 MSMBX07V.corp.enron.com>
 Thread-Topic: Credit issues
 Thread-Index: AcGI2mwC6ROyBN67QaSXzGUkcKjj/A==
 From: "St. Clair, Carol" <Carol.St.Clair@ENRON.com>
 To: "Mellencamp, Lisa" <Lisa.Mellencamp@ENRON.com>,
 "Sager, Elizabeth" <Elizabeth.Sager@ENRON.com>
 Cc: "Shackleton, Sara" <Sara.Shackleton@ENRON.com>
 Return-Path: Carol.St.Clair@ENRON.com
 X-OriginalArrivalTime: 19 Dec 2001 22:13:10.0546 (UTC)
 FILETIME=[581A6F20:01C188DA]

MESSAGEID : 053c29cc8315964cb98e1bd5bd48e3080c462d@nahou-
 msmbx07v.corp.enron.com

BODY : Lisa and Liz;
 I am very concerned about the way that credit is handling and
 coordinating with us on margin issues. For over a week we have
 been waiting for them to compile and send to us information on

LC's that are due to expire at the end of December. We finally received a very cryptic spreadsheet this afternoon which requires a lot of follow up in order for us to determine what our rights are. I get the sense that credit assumes that since we are in bankruptcy we will never have the right to draw on LC's that we are holding when in fact we know that this is not necessarily true. For example, this afternoon I found out that we are holding an \$8 million LC for trades done with Enserco under an ISDA. The drawing condition is a failure to pay. Under the ISDA, they were required to renew this LC within 20 Business days of the expiry date which is 12/31. If they don't renew I'm hoping that we can declare an Event of Default, terminate, request payment of a termination payment and if they don't pay draw. I'm not sure that by following all of the cure periods in the ISDA we can be in a position to draw on the 31st. That's just one example. Do you have any thoughts on this?

Carol St. Clair
EB 4539
713-853-3989 (phone)
713-646-3393 (fax)
281-382-1943 (cell phone)
8774545506 (pager)
281-890-8862 (home fax)
carol.st.clair@enron.com

EXHIBIT 25

You are viewing document 899,962 (899962) of 1,368,775



Select
This
Record

VIEW ALL
SELECTIONS

SELECT ALL RECORDS
IN CURRENT SEARCH

CLEAR ALL SELECTIONS



WORD FINDER:

go

SDOC_NO = 936742
 BOX_NO = WAS122
 MEDIA_LABEL : Sara_Shackleton_Jan2002
 FILENAME : sshackl (Non-Privileged).pst
 FROM : Mellencamp, Lisa
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=LMELLEN>
 TO : Shackleton, Sara
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=SSHACKL>
 CC : St. Clair, Carol
 </O=ENRON/OU=NA/CN=RECIPIENTS/CN=Cstclai>
 DATE = 12/27/2001
 TIME : 17:22:44 -0600
 ORIGIN : Shackleton-S
 SUBJECT : RE: Requests for return of cash collateral
 FOLDER : \Sara_Shackleton_Jan2002\Shackleton, Sara\Inbox
 HEADER : Microsoft Mail Internet Headers Version 2.0
 Received: from NAHOU-MSMBX07V.corp.enron.com
 ([192.168.110.98]) by NAHOU-MSAPP01S.corp.enron.com with
 Microsoft SMTPSVC(5.0.2195.2966);
 Thu, 27 Dec 2001 17:22:45 -0600
 X-MimeOLE: Produced By Microsoft Exchange V6.0.4712.0
 content-class: urn:content-classes:message
 MIME-Version: 1.0
 Content-Type: application/ms-tnef;
 name="winmail.dat"
 Content-Transfer-Encoding: binary
 Subject: RE: Requests for return of cash collateral
 Date: Thu, 27 Dec 2001 17:22:44 -0600
 Message-ID:
 <C672A089695E0A48AE01F91C2B30601710E4A1@NAHOU-
 MSMBX07V.corp.enron.com>
 X-MS-Has-Attach:
 X-MS-TNEF-Correlator:
 <C672A089695E0A48AE01F91C2B30601710E4A1@NAHOU-
 MSMBX07V.corp.enron.com>
 Thread-Topic: Requests for return of cash collateral
 Thread-Index:
 AcGO+FgePk+DlpmLRt6qSVkW0P67JQAEhdpQAAb0m4AAAZG
 Fbw==
 From: "Mellencamp, Lisa" <Lisa.Mellencamp@ENRON.com>
 To: "Shackleton, Sara" <Sara.Shackleton@ENRON.com>
 Cc: "St. Clair, Carol" <Carol.St.Clair@ENRON.com>
 Return-Path: Lisa.Mellencamp@ENRON.com
 X-OriginalArrivalTime: 27 Dec 2001 23:22:45.0132 (UTC)
 FILETIME=[63A7B4C0:01C18F2D]

MESSAGEID : c672a089695e0a48ae01f91c2b30601710e4a1@nahou-
 msmbx07v.corp.enron.com

BODY : they will need to file a proof of claim for this amount. the money
 was not segregated so they have a claim just like any other
 unsecured creditor. we should call them and advise that they will
 need to file a claim for the funds.

-----Original Message-----

From: Shackleton, Sara
Sent: Thu 12/27/2001 4:32 PM
To: Mellencamp, Lisa
Cc:
Subject: RE: Requests for return of cash collateral

yes, earlier this year (posted in the form of "up front collateral").

-----Original Message-----

From: Mellencamp, Lisa
Sent: Thursday, December 27, 2001 1:13 PM
To: Shackleton, Sara
Subject: RE: Requests for return of cash collateral

was the cash margin given to us pre-petition?

-----Original Message-----

From: Shackleton, Sara
Sent: Thursday, December 27, 2001 11:03 AM
To: Mellencamp, Lisa
Cc: St. Clair, Carol
Subject: Requests for return of cash collateral

Lisa:

ENA has received a second written request from a financial counterparty (Union Spring Fund Ltd.) for the return of \$150,000 cash collateral plus interest. The cash was posted as initial margin on trade date of the swaps. We have confirmed that all trades were terminated as of mid-December, 2001. The counterparty has not sent a "termination letter" as there was nothing to terminate, but has sent a letter requesting return of the collateral.

Although we may not want to return the cash, aren't we obligated to do so?

Sara Shackleton
Enron Wholesale Services
1400 Smith Street, EB3801a
Houston, TX 77002
Ph: (713) 853-5620
Fax: (713) 646-3490

EXHIBIT 26

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

-----	X	
	:	
In re:	:	Chapter 11
	:	
ENRON CORP., et al.,	:	Case No. 01-16034 (AJG)
	:	
Debtors.	:	Jointly Administered
	:	
-----	X	

**SECOND INTERIM REPORT OF NEAL BATSON,
COURT-APPOINTED EXAMINER**

January 21, 2003

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	BACKGROUND	5
	A. Enron Prior to Events of Fall 2001	5
	B. Fall 2001 Events	5
	C. The Bankruptcy Filings and Subsequent Events	11
III.	EXAMINER'S INVESTIGATION AND THIS REPORT	12
	A. Ongoing Investigation	12
	B. Matters Covered in This Report	12
	C. How to Read This Report	14
IV.	ENRON'S USE OF SPEs	15
	A. Overview	15
	B. Why Did Enron Manage its Financial Statements?	15
	C. Enron's Six Accounting Techniques	36
	D. The Impact of Enron's Six Accounting Techniques	46
	E. Enron's Misuse of its Six Accounting Techniques	49
	F. Interim Report on Enron's SPE Transactions	57
V.	PREPAY TRANSACTIONS	58
	A. Overview of Prepay Transactions	58
	B. Background of Prepay Transactions	59
	C. Examiner's Conclusions Regarding Prepay Transactions	66
VI.	SHARE TRUST TRANSACTIONS	67
	A. Overview of Share Trust Transactions	67
	B. Background of Share Trust Transactions	68
	C. Marlin	70
	D. Whitewing	73
	E. Examiner's Conclusions Regarding the Share Trust Transactions	76
VII.	MINORITY INTEREST TRANSACTIONS	79
	A. Overview of Minority Interest Transactions	79
	B. Background of Minority Interest Transactions	80
	C. Project Rawhide	83
	D. Examiner's Conclusions Regarding Project Rawhide	85
VIII.	TAX TRANSACTIONS	87
	A. Overview of Tax Transactions	87
	B. General Nature of Tax Transactions	89
	C. Aggregate Income Effect of Tax Transactions	93
	D. Examiner's Conclusions Regarding Tax Transactions	94

IX.	FOREST PRODUCTS TRANSACTIONS	95
	A. Overview of Forest Products Transactions.....	95
	B. Fishtail and Bacchus.....	96
	C. Sundance Industrial and Slapshot.....	100
	D. Examiner’s Conclusions Regarding Forest Products Transactions	102
X.	RELATED PARTY TRANSACTIONS.....	104
	A. Overview of Related Party Transactions.....	104
	B. Examiner’s Conclusions Regarding Related Party Transactions	105
XI.	FAS 140 TRANSACTIONS.....	107
	A. Overview of FAS 140 Transactions	107
	B. Background of FAS 140 Transactions.....	109
	C. Examiner’s Conclusions Regarding FAS 140 Transactions.....	111
XII.	BAMMEL TRANSACTIONS.....	113
	A. Overview of Bammel Transactions	113
	B. Background of Bammel Transactions	114
	C. Examiner’s Conclusions Regarding Bammel Transactions	116
XIII.	JEDI II TRANSACTIONS	118
	A. Overview of JEDI II Transactions.....	118
	B. Background of JEDI II Transactions	118
	C. Examiner’s Conclusions Regarding JEDI II Transactions	120
XIV.	MISCELLANEOUS TRANSACTIONS.....	122
	A. Overview of Miscellaneous Transactions.....	122
	B. Background of Miscellaneous Transactions	123
	C. Examiner’s Conclusions Regarding Miscellaneous Transactions.....	127
XV.	AVOIDANCE ACTIONS	129
	A. Overview of Avoidance Actions	129
	B. Avoidance Actions in SPE Transactions	130
	C. Selected Insider Avoidance Actions.....	130
	D. Selected Professional Avoidance Actions	132
XVI.	INTERIM NATURE OF REPORT	133
XVII.	FUTURE REPORTS	134

Appendix A	—	Certain Defined Terms
Appendix B	—	Accounting Standards
Appendix C	—	Legal Standards
Appendix D	—	Enron's Disclosure of Its SPEs
Appendix E	—	Prepay Transactions
Appendix F	—	Miscellaneous Transactions
Appendix G	—	Whitewing Transaction
Appendix H	—	Marlin Transaction
Appendix I	—	Minority Interest Transactions
Appendix J	—	Tax Transactions
Appendix K	—	Forest Products Transactions
Appendix L	—	Related Party Transactions
Appendix M	—	FAS 140 Transactions
Appendix N	—	Bammel Transactions
Appendix O	—	JEDI II Transactions
Appendix P	—	Avoidance Actions
Appendix Q	—	Schedules Depicting Impact of Enron's Six Accounting Techniques

I. INTRODUCTION

On December 2, 2001 (the "Petition Date") and on certain dates thereafter, Enron Corp. ("Enron") and certain of its affiliates (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11, Title 11, of the United States Code (the "Bankruptcy Code") with the United States Bankruptcy Court for the Southern District of New York (the "Court") (collectively, the "Bankruptcy Case").

This Court entered an Order on April 8, 2002 (the "April 8th Order") authorizing and directing the appointment of an examiner pursuant to 11 U.S.C. § 1104(c).¹ On May 22, 2002, the United States Trustee appointed Neal Batson (the "Examiner") as the examiner. The Court, by Order dated May 24, 2002, approved the appointment.

On September 21, 2002, the Examiner filed the First Interim Report of Neal Batson, Court-Appointed Examiner (the "September Report").² This Second Interim Report of Neal Batson, Court-Appointed Examiner, constitutes the Examiner's second

¹ Among other things, the April 8th Order authorized the examiner to:

inquire into, *inter alia*, all transactions (as well as all entities as defined in the Bankruptcy Code and prepetition professionals involved therein): (i) involving special purpose vehicles or entities created or structured by the Debtors or at the behest of the Debtors (the "SPEs"), that are (ii) not reflected on the Enron Corp. balance sheets, or that (iii) involve hedging using the Enron Corp. stock, or (iv) as to which the Enron examiner has the reasonable belief are reflected, reported or omitted in the relevant entity's financial statements not in accordance with generally accepted accounting principles, or that (v) involve potential avoidance actions against any prepetition insider or professional of the Debtors.

² The Examiner appreciates the efforts of several current Enron employees who have been helpful in providing data and explanations to the Examiner during the course of the investigation. When the September Report and this Report refer to these individuals in this capacity, the Examiner does not intend by these references to suggest any wrongdoing by the named individuals. In addition, any references in the September Report and this Report to meetings, communications, contacts and actions between the Examiner and third parties are intended to refer to the office of the Examiner, which shall include the Examiner and his professionals. Therefore, references to any meetings, communications, contacts, and actions taking place between the Examiner and a third party should not be construed as indicating that Neal Batson was present personally for such meetings, communications, contacts or actions.

report (the "Report").³

The Examiner has been authorized to investigate all transactions involving special purpose vehicles created or structured by the Debtors or at the behest of the Debtors (the "SPEs") and those individuals, institutions and professionals involved therein.⁴

Six SPE transactions were examined in the September Report, and the Examiner concluded that the transactions were, in varying degrees, susceptible of being

³ The Second Interim Report of Neal Batson, Court-Appointed Examiner was submitted to the Court, the Debtors and the Creditors' Committee (which was authorized to disseminate such report to its members) and their legal professionals on January 21, 2003 pursuant to the Court's Order Amending and Supplementing the Order of April 8th Pursuant to 11 U.S.C. § 1104(b) and § 1106(b) Directing the Appointment of Enron Corp. Examiner entered on January 10, 2003 [Docket No. 8667]. This Report reflects changes resulting from the: (i) correction of certain typographical and grammatical errors, (ii) resolution of certain privilege issues with the Debtors and (iii) clarification and amplification of certain statements in the Report based, in part, on discussions with representatives of and legal professionals for the Debtors and a member of the Creditors' Committee, J.P. Morgan Chase & Co. ("JPMorgan"). Notwithstanding these changes, the Examiner believes this Report does not contain any material changes to the Examiner's conclusions set forth in the Second Interim Report of Neal Batson, Court-Appointed Examiner submitted to the Court, the Debtors and the Creditors' Committee on January 21, 2003. In addition, pursuant to the Court's Second Order Further Amending and Supplementing the Order of April 8th Pursuant to 11 U.S.C. § 1104(b) and § 1106(b) Directing the Appointment of Enron Corp. Examiner, entered on February 14, 2003 [Docket No. 9246], this Report was submitted to the Department of Justice and the Office of the United States Trustee on or about February 27, 2003. No changes were made to the Report as a result of this submission.

Finally, in certain instances in this Report, the evidentiary reference is to a "Stipulation of Debtors." In such cases, the Examiner and the Debtors have entered into a stipulation as a method for establishing a fact in lieu of using a potentially privileged document.

⁴ The April 8th Order also provides that, to the extent possible, the Examiner shall avoid duplication of efforts of the Debtors and any official committee appointed in the Bankruptcy Case in connection with investigations to be pursued. The Examiner contacted the major parties in interest in the Bankruptcy Case, including, without limitation, the Debtors and the Official Committee of Unsecured Creditors (the "Creditors' Committee") to, among other things, coordinate to avoid duplication of work. In that regard, the Examiner and/or his professionals have met with a number of parties, including officers and employees of the Debtors; the Debtors' restructuring lawyers, Weil, Gotshal & Manges LLP ("Weil"); PricewaterhouseCoopers LLP ("PWC"), accountants to the Debtors in the Bankruptcy Case; Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden, Arps"), special counsel to the Debtors; Milbank, Tweed, Hadley & McCloy LLP ("Milbank") and Squire, Sanders & Dempsey L.L.P. ("Squire, Sanders"), co-counsel to the Creditors' Committee; Ernst & Young LLP ("E&Y"), accountants for the Creditors' Committee; Wilmer, Cutler & Pickering ("Wilmer Cutler"), counsel to the Powers Committee (as defined below); Deloitte & Touche LLP ("D&T"), accountants to the Powers Committee; several of the Debtors' major lenders; Harrison J. Goldin (the "ENA Examiner"), the court-appointed examiner in the bankruptcy case of Enron North America Corp. (f/k/a Enron Capital & Trade Resources Corp.) ("ENA"); and counsel for the plaintiffs in the Newby Class Action, Milberg Weiss Bershad Hynes & Lerach LLP and its bankruptcy counsel, Genovese Joblove & Battista, P.A.

recharacterized under a "true sale" challenge. If this were to occur, the remaining assets in these structures, having a value of approximately \$500 million, would be restored to the Debtors' estates.

This Report focuses on substantially all of Enron's material SPE transactions identified to date. The Examiner provides his preliminary views of the role of the SPEs in the collapse of Enron, including a discussion of how Enron used the SPEs in conjunction with six accounting techniques to impact dramatically its financial statements. For example, in the year 2000, with respect to the SPE transactions the Examiner has considered, 96% of Enron's reported net income and 105% of its reported funds flow from operations were attributable to these six accounting techniques. Moreover, were it not for the use of these six accounting techniques, Enron's reported debt at December 31, 2000, would have been \$22.1 billion rather than \$10.2 billion.

This Report also sets forth the Examiner's conclusions that many of these transactions are, in varying degrees, susceptible of "true sale" or substantive consolidation challenges which, if successful, would result in assets having an estimated aggregate value⁵ between \$1.7 billion and \$2.1 billion being restored to the Debtors' estates.⁶ Furthermore, the Examiner has identified potential avoidable transfers in the

⁵ Statements in this Report about estimated values of various assets or portfolios of assets are derived primarily from information provided to the Examiner by employees of the Debtors. In addition, the estimates typically are not based upon any independent valuation analysis and may not reflect the Debtors' current beliefs about the value of the assets. The Examiner has reflected estimated asset values in this Report primarily for the purpose of providing an indication of the general magnitude of the value of the assets remaining in various structures. Therefore, many of these values may not reflect the actual current fair market value of the assets.

⁶ Some, but not all, of the Enron entities that transferred the assets are Debtors in the Bankruptcy Case. Where a non-Debtor transferor is involved in a transaction that is recharacterized as a loan, the most expeditious method to permit the transferor to recover such assets may be for Enron to cause the transferor to file a voluntary petition as part of the Bankruptcy Case. The Examiner has not analyzed the avenues for similar relief in litigation pursued in either state or other federal courts. For purposes of this Report (as

face amount of approximately \$2.9 billion that, to varying degrees, may be recovered by the Debtors' estates.⁷

To assist the reader in understanding the context in which the Examiner's investigation is being conducted, the next section of this Report will briefly summarize certain events leading up to and surrounding Enron's bankruptcy filing.

well as the September Report), any references to assets being added to or otherwise available to the Debtors' estates shall be deemed to include any transferor of an asset, regardless of whether such transferor is actually a current debtor in the Bankruptcy Case. Furthermore, certain of the subject assets that are potentially recoverable as part of the Debtors' estates have been sold after the Petition Date, with the proceeds being held in escrow subject to further order from the Court. For purposes of the Report (as well as the September Report), references to assets being added to, restored to or otherwise available to the Debtors' estates shall be deemed to include the proceeds of any asset sale. In addition, as noted in the September Report, in a "true sale" analysis, when credit support is provided by an *affiliate* of the asset transferor, rather than the asset transferor itself, an issue may be raised as to whether the presence of such credit support is a factor that can be relied upon to support a recharacterization of the purported sale as a loan. The Examiner believes that, even where the Enron party providing the credit support is the parent or other affiliate of the asset transferor, rather than the asset transferor itself, the existence of the credit support is a relevant factor in determining whether there was a "true sale." A discussion of this issue is contained in Appendix C (Legal Standards).

⁷ The ability of the Debtors to realize on certain of these avoidance actions is subject to (i) affirmative defenses of any transferee, (ii) valuation evidence (particularly in the case of constructively fraudulent transfers) and (iii) collectability. In this Report, the Examiner has sought to identify the likely affirmative defenses and, if possible, assess the likelihood of success of the action and defenses. As to valuation, both the Debtors and the Creditors' Committee have engaged investment bankers or other valuation experts. In order to avoid duplication of efforts, and because the Examiner does not have authority to prosecute actions on behalf of the Debtors' estates, the Examiner has not sought to retain such an expert. To the extent an action is pursued by the Debtors or the Creditors' Committee, investment bankers retained by such party may provide valuation advice.

Finally, the Examiner expresses no views as to collectability. The Examiner notes that many of the transferees of potentially voidable transfers are affiliates of Enron. For example, in Appendix I (Minority Interest Transactions), the Examiner identifies and discusses approximately \$859 million of preference claims against Ponderosa Assets, L.P., a wholly owned subsidiary of Enron. Appendix G (Whitewing Transaction) identifies and discusses preference claims in excess of \$900 million against Whitewing Associates, LLC, a partially owned subsidiary of Enron, and certain subsidiaries or affiliates of Whitewing Associates. As a result, affirmative relief against these affiliates may be of limited value, and in the event of substantive consolidation, all or part of such claims may not be recoverable. However, to the extent that these SPEs (or entities claiming through them) hold claims against Enron (or other Debtors), the Debtors may be able to utilize Section 502(d) of the Bankruptcy Code to disallow those claims. The result of such disallowance would be to limit or preclude recovery by investors in the SPE.

II. BACKGROUND

A. Enron Prior to Events of Fall 2001

Until the fall of 2001, Enron was one of the largest companies in the world.⁸ It was also considered to be one of the most innovative and successful.⁹ It grew from a traditional energy production and transmission company in the mid-1980s to a global enterprise that was an industry leader in the purchase, transportation, marketing and sale of natural gas and electricity, as well as other energy sources and related financial instruments, and in the development, construction and operation of pipelines and various types of power facilities.¹⁰ Enron reported revenues for the fiscal year ended December 31, 2000 in excess of \$100 billion.¹¹

B. Fall 2001 Events

In the fall of 2001, however, Enron made a series of financial disclosures and restatements of its financial statements pertaining in large part to certain related party transactions that triggered a chain of events culminating in its bankruptcy filing.¹²

⁸ According to the 2001 Fortune 500 Rankings, Fortune magazine ranked Enron as the seventh largest corporation in the world, based upon revenues. *The 500 Largest U.S. Corporations*, Fortune, Apr. 16, 2001, at F-1.

⁹ For example, Fortune magazine named Enron as the "Most Innovative Company in America" for five consecutive years. See *America's Most Admired Companies*, Fortune, Feb. 19, 2001, at 104; *America's Most Admired Companies*, Fortune, Feb. 21, 2000, at 110; *America's Most Admired Companies*, Fortune, Mar. 1, 1999, at 70; *America's Most Admired Companies*, Fortune, Mar. 2, 1998, at 86; *America's Most Admired Companies*, Fortune, Mar. 3, 1997, at 73.

¹⁰ Enron was also engaged in other types of businesses, including, among other things, broadband management and communications and operation of water, renewable energy and clean fuel plants.

¹¹ Enron Form 10-K filed with the SEC for the Year ended Dec. 31, 2000 (the "10-K for 2000").

¹² Perhaps prophetically, in a presentation at a joint meeting of the Audit and Compliance and Finance Committees of the Enron Board of Directors held in August 2001, Enron management and Committee members discussed various "stress scenarios." One scenario discussed included the following:

- (i) a warning that Enron would miss a quarterly earnings target,
- (ii) which would lead to a stock sell-off,

October 16th Earnings Release

In an earnings release on October 16, 2001, Kenneth Lay ("Lay"), Enron's Chairman and CEO, while expressing confidence in Enron's "strong earnings outlook," announced, among other things, that Enron was taking "after-tax non-recurring charges" of \$1.01 billion in the third quarter. These "non-recurring charges" resulted in a net loss for the third quarter of \$618 million compared to reported net income of \$404 million for the preceding quarter and \$292 million for the third quarter of 2000. Although there were several components to the charge,¹³ one component related to Enron's "early termination during the third quarter of certain structured finance arrangements with a previously disclosed entity."

-
- (iii) which would lead to the collapse of Enron's balance sheet because its off balance sheet vehicles capitalized with Enron stock would have to unwind,
 - (iv) which would lead to a credit downgrade,
 - (v) which would trigger a "material adverse change" event in the great majority of Enron's price risk management agreements with counterparties,
 - (vi) which would result in margin calls and the requirement that collateral be posted,
 - (vii) which would result in loss of investor confidence, loss of liquidity and loss of intellectual capital.

Materials for Joint Meeting of the Audit and Compliance and Finance Committees of the Enron Board of Directors, Aug. 13, 2001, Appendix II - Extracts from Market Risk Discussion Items from February 2001 Finance Committee Meeting, at II-7 [AB000204103-AB000204117] and Appendix III, at III-3 - Stress Scenarios [AB000204119-AB000204126].

¹³ Enron identified the components of this charge as:

- \$287 million from the write down of its investment in the Azurix Corp. water systems business;
- \$180 million from "restructuring" its Broadband Services business; and
- \$544 million "related to losses associated with certain investments, principally Enron's interest in The New Power Company ("New Power Company"), broadband and technology investments, and early termination during the third quarter of certain structured finance arrangements with a previously disclosed entity."

Enron Press Release, "Enron Reports Recurring Third Quarter Earnings of \$0.43 Per Diluted Share; Reports Non-Recurring Charges of \$1.01 Billion After-Tax; Reaffirms Recurring Earnings Estimates of \$1.80 for 2001 and \$2.15 for 2002; And Expands Financial Reporting," Oct. 16, 2001 [ELIB00002783]. Enron's third quarter ended September 30th.

The “previously disclosed entity” was LJM2 Co-Investment, L.P. (“LJM2”), a private investment limited partnership funded in December 1999. LJM2 was run by Andrew S. Fastow (“Fastow”), Enron’s CFO, and Michael J. Kopper (“Kopper”),¹⁴ an Enron employee, and had as its limited partners a significant number of institutional and individual investors.¹⁵ The charge related to Enron’s termination of four SPEs known as Raptor I, II, III and IV (the “Raptor SPEs”) pursuant to which Enron had entered into certain hedging transactions.¹⁶ As a result of this termination, Enron recognized the \$544 million after-tax charge to net income for the third quarter 2001.¹⁷ Enron also disclosed,

¹⁴ On August 21, 2002, Kopper pled guilty in a criminal information filed in the United States District Court for the Southern District of Texas alleging one count of conspiracy to commit wire fraud in violation of 18 U.S.C. § 371 and one count of conspiracy to engage in monetary transactions in property derived from specified unlawful activity (money laundering), in violation of 18 U.S.C. §§ 1956(h) and 1957. As part of his cooperation agreement (and to settle a related civil action filed by the United States Securities & Exchange Commission (“SEC”)), Kopper agreed to surrender \$12 million in assets and to cooperate fully with the United States Department of Justice.

¹⁵ Enron Form 10-Q filed with the SEC for the Quarter ended Sept. 30, 2001 (the “10-Q for 3Q/2001”), at 18-19, Note 4 to Consolidated Financial Statements in connection with related party transactions. Several of the Related Party Transactions are discussed below in Section X.

¹⁶ Enron entered into hedging transactions with the Raptor SPEs under which the Raptor SPEs agreed to pay to Enron the amount of the decline in the value of various Enron investments and other assets. As a result of these hedging transactions with the Raptor SPEs, Enron was able to offset or “hedge” for financial statement purposes a \$954 million decline in the value of a number of Enron’s investments during 2000 and the first three quarters of 2001. See 10-Q for 3Q/2001, at 24, Note 4 to Consolidated Financial Statements in connection with related party transactions. The Raptor SPEs’ principal asset was common stock of Enron, or in the case of Raptor SPE III, warrants to purchase stock in NewPower Holdings, Inc. (“NewPower Holdings”), the parent company of New Power Company. Thus, the Raptor SPEs’ ability to satisfy their hedging obligations to Enron was dependent upon the value of the Enron stock or warrants to purchase NewPower Holdings common stock they held. By the end of the third quarter of 2001, the hedging obligations of the Raptor SPEs exceeded the value of the assets available to satisfy those obligations. Enron terminated the structures by purchasing LJM2’s interest in the Raptor SPEs for \$35 million. As a result of this termination, Enron recognized the \$544 million after-tax charge to net income for the third quarter 2001. The pre-tax charge was \$710 million. See also Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. released February 1, 2002 (the “Powers Report”), at 125-33. LJM2 and another partnership, LJM Cayman, L.P. (“LJM1”), as well as other investment partnerships, were the principal focus of the Powers Report.

¹⁷ The pre-tax charge was \$710 million. 10-Q for 3Q/2001.

on October 16, 2001, that it would record a \$1.2 billion reduction in shareholders' equity as of the end of the third quarter.¹⁸

Other October Events

During this period, several other events occurred:

- On October 24, 2001, Enron announced that Fastow had been placed on leave of absence.¹⁹
- On or about October 30, 2001, and continuing through the Petition Date, a number of the senior managers of various Enron operating companies requested, and received, accelerated distributions of certain deferred compensation payments. Those distributions totaled in excess of \$50 million.²⁰
- On October 31, 2001, Enron announced that its Board of Directors had formed a Special Investigative Committee, headed by William Powers, Jr., Dean of the University of Texas Law School (the "Powers Committee"), to examine and recommend actions with respect to transactions between Enron and entities connected with related parties.²¹

Enron's November 8, 2001 Restatement and Third Quarter 2001 Form 10-Q.

On November 8, 2001, Enron announced its intention to restate its financial statements for 1997 through 2000 and the first and second quarters of 2001 to reduce previously reported net income by an aggregate of \$586 million.²² Enron attributed the

¹⁸ October 16, 2001, 9:00 a.m. C.T., Enron Corp. Conference Call regarding Third Quarter 2001 Earnings Release, Moderator: Mark Koenig (the "Earnings Release") [AB025204603-AB025204629].

¹⁹ Enron Press Release, "Enron Names Jeff McMahon Chief Financial Officer," Oct. 24, 2001 [ELIB00001788].

²⁰ Enron's Statement of Financial Affairs Exhibit 3b.2 (Docket No. 4500, as amended, Docket No. 5823) and certain supporting schedules provided to the Examiner's professionals by Enron's financial professionals. These transfers are discussed in Appendix P (Avoidance Actions) attached hereto.

²¹ Enron Form 8-K filed with the SEC on Nov. 8, 2001 (the "Nov. 8th 8-K"). Additional information surrounding the Related Party Transactions can be found in the Nov. 8th 8-K.

²² At the time of the announced restatement, the third quarter 2001 financial statements had not been filed, but a loss of \$618 million had been announced in the Earnings Release.

restatement to transactions involving three entities: Chewco Investments, L.P. ("Chewco"), a limited partnership run by Kopper; Joint Energy Development Investments Limited Partnership ("JEDI"), an investment partnership between Chewco and Enron; and LJM1, an investment partnership that had two institutional investors as limited partners and whose general partner was a limited partnership wholly owned by Fastow.

Enron filed its third quarter Form 10-Q, including interim financial statements, on November 19, 2001.²³ These financial statements gave effect to the previously announced "non-recurring charges" and restatement of prior financial statements.²⁴ In addition, in its third quarter 2001 balance sheet, Enron reported total debt under generally accepted accounting principles ("GAAP") of \$12.978 billion.²⁵

Enron's November 19, 2001 Bank Presentation

On November 19, 2001, the same day Enron filed its third quarter financial statements, senior Enron executives met with certain of Enron's bankers at the Waldorf Astoria hotel in New York City. Enron's objectives for the meeting were to restore creditor confidence, relieve its liquidity crisis and discuss its proposed merger with Dynegy, Inc. ("Dynegy").²⁶ During this meeting, Enron informed its bankers that, while

²³ 10-Q for 3Q/2001.

²⁴ Due to the pending investigation by the Powers Committee and the previously announced restatement, Enron's accounting firm, Arthur Andersen LLP ("Andersen"), was unable to finalize its review of these quarterly statements as required by SEC Rule 10-01(d) of Regulation S-X.

²⁵ 10-Q for 3Q/2001. The debt consisted of \$6.434 billion of short-term debt and \$6.544 billion of long-term debt.

²⁶ The proposed merger was ultimately abandoned by Dynegy, allegedly because of undisclosed liabilities of Enron. Enron sued Dynegy in this Bankruptcy Case (Adversary Proceeding No. 01-03626) (Docket No. 1) on the Petition Date, seeking more than \$10 billion in damages arising from Dynegy's alleged breach of contract for wrongful termination of the merger. On August 15, 2002, the parties announced they had settled the litigation. By motion dated August 19, 2002 filed in the Bankruptcy Case, Enron and its wholly

the debt reflected on its third quarter 2001 balance sheet under GAAP was \$12.978 billion, Enron's "debt" (as described in the presentation (the "Bank Presentation")) was \$38.094 billion.²⁷ Thus, as Enron noted, \$25.116 billion of debt was "off balance sheet," or in some cases, reflected on the balance sheet, but classified as something other than debt. Approximately \$14 billion of this \$25.116 billion of additional "debt" was incurred through structured finance transactions involving the use of SPEs. The Bank Presentation²⁸ divided the additional "debt" into the following eight categories: FAS 140 Transactions;²⁹ Minority Interest Financings;³⁰ Commodity Transactions with Financial Institutions;³¹ Share Trusts;³² Equity Forward Contracts;³³ Structured Assets;³⁴ Unconsolidated Affiliates;³⁵ and Leases, as shown in the following table:

owned subsidiary CGNN Holding Company, Inc. ("CGNN"), among others, sought approval of the settlement with Dynegy (Docket No. 5902). The settlement involved releases between the Enron Parties (as defined in the settlement agreement) and the Dynegy parties and the payment of \$25 million to Enron (pursuant to an escrow agreement). The settlement also provided for the release of \$63 million, including accrued interest, from an escrow account to CGNN. The Court approved the settlement by Order dated August 29, 2002 (Docket No. 6202). Certain parties appealed the Order approving the settlement. *See Ann C. Pearl v. Enron Corp.*, No. 02-CV-8489 (S.D.N.Y. filed Oct. 24, 2002).

²⁷ Enron Corp. PowerPoint Bank Presentation, Waldorf Astoria, New York, N.Y., Nov. 19, 2001 (the "Bank Presentation"), at 42 [AB000321534-AB000321605].

²⁸ The Bank Presentation is discussed in this Report because the Examiner believes it is useful in order to place the Examiner's investigation of the various SPEs in the overall context of Enron's financial affairs.

²⁹ Several of Enron's FAS 140 Transactions were discussed in the September Report. Additional discussion about those FAS 140 Transactions is included below in Section XI.

³⁰ Enron's minority interest transactions are discussed below in Section VII.

³¹ Enron's prepay transactions are discussed below in Section V. These transactions involved what the Counsel and Chief Investigator of the Permanent Subcommittee on Investigations of the Senate Governmental Affairs Committee has characterized as loans from JPMorgan and Citibank, N.A. ("Citibank") to Enron, but the transactions were structured as prepaid forward contracts for the future delivery of natural gas, crude oil or electric power. *See The Role of Financial Institutions In Enron's Collapse, Hearing before the Permanent Subcomm. on Investigations, Senate Comm. on Governmental Affairs, 107th Cong. (July 23, 2002) (statement of Robert Roach, Chief Investigator) (the "Financial Institutions Hearing") (available at http://www.senate.gov/~gov_affairs/072302roachindex.htm). One such prepay, known as the "Mahonia" transaction, has been the subject of litigation between JPMorgan, on behalf of Mahonia Limited and Mahonia Natural Gas Limited, and 11 insurance companies, which litigation was recently settled. *JPMorgan Chase Bank v. Liberty Mut. Ins. Co.*, No. 01-CV-11523 (S.D.N.Y. filed Dec. 18, 2001).*

Category of Additional "Debt"	Amount at 9/30/01 in billions
FAS 140 Transactions	\$2.087
Minority Interest Financings	\$1.690
Commodity Transactions with Financial Institutions	\$4.822
Share Trusts	\$3.352
Equity Forward Contracts	\$.304
Structured Asset	\$1.532
Unconsolidated Affiliates	\$10.733
Leases	\$.596
Total	\$25.116

C. The Bankruptcy Filings and Subsequent Events

Less than one month after its meeting with its bankers, Enron and certain of its affiliates filed for bankruptcy. In the months immediately following Enron's disclosures, allegations surfaced of securities fraud, accounting irregularities, energy market price manipulation, money laundering, breach of fiduciary duties, misleading financial information, ERISA violations, insider trading, excessive compensation and wrongdoing by certain of Enron's bankers.³⁶

³² Enron's share trust transactions are discussed below in Section VI.

³³ Under a typical equity forward contract, an issuer will sell equity securities to a counterparty for cash equal to the current price and agree to repurchase the same number of equity securities from the counterparty in the future for the original price plus a premium.

³⁴ The Destec Transaction (as described in the September Report) is an example of what Enron classified as a "structured asset" transaction in the Bank Presentation. *See also* Section XIV below.

³⁵ This category represents the amount of debt owed by entities that Enron did not consolidate, but accounted for under the equity method of accounting, such as Azurix Corp. (water system), Dabhol Power Company (power plant in India) and certain investment partnerships. According to Enron internal documents reviewed by the Examiner's counsel, much of this debt was non-recourse to Enron, but if the unconsolidated equity affiliate was unable to pay the debt, Enron's investment would be lost.

³⁶ Numerous Congressional Committees are investigating aspects of Enron's business activities or practices. In addition, there have been several class action lawsuits filed on behalf of shareholders and employees, which are still pending, naming the Debtors, certain of their directors, Andersen, certain other professionals, and others as defendants. These include *Newby v. Enron Corp.*, No. 01-CV-3624 (S.D. Tex. filed Oct. 22, 2001), a lawsuit alleging, among other things, violations of securities laws (the "Newby Class Action"). On December 19, 2002, the Court issued its Memorandum and Order Re Secondary Actors' Motions to Dismiss in which it denied Credit Suisse First Boston's motion to dismiss, granted in part and denied in part Bank of America Corporation's motion to dismiss, denied Merrill Lynch & Co.'s motion to dismiss, provided the lead plaintiff supplements its complaint, granted in part and denied in part Lehman

III. EXAMINER'S INVESTIGATION AND THIS REPORT

A. Ongoing Investigation

As discussed in the September Report, the Examiner's investigation continues to examine in detail a number of significant questions.³⁷ These include:

- Are the SPE structures subject to legal challenge such that assets that were purportedly transferred from the Debtors' estates should properly be considered part of the Debtors' estates?
- What was the role of the SPEs in the collapse of Enron?
- Did Enron use SPEs to manipulate its financial statements in violation of GAAP or applicable laws?
- Was there proper disclosure to the public of these SPE transactions under applicable disclosure standards?
- If it is determined that wrongful acts were committed in connection with the SPE transactions (including manipulation of Enron's financial statements in violation of GAAP or applicable laws), are the officers, directors, professionals or other third parties involved in such transactions liable under applicable legal standards?

B. Matters Covered in This Report

In this Report the Examiner provides: (i) his views on the role of the SPEs in the collapse of Enron, and particularly, how the SPEs were used to engineer its reported financial position and results without providing adequate disclosure; (ii) an interim report on substantially all of Enron's material SPE transactions identified to date; and (iii) his

Brothers Holdings, Inc.'s motion to dismiss, granted Deutsche Bank AG's motion to dismiss, granted Kirkland & Ellis's motion to dismiss, denied Vinson & Elkins L.L.P.'s ("Vinson & Elkins") motion to dismiss, denied Andersen's motion to dismiss, and dismissed certain of the lead plaintiff's claims relating to the 7% Exchangeable Notes and 8.375% Notes. Docket No. 1194. Other class actions include *Severed Enron Employees Coalition v. The Northern Trust Co.*, No. 02-CV-267 (S.D. Tex. filed Jan. 24, 2002), a lawsuit alleging, among other things, breach of fiduciary duty under ERISA; and *Tittle v. Enron Corp.*, No. 01-CV-3913 (S.D. Tex. filed Nov. 13, 2001), a lawsuit alleging, among other things, breach of fiduciary duty under ERISA.

³⁷ There will be additional questions to be addressed as the examination continues.

initial conclusions regarding certain avoidance actions available to the Debtors' estates against Lay, certain Enron employees who received accelerated deferred compensation payments on the eve of the Petition Date and certain professionals currently providing legal services to the Debtors and the Creditors' Committee.

This Report concludes that SPE assets and other transfers having substantial value could potentially be recovered or restored to the Debtors' estates.³⁸ Specifically, this Report concludes that:

- certain of the SPE structures are subject to legal challenge through "true sale" challenges or substantive consolidation of the SPEs involved in the structure;
- certain transfers made in connection with the SPE transactions can be avoided as constructively fraudulent or preferential; and
- certain transfers made to Lay, certain other Enron employees and certain professionals can be avoided as constructively fraudulent transfers and preferential transfers.

This Report will not discuss other potential legal issues, which include principles of equitable subordination, third-party culpability (including culpability of any officer, director, professional or financial institution) or other potential affirmative claims of the Debtors' estates. The Examiner is in the process of gathering and analyzing the evidence necessary to report on these matters in subsequent reports.³⁹

³⁸ See *supra* notes 6 and 7.

³⁹ The Examiner has requested, and in some cases has not yet received, documents from certain parties involved in the transactions discussed in this Report and is in the process of reviewing those documents already produced, seeking to obtain documents not yet produced, and conducting other means of discovery.

C. How to Read This Report

This Report (including its Appendices) exceeds 2,000 pages. Because of the volume of information, the remaining Sections of this Report provide an overview of the Examiner's conclusions with respect to the matters identified above. More detailed analyses and supporting evidence are set forth in the Appendices to this Report. Therefore, the reader should review the applicable Appendices (and any attached Annexes) for a more complete understanding of the issues raised in the summaries below.

In addition, the first three Appendices to this Report – Appendix A (Certain Defined Terms), Appendix B (Accounting Standards)⁴⁰ and Appendix C (Legal Standards)⁴¹ – are designed to provide the reader with background helpful to understanding the other Appendices to the Report.

⁴⁰ Accounting issues addressed in Appendix B (Accounting Standards) include consolidation, sale accounting, balance sheet classification and reporting of cash flows.

⁴¹ Legal issues addressed in Appendix C (Legal Standards) include true sale, substantive consolidation, and avoidance actions under the Bankruptcy Code.

IV. ENRON'S USE OF SPEs

A. Overview

The Examiner has concluded that, through pervasive use of structured finance techniques involving SPEs and aggressive accounting practices, Enron so engineered its reported financial position and results of operations that its financial statements bore little resemblance to its actual financial condition or performance. This financial engineering in many cases violated GAAP and applicable disclosure laws, and resulted in financial statements that did not fairly present Enron's financial condition, results of operations or cash flows.

B. Why Did Enron Manage its Financial Statements?

Two key factors drove Enron's management of its financial statements: (i) its need for cash and (ii) its need to maintain an investment grade credit rating. Enron was reluctant to issue equity to address these needs for fear of an adverse effect on its stock price and was reluctant to incur debt because of a possible adverse effect on its credit ratings.⁴² Moreover, Enron's use of mark-to-market ("MTM") accounting created a large gap between net income and funds flow from operations. This "quality of earnings" problem made it particularly challenging for Enron to raise cash without issuing equity while maintaining its credit rating.

⁴² In mid-1998, a DLJ analyst commenting on the recently announced acquisition of Wessex Water noted:

Combining this acquisition with the recently announced acquisition of a Brazilian electric utility for \$1.5 billion shows that Enron Corp. has "spent" about \$3.5 billion in recent weeks. To date, Enron Corp.'s debt ratings have been reaffirmed based upon the operating fundamentals of the acquisitions and unspecified plans to sell assets or take other actions to reduce debt. No additional equity is required by Enron Corp. to maintain its balance sheet ratios and credit ratings.

Donaldson, Lufkin & Jenrette *Comment on Enron Corp., "Acquisition of U.K. Water Company Adds to EPS and Opportunities for Growth,"* July 24, 1998, at 3 [ELIB00000544-00001 to ELIB00000544-00006].

Enron's Need for Cash

By the mid-1990s, Enron's business and business model changed dramatically. Starting out as a company that had a concentration in natural gas pipelines, it became over time a company that depended less on pipelines and transportation and more on energy trading and investing in new technologies and businesses.⁴³ In its 2000 Annual Report, Enron described its four business segments: Wholesale Services, Energy Services, Broadband Services and Transportation Services. Enron Wholesale Services was highlighted as its "largest and fastest growing business."⁴⁴ Wholesale Services created trading markets in gas, oil, electricity and other energy products and provided price risk management and other related services. The second segment was Enron Energy Services, the retail arm designed to serve users of energy in the commercial and industrial markets. Enron Broadband Services was the third segment. This segment, newly minted in 2000, was in the "hot" telecommunications sector. Its objectives, typical of the hype of the times, were to "deploy the most open, efficient global broadband network, . . . be the world's largest marketer of bandwidth and network services [and] be

⁴³ In March 1998, Merrill Lynch commented on Enron as follows:

[O]nly 42% (and dropping) of its EBIT⁴³ comes from regulated pipeline and power assets. . . . About 48% of its *normalized* 1997 EBIT came from foreign operations. . . . North America is currently a \$300 billion/year energy market with gas 100% deregulated at the wholesale market and perhaps 20% at retail. Power is maybe 20% unbundled at wholesale and 10% at retail. *In five year's time, it will all be commoditized*, with only pipelines, LDC and transmission infrastructure still regulated. ENE will be one of perhaps 10-15 energy conglomerates with \$30-\$40 billion of assets expecting to flourish in this coming trading and arbitrage market.

Merrill Lynch *Comment* on Enron Corp., Mar. 31, 1998, at 2 (emphases added) [ELIB00000544-00001 to ELIB00000544-00004].

⁴⁴ Enron 2000 Annual Report, at 9.

the world's largest provider of premium content delivery services."⁴⁵ Relegated to last in the 2000 Annual Report's narrative was Enron Transportation Services, the newly renamed segment that housed the pipelines and Portland General.⁴⁶

Enron's expansion during this time made Enron a voracious consumer of cash.⁴⁷ Enron's management made it clear to the investment community that it was aware of the issues posed by its expansion and gave assurances that Enron could manage its way through these risks without upsetting investor expectations. For example, in the analysts' conference call following the earnings release for the third quarter of 2000, Jeff Skilling ("Skilling"), then Enron's Chief Operating Officer, remarked in response to a question about Enron's capital needs over the next two years:

We have been running about \$2.5 billion capital expenditures, and I would imagine that that sort of expenditure number will keep up. As I have mentioned in the past, we are working extremely hard to find places where we can monetize assets, increase the velocity of capital through Enron and you will be seeing a lot of that over the next couple of quarters. So, in aggregate, we would expect, not only expect, we are pretty certain, no new

⁴⁵ Perhaps also typical of the times, Enron Broadband Services lost \$60 million on revenues of \$408 million for 2000.

⁴⁶ Enron 2000 Annual Report, at 18. The Enron Transportation Services segment produced reported earnings of \$732 million on revenues of \$2.9 billion for 2000.

⁴⁷ In mid-1999, an analyst at JPMorgan noted:

Unlike the typical domestic electric utility, ENE is not a cash flow story. It has not invested in infrastructure during the past 100 years in order to rest on its depreciation laurels. It is investing vigorously in its future. As such, operating cash flow is eaten up by the need for working capital and capital expenditures. Beyond that, ENE's equity investments need to be funded via bank debt, debt and equity capital markets, and asset divestitures. . . .

Although cash from operations should exceed \$2 billion per year, Enron's appetite for expansion and pipeline of projects won't allow those funds to sit on the balance sheet.

J.P. Morgan Securities, Inc. Company Report on Enron Corp., June 9, 1999 (the "JP Morgan June 1999 Report"), at 7 [ELIB00000751-00001 to ELIB00000751-00048].

equity issues and in fact I think it is going in the other direction. We expect to see enhanced liquidity over the next couple of quarters.⁴⁸

Importance of Enron's Credit Ratings

Enron considered its credit ratings critical to its success. As indicated in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") in Enron's 1999 Annual Report:

Enron's senior unsecured long-term debt is currently rated BBB+ by Standard & Poor's Corporation and Baa2 by Moody's Investor Services. Enron's *continued investment grade status is critical to the success of its wholesale business as well as its ability to maintain adequate liquidity.* Enron's management believes it will be able to maintain or improve its credit rating.⁴⁹

By 1999, Enron's Wholesale Services was by far the most significant of Enron's business segments, accounting for 66% of its 1999 income before interest, minority interests and income taxes ("IBIT"), and exceeding by almost a factor of two the combined IBIT from its interstate gas pipelines and Portland General electric utility businesses.⁵⁰ In order to continue the growth of this business, Enron needed to trade with

⁴⁸ Enron Q3/2000 Conference Call, Oct. 17, 2000, at 29 [ELIB00001903-00001 to ELIB00001903-00031].

⁴⁹ "Financial Review--Management's Discussion and Analysis of Financial Condition and Results of Operations--Capitalization," Enron 1999 Annual Report, at 37 (emphasis added). The same statement was repeated in Enron's 2000 Annual Report, except that the Moody's rating was listed as Baa1 and the words "or improve" in the last sentence did not appear. "Financial Review--Management's Discussion and Analysis of Financial Condition and Results of Operations--Capitalization," Enron 2000 Annual Report, at 27.

⁵⁰ 1999 IBIT from Enron's five business segments is summarized as follows (dollars in millions):

other market participants without being required to post collateral. Thus, the continued success of Enron's entire business was dependent upon the continued success of its Wholesale Services business segment, which in turn was dependent upon Enron's credit ratings for its senior unsecured long-term debt.

Analysts expressed concerns about Enron's ability to finance both its operations and its expansion plans and maintain its credit rating.⁵¹ The credit rating depended on achieving certain financial ratios. The five key credit ratios consisted of:⁵² funds flow interest coverage;⁵³ pre-tax interest coverage;⁵⁴ funds flow from operations to total obligations; total obligations to total obligations plus shareholders' equity and certain

Business Segment	1999 IBIT	% of Total
Transportation and Distribution:		
Transportation Services (interstate gas pipelines)	\$380	19%
Portland General	305	15%
Wholesale Services	1,317	66%
Retail Energy Services	(68)	(3%)
Broadband Services (new business segment in 2000)	-	-
Exploration & Production (discontinued Aug 1999 with sale of EOG)	65	3%
Corporate and Other (Azurix, wind farms, methanol, MTBE)	(4)	(0)%
Total IBIT	\$1,995	100%

See "Financial Review--Management's Discussion and Analysis of Financial Condition and Results of Operations--Results of Operations-Consolidated Net Income," Enron 2000 Annual Report, at 21.

⁵¹ In March of 1999, a Merrill Lynch analyst reported:

ENE's ratings have been Baa2/BBB+ for several years, and both rating agencies [S&P and Moody's] currently maintain stable outlooks. The rating agencies cite ENE's strong market position and diversified assets, mitigated partly by the risks associated with its aggressive expansion plans and related effects on the company's credit measures. Moody's specifically stated in its latest ratings review (December 21, 1998) that ENE's rating is *pressured* in its rating category.

Merrill Lynch *Comment* on Enron Corp., Mar. 31, 1999, at 5 (emphasis added) [ELIB00000651-00001 to ELIB00000651-00007].

⁵² See Enron 2000 Annual Report, at 52.

⁵³ Funds flow from operations plus interest incurred and estimated lease expense, divided by interest incurred and estimated lease expense.

⁵⁴ Adjusted earnings for credit analysis divided by interest incurred and estimated lease expense.

other items; and debt to total capital. As indicated in its 2000 Annual Report, the components of these key credit ratios were:⁵⁵

- *Funds flow from operations*, defined as net cash provided by operating activities (from the cash flow statement) less cash provided from decreases in working capital (or plus cash used for increases in working capital).
- *Balance Sheet Debt*, defined as short-term and long-term debt appearing on the face of the balance sheet.
- *Total Obligations*, defined as Balance Sheet Debt, plus guarantees of debt of third parties and guarantees of lease residual values, plus any excess of price risk management liabilities over price risk management assets. Guaranteed debt was reduced by the value Enron attributed to the assets supporting the underlying debt. Debt of unconsolidated equity affiliates was not included because (unless guaranteed) it was non-recourse to Enron.
- *Shareholders' Equity and certain other items*, defined as shareholders' equity, plus the "mezzanine" items, minority interests and company-obligated preferred securities of subsidiaries.
- *Adjusted Earnings for credit analysis*, defined as IBIT, less gain on sale of non-merchant assets and the excess of earnings from equity method investees over distributions from those investees, plus impairment losses.
- *Interest Expense*, defined as interest incurred, less interest capitalized, plus estimated lease interest expense.

Enron's need to maintain its credit rating was known throughout the institution, from its Board of Directors (the "Enron Board") to its mid-level management. The former Chairman of the Finance Committee of Enron's Board recently described

⁵⁵ See "Financial Review—Selected Financial and Credit Information (Unaudited)," Enron 2000 Annual Report, at 52.

management's system for assuring that Enron remained focused not only on generating cash, but also on generating funds flow from operations:

Yes, sir, each business unit would have had an income target and a funds flow target and so that business unit would have been looking at its portfolio of assets and considering do I sell a minority interest, do I deconsolidate it by selling it to an SPE, do I sell it outright, what do I do with it to achieve the overall goals I am trying to achieve?⁵⁶

When asked whether the income and funds flow targets would put undue pressure on management to achieve the targets, the former Finance Chairman noted the relationship between Enron's credit rating and its ability to balance MTM earnings with funds flow:

Well, the company as a whole had these debt ratios, rating agencies ratios to which we referred, so everybody knew that to maintain the investment grade rating and to make sure the mark to market earnings and the funds flow didn't get too far out of balance, that whatever people were doing they had to make sure the two stayed reasonably in sync.

Certainly to the extent anybody, either because their assets aren't doing as well or more likely the case is because they had lots more assets opportunities would always be trying to find ways to generate funds flow to match up with the mark to market earnings. . . .⁵⁷

An Enron manager who actively participated in the design and implementation of many of Enron's structured finance transactions confirmed how well he appreciated the importance of financial engineering in a self-evaluation memorandum prepared sometime after the close of the 2000 fiscal year. He began that memorandum by pointing out his own contribution to Enron's funds flow and its balance sheet from 1995 through 2000:

⁵⁶ Volume 2, Deposition of Herbert S. Winokur, Jr., former Director of Enron Corp. and Chairman of the Board's Finance Committee, by John L. Latham, Partner, Alston & Bird LLP ("A&B"), Nov. 21, 2002 ("Winokur 2"), at 122-23. The Examiner's counsel has not received the executed errata sheet from Mr. Winokur but has no reason to believe that the quoted testimony is inaccurate.

⁵⁷ Winokur 2, at 123-24.

Funds Flow

One key metric that I have been intimately involved with has been the generation and measurement of Enron's funds flow objectives. "Funds flow" is the "net operating cash flow" that is used to pay debt service and is probably the single most critical metric and difficult metric for Enron to achieve to maintain its BBB+ rating. . . . [He then noted that of the aggregate \$9.686 billion of operating cash flow reported by Enron for 1995 through 2000, he had led or had significant participation in SPE transactions that accounted for 56% of it.]

Balance Sheet

While the funds flow metric allows Enron to maintain its current debt rating assuming a certain balance sheet capital structure, of equal importance is the maintenance of that capital structure and maintaining debt ratios which have been generally in the 40% range over the past five years. To maintain our credit rating, if Enron were to finance itself primarily or solely through simpler, on-balance sheet reported structures, 40% of each transaction would be funded by the issuance of new debt and 60% through retained earnings or new equity. . . .

...
For 2000, I was responsible for the Global Finance team that generated approximately \$5.5 billion of overall off-balance sheet financing which, at a 60% equity allocation, would have required \$3.3 billion of new equity capital in 2000 to support a BBB+ credit rating. The value of avoiding \$6.11 billion of equity dilution is difficult for me to quantify although, as a shareholder, I know it's reflected in the valuation given the avoided dilution of earnings per share.⁵⁸

Enron's MTM Accounting and Quality of Earnings Problem

The Genesis and Evolution of Enron's MTM Accounting. On June 11, 1991, Enron wrote to the SEC Office of Chief Accountant to inform the SEC that Enron

⁵⁸ Enron Interoffice Memorandum to David Delainey from Joe Deffner, regarding Year End Accomplishments and Overall Past Enron Accomplishments, undated [AB025204029-AB025204052].

intended to use MTM accounting for its gas trading business, Enron Gas Services.⁵⁹ Under MTM accounting, assets are carried at their "fair value," based upon publicly quoted prices, or if there are none available, based upon management's estimate using the best information available to determine the fair value of the assets. Changes in values from quarter-to-quarter are recorded as gains or losses in the income statement.⁶⁰

In a letter dated January 30, 1992, then SEC Chief Accountant Walter P. Schuetze informed Enron that, based upon Enron's representations, the SEC accounting staff would not object to Enron's use of MTM accounting for its natural gas trading activities beginning in 1992 (the "Schuetze Letter").⁶¹

From this modest beginning in 1992, MTM accounting spread throughout Enron so that by December 31, 2000, approximately \$22.8 billion of Enron's assets were accounted for using MTM accounting,⁶² representing 35% of its \$65.5 billion of total

⁵⁹ Letter from Jack L. Tompkins, Senior Vice President and Chief Financial Officer, Enron Corp., and George W. Posey, Vice President, Finance & Accounting, Enron Gas Services, to George H. Diacont, Acting Chief Accountant, SEC, and Robert Bayless, Associate Director, Office of Chief Accountant, SEC, June 11, 1991 [AB000516897-AB000516898]. Enron's letter contained a lengthy memorandum supporting Enron's position, as well as letters from accounting firms Andersen and E&Y in support. The letter cites changes in the natural gas industry, including price deregulation, and the emergence of spot trading and creation of a forward market for natural gas as reasons for Enron's decision to change from the historical cost method of accounting. Enron stated that its gas business was operated independently of Enron's other businesses and consisted of contracts and financial instruments (rather than fixed assets such as pipelines). Enron analogized its gas trading operations to securities trading activities of broker/dealers. During the balance of 1991, Enron and the SEC had a series of meetings and telephone calls during which Enron answered numerous questions posed by the SEC accounting staff and provided significant additional support for its position.

⁶⁰ In some cases, changes are recorded directly to shareholders' equity through other comprehensive income. See FAS 115, *Accounting for Certain Investment Debt and Equity Securities*.

⁶¹ Letter from Walter P. Schuetze, Chief Accountant, SEC, to Jack L. Tompkins, Senior Vice President and Chief Financial Officer, Enron Corp., Jan. 30, 1992 [AB000516971-AB000516972].

⁶² Price Risk Management Assets (\$21 billion), interests in equity affiliates using MTM (\$1.2 billion), merchant investments (\$0.6 billion). Enron 2000 Annual Report.

assets. A mere 5% fluctuation in value of these assets would have resulted in gain or loss of \$1.1 billion, an amount greater than Enron's 2000 net income of \$979 million.⁶³

Enron's MTM accounting evolved after the Schuetze Letter as follows:⁶⁴

- Enron (apparently without soliciting the SEC's further advice) extended the use of MTM accounting for its gas trading business to trading in other commodities, including electric power, pulp and paper, and coal.
- In 1996, Enron extended its MTM accounting to JEDI, an investment partnership between Enron and the California Public Employees' Retirement System ("CalPERS"), by analogizing JEDI's activities to

⁶³ A large loss as a result of changes in commodity or equity prices was not statistically likely to occur, at least according to Enron's description of its risk profile. Balancing its \$22.8 billion of MTM assets were \$19.9 billion of MTM price risk management liabilities. Thus, if the value of its assets declined, much of the decline should have been offset with a decline in the value of these liabilities. If the \$4 billion of prepay liabilities that existed on December 31, 2000, were eliminated from Enron's MTM liabilities, Enron's MTM "book" would appear to be approximately \$6.9 billion out of balance. According to Enron's 2000 Annual Report, however, Enron took this into account in computing its value at risk. Specifically, Enron states that it had performed an entity-wide value-at-risk analysis on virtually all of its financial instruments, including its price risk management assets and liabilities. Enron 2000 Annual Report, at 28. As a result of this analysis, Enron reported that its commodity price risk plus equity price risk aggregated \$125 million based on a one-day holding period and at a 95% confidence level. This means that after running sophisticated and highly regarded statistical modeling techniques (i.e., Monte Carlo simulation) Enron had concluded that in 95 days out of every 100, it should not lose more than \$125 million based upon the movements of commodity and equity prices. Although the Examiner has not investigated whether this analysis was actually and properly performed, or whether Monte Carlo simulation can accurately quantify price risk of assets for which there is no public market, his investigation has revealed no reason to believe that Enron's reporting of its value at risk was inaccurate.

Moreover, although the Examiner has not evaluated Enron's trading assets and liabilities, the valuation techniques Enron used, or the movements in commodity and equity prices during the period prior to Enron's bankruptcy, nothing has come to the Examiner's attention that suggests that the collapse of Enron was related to changes in commodity or equity prices. While the downgrading of its credit rating obviously adversely impacted the value of its trading operations when counterparties required collateral to be posted and exercised other remedies available to them under their contractual arrangements, the Examiner has found no evidence to suggest that the downgrading was the result of shifting commodity prices.

Enron's value at risk has little to do with its MTM accounting. It would have had the same risk had it accounted for these assets and liabilities based on historical cost. In fact, the proper use of MTM accounting for assets and liabilities subject to frequent price fluctuation, and related disclosures of value at risk, arguably provides more relevant and reliable financial information than would historical cost. Setting aside valuation abuses, the problem was not that Enron used MTM accounting, but rather that Enron resorted to financial engineering to address the effects of MTM accounting.

⁶⁴ See "Application of Mark-to-Market and Fair Value Accounting," Oct. 11, 1999, presented to a meeting of the Enron Board's Audit Committee on that date by Richard A. Causey, Enron's Chief Accounting Officer [AB024601353-AB024601361].

that of an investment company and applying the specialized accounting treatment applicable to investment companies. Enron accounted for JEDI under the equity method of accounting and included its 50% share of JEDI's MTM gains and losses in Enron's financial statements.⁶⁵

- In 1997, the JEDI investment company analogy spread to Enron itself, when Enron decided to adopt MTM accounting for its "merchant banking business," and thus began marking-to-market its merchant investments.⁶⁶
- In 1998, the rest of the energy-trading world caught up with Enron when the EITF reached a consensus in EITF 98-10⁶⁷ "that energy trading contracts should be marked to market (that is, measured at fair value determined as of the balance sheet date) with gains and losses included in earnings and separately disclosed in the financial statements or footnotes thereto."⁶⁸
- In 1999-2000, Enron sought to extend EITF 98-10 by analogy to non-energy commodities.

The "Quality of Earnings" Problem Caused by MTM Accounting. Enron's use of MTM accounting for energy-related contracts, and its extension of this concept by analogy to other commodities and financial instruments, was a potent generator of earnings. This was particularly true when applied to such things as (i) Enron's energy

⁶⁵ Enron Form 10K filed with the SEC for the year ended Dec. 31, 1999.

⁶⁶ The treatment of its merchant investments as MTM assets was an exception to FAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires companies generally to mark to fair value equity securities only if prices or bid-and-ask quotations are available on recognized exchanges that provide reliable trading data. When marking securities to market, FAS 115 requires unrealized gains or losses for equity investments held in "trading" portfolios to be included in current income, but requires such gains or losses for investments held in "available-for-sale portfolios" to be included in stockholders' equity without being reported in net income.

⁶⁷ EITF 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*.

⁶⁸ Energy contracts for this purpose were "contracts entered into (or indexed to) the purchase or sale of electricity, natural gas, natural gas liquids, crude oil, refined products, coal, and other hydrocarbons (collectively, *energy*)," and included energy-related contracts, such as capacity contracts, requirements contracts and transportation contracts. EITF 98-10.

contracts with power plants in which it had an interest,⁶⁹ (ii) Enron's energy outsourcing contracts from Enron's Energy Services business segment,⁷⁰ (iii) Enron's pulp and paper contracts⁷¹ and (iv) Enron's contract with Blockbuster, Inc. ("Blockbuster") to jointly develop the capability to deliver video on demand.⁷²

Through MTM accounting, Enron often recognized earnings long before these activities generated any cash. Acceleration of earnings caused by its MTM accounting was noticed by analysts and led to a "quality of earnings" problem, as described in this note from a JPMorgan analyst's report issued in June 1999:

Financial Engineering Accelerates Earnings

[ENA] has significant flexibility in structuring contracts and hence booking earnings. It is primarily a financial business and hence uses "mark to market" accounting. As such, contracts can be structured to recognize the economic value of projects long before they are operational and cash is coming in the door. For example, Sutton Bridge, a power plant that will start operations in the second quarter of 1999, hit ENE's bottom line in 1997. Its output is the backstop for a swap agreement, the present value of which has already been marked to market and booked by [ENA]. This has two effects: front-end-loaded earnings that bias the denominator in the P/E ratio and a timing disconnect between projects' cash and earnings effects.⁷³

⁶⁹ For example, the Cuiaba Transaction was designed to deconsolidate a Brazilian power plant in order to recognize MTM gain of \$84 million over seven quarters resulting from an energy contract between the plant and Enron. See Annex 3 to Appendix L (Related Party Transactions).

⁷⁰ For example, the Eli Lilly transaction discussed below.

⁷¹ See Appendix K (Forest Products Transactions).

⁷² See discussion below under "MTM Valuation -- The Blockbuster Transaction."

⁷³ JPMorgan June 1999 Report, at 4. Later in the same report, JPMorgan elaborated on the impact of mark-to-market accounting as follows:

Enron structures financial products and uses "mark to market" accounting. This limits the comparability of financial statements, as a project's bottom-line effect is bound only by [ENA's] financial engineering skills.

Id. at 6.

Solving the Quality of Earnings Problem – Project Nahanni. Enron's quality of earnings problem – the gap between net income and funds flow from operations – was apparently a serious problem by the end of 1999. With the help of Citibank, in December 1999, Enron closed a slightly modified minority interest financing known as Project Nahanni, that appears to have been designed solely to permit Enron to record \$500 million in cash flow from operating activities for the year then ended.

In Project Nahanni, Citibank loaned \$485 million to Nahanni Investors L.L.C. ("Nahanni") and equity participants contributed \$15 million. In a typical minority interest financing, the funds obtained would have been invested by Nahanni in a consolidated subsidiary of Enron, which in turn, would have loaned the funds to Enron. In project Nahanni, however, Nahanni used the \$500 million to purchase Treasury securities, which it contributed to an Enron subsidiary ("Marengo") in exchange for a 50% limited partnership interest. Marengo immediately sold the Treasury securities and loaned the resulting \$500 million in proceeds to Enron.

Enron extended the MTM accounting that it applied to its merchant investment venture capital activities to cover the sale of the Treasury securities that Nahanni contributed to Marengo. As a result, Enron's 1999 financial statements reflected (i) Nahanni's \$500 million contribution to Marengo as a minority interest rather than debt, (ii) the receipt of the \$500 million contribution as cash flows from financing activities - issuance of subsidiary equity, and (iii) the proceeds from the sale of the \$500 million of Treasury securities as net cash provided by operating activities. This cash flow represented 41% of the total of \$1.2 billion of operating cash flow reported by Enron for 1999. Having achieved this significant impact on its 1999 financial statements, Enron

repaid the Nahanni debt on January 14, 2000, less than one month after the transaction was consummated.

Thus, through Project Nahanni, Enron borrowed \$500 million, bought Treasury securities with it, sold the Treasury securities, recognized \$500 million of operating cash flow, and repaid the loan—all within 30 days straddling its 1999 year end—and without reflecting the loan as debt on its financial statements.⁷⁴

The seeds for this financial engineering were sown in 1997, when Enron determined that it should use MTM accounting for its “merchant investments” because at the time it analogized what it called its “merchant banking activities” to those of venture capital investment companies, which under GAAP are permitted to use MTM accounting.⁷⁵ That analogy itself seems aggressive. Enron’s position that *venture capital* investment companies trade in Treasury securities, or that trading in Treasury securities was a regular part of Enron’s venture capital business, illustrates Enron’s and Andersen’s elasticity in addressing Enron’s quality of earnings problem.

⁷⁴ The Nahanni transaction was one of Enron’s clearest violations of GAAP. For a complete discussion of Project Nahanni, see Annex 3 to Appendix I (Minority Interest Transactions).

⁷⁵ Enron Corp. Fair Value Memorandum, Aug. 28, 1997 [AB02092250-AB02092268].

*MTM Valuation*⁷⁶

Two examples of how Enron valued assets for which there were no quoted market prices are (i) the “Blockbuster” transaction, Enron’s monetization of its video on demand (“VOD”) contract with Blockbuster, and (ii) the “Eli Lilly” transaction, Enron’s monetization of its interests in future cash flows resulting from anticipated energy savings under a contract with Eli Lilly and Company (“Lilly”).⁷⁷

The Blockbuster Transaction. On July 19, 2000, Enron announced that it had entered into “a 20-year, exclusive agreement to deliver a Blockbuster entertainment service, initially featuring movies-on-demand, via the Enron Intelligent Network.”⁷⁸ This agreement reflected nothing more than an aspiration. Enron did not have the technology to deliver VOD on a commercially viable basis and Blockbuster did not have rights to movies to be delivered. Nevertheless, Enron contributed this contract to a subsidiary, EBS Content Systems, LLC (“EBS”), and then sold a 45% interest in EBS to the Hawaii

⁷⁶ As noted above, the Examiner has not engaged valuation experts or otherwise undertaken to determine whether Enron properly valued the assets subject to its MTM accounting. Under MTM accounting, assets for which there are not publicly quoted prices are to be valued by management based upon the best information available to determine the fair value of the assets. Many of Enron’s assets were in this category, including most of its merchant investments and all of the Total Return Swaps it entered into in connection with the FAS 140 transactions (and treated as price risk management assets or liabilities). In addition, the Examiner has not considered the propriety of Enron’s extension of its MTM accounting to commodities not covered by EITF 98-10, or, other than the Prepays, whether contracts that Enron claimed were “energy trading contracts” or “energy-related contracts” under EITF 98-10 were in fact those types of contracts.

⁷⁷ The appraisals discussed in the Blockbuster and Eli Lilly transactions were technically performed to support the amount of gain to be recognized in the FAS 140 transfers of the LLC interests involved in those transactions, rather than to support MTM accounting gain or loss. Regardless of whether the valuation is to support FAS 140 gain or MTM accounting, if no quoted market price exists, fair value must be determined by management based on the best information available. See EITF 00-17; AICPA Audit and Accounting Guide, Audits of Investment Companies; and FAS 140 ¶ 43.

⁷⁸ Enron Press Release, “Enron and Blockbuster to Launch Entertainment On-Demand Service Via the Enron Intelligent Network,” July 19, 2000, at AB025203626 [AB025203626-AB025203629].

FAS 140 securitization structure⁷⁹ for \$57 million, recognizing a \$53 million gain and \$57 million in funds flow from operations.

In order to recognize this gain, applicable GAAP required that it be practical to measure the fair value of the asset.⁸⁰ Andersen appraised the value of this contractual arrangement at between \$120 million and \$150 million, even though the anticipated business did not have the technology to deliver its product or any rights to the product it proposed to deliver. In arriving at this valuation, Andersen made the following assumptions:

- The LLC would begin commercial operations of its VOD business in 10 metro areas, each with a population of 1.6 million, within the next 12 months;
- The LLC would add eight additional metro areas per year until 2010 and these metro areas would grow at 1% per year;
- Digital subscriber lines (DSLs) would run to 5% of the households in these metro areas in 2001 growing to 32% by 2010 (this based on a Morgan Stanley report);
- The number of these DSL lines that would have sufficient speed to carry VOD would be 5% in 2001 growing to 80% in 2010;
- The percentage of eligible DSL subscribers using VOD would be 5% in 2001 and grow to 70% by 2010; and
- EBS would garner 50% of this market (this based on "research" performed by EBS and McKinsey & Co.).⁸¹

⁷⁹ The Hawaii FAS 140 transaction was discussed in detail in the September Report and is discussed in Appendix M (FAS 140 Transactions).

⁸⁰ FAS 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("FAS 125") ¶ 45.

⁸¹ Andersen Memorandum to Roger Willard, Andersen, from Warren White, Andersen, and Brent Dickey, Andersen, regarding FMV of EBS Content Systems LLC, Jan. 19, 2001 [PSI00028563-PSA00028575]; Andersen Memorandum to Roger Willard, Andersen, from Warren White, Andersen, and Brent Dickey, Andersen, regarding FMV of EBS Content Systems LLC, Mar. 15, 2001 [PSI00020764-PSA00020777].

Using these assumptions, Andersen projected future cash flows and discounted the cash flows to present value using discount rates ranging from 31% to 34%. While a venture capitalist might find the analysis informative in assessing whether to make a seed investment in a speculative start-up situation, given the underlying facts, the Examiner questions whether it was appropriate for a public company to transfer this contract to a structured finance vehicle, assign it a speculative value and recognize that amount currently as income and cash flow from operating activities. Of the \$63 million of revenue that Enron reported as earned by its Broadband Services business segment in the fourth quarter of 2000,⁸² \$53 million was attributable to this monetization transaction, code-named "Braveheart."

On March 9, 2001, Enron announced that it had terminated its exclusive relationship with Blockbuster.⁸³ The press release stated that:

Enron intends to initiate discussions with various content providers for delivering their content over the Enron platform. In addition to streaming movies to the television, Enron is working on agreements to deliver games, television programming and music via the Enron Intelligent Network.⁸⁴

Apparently, Enron's intention "to initiate discussions" was even more valuable than its "exclusive relationship with Blockbuster," because in the first quarter of 2001, after this announcement, Enron marked to market the Total Return Swap (as defined below) it used in the fourth quarter Blockbuster monetization and monetized the Total

⁸² Enron Press Release, "Enron Reports Recurring Annual Earnings of \$1.47 per Diluted Share in 2000 and Fourth Quarter Earnings of \$0.41," Jan. 22, 2001, at AB025203633 [AB025203630-AB025203634].

⁸³ Enron Press Release, "Enron Expanding Entertainment On-Demand Service: Terminates Exclusive Relationship With Blockbuster Inc.," Mar. 9, 2001 [AB025203639].

⁸⁴ *Id.*

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

-----	X	
	:	
In re:	:	Chapter 11
	:	
ENRON CORP., et al.,	:	Case No. 01-16034 (AJG)
	:	
Debtors.	:	Jointly Administered
	:	
-----	X	

APPENDIX Q

(Schedules Depicting Impact of Enron's Six Accounting Techniques)

to

**SECOND INTERIM REPORT OF NEAL BATSON,
COURT-APPOINTED EXAMINER**

Reference is made to the preceding Second Interim Report of Neal Batson, Court-Appointed Examiner (the "Report"). This Appendix constitutes an integral part of the Report. All capitalized terms not otherwise defined herein shall have the meanings set forth in the Report.

TABLE OF CONTENTS

I. SCHEDULE DEPICTING IMPACT OF ENRON'S SIX ACCOUNTING
TECHNIQUES ON ENRON'S 2000 FINANCIAL STATEMENTS.....1

II. SCHEDULES DEPICTING IMPACT OF ENRON'S SIX ACCOUNTING
TECHNIQUES ON ENRON'S 2000 KEY CREDIT RATIOS AND RATIO
COMPONENTS2

Impact of Enron's Six Accounting Techniques on Enron's 2000 Financial Statements

	Income Statement	Statement of Cash Flows			Balance Sheet				Minority Interest	Prepaid Subs	Equity			
		Funds Flow From Operations	Cash Used in Investing Activities	Cash From Financing	PRM Assets	Other Assets	Total Assets	PRM Liabilities				Deferred Taxes	Debt	Total Liabilities
As Originally Reported	\$ 979.0	\$ 3,010.0	\$ (4,264.0)	\$ 571.0	\$ 21,006.0	\$ 44,497.0	\$ 65,503.0	\$ 19,918.0	\$ 1,644.0	\$ 10,229.0	\$ 50,715.0	\$ 2,414.0	\$ 904.0	\$ 11,470.0
Accounting Techniques														
FAS 140 Transactions	\$ (36.8)	(51.8)	-	51.8	-	15.0	15.0	-	-	51.8	51.8	-	-	(36.8)
Hawaii-Kiva	(75.1)	(75.1)	-	75.1	-	-	-	-	-	75.1	75.1	-	-	(75.1)
Hawaii-NewPower Warrants - initial monetization	(27.0)	(27.0)	-	27.0	-	-	-	-	-	27.0	27.0	-	-	(27.0)
Hawaii-McGarratt G remonetization	(66.0)	(66.0)	-	66.0	-	-	-	-	-	66.0	66.0	-	-	(66.0)
Hawaii-Brucehart	(53.0)	(57.0)	-	57.0	-	4.0	4.0	-	-	57.0	57.0	-	-	(53.0)
Cerberus	-	(317.5)	-	317.5	-	517.5	517.5	-	-	517.5	517.5	-	-	(112.0)
Bachus (Forest Products)	(112.0)	(200.0)	-	200.0	-	88.0	88.0	-	-	200.0	200.0	-	-	(104.0)
ETOL	(104.0)	(104.0)	-	104.0	-	120.0	120.0	-	-	224.0	224.0	-	-	(104.0)
Avici	-	(35.0)	-	35.0	-	35.0	35.0	-	-	35.0	35.0	-	-	(67.0)
Backbone	(540.9)	(100.0)	-	100.0	-	33.0	33.0	-	-	100.0	100.0	-	-	(540.9)
Subtotal	189.3	(1,158.3)	-	1,353.4	-	812.5	812.5	-	(189.3)	1,353.4	1,353.4	-	-	(540.9)
Deferred income taxes on gains	-	-	-	-	-	-	-	-	(189.3)	-	(189.3)	-	-	189.3
Total FAS 140 Transactions	(351.6)	(1,158.3)	-	1,353.4	-	812.5	812.5	-	(189.3)	1,353.4	1,641.1	-	-	(351.6)
Tax Transactions														
Teresa	(120.1)	-	-	-	-	-	-	-	352.0	-	352.0	-	-	(120.1)
Steele	(14.9)	-	-	-	-	-	-	-	78.8	-	78.8	-	-	(14.9)
Tomas	(15.0)	(15.0)	-	15.0	-	-	-	-	-	-	-	-	-	(15.0)
Cochise	(50.3)	(11.8)	-	36.5	-	-	-	-	117.4	-	117.4	-	-	(50.3)
Apache	(33.8)	(33.8)	-	33.8	-	-	-	-	-	-	-	-	-	(33.8)
Condor	(35.0)	(60.6)	-	60.6	-	-	-	-	99.1	-	99.1	-	-	(35.0)
Total Tax Transactions	(269.1)	(60.6)	-	60.6	-	-	-	-	547.3	-	547.3	-	-	(269.1)
Non-Economic Hedges														
Raptors (1 through IV)	(531.9)	-	-	-	-	(365.8)	(365.8)	-	(150.0)	(13.1)	(163.1)	-	-	(531.9)
Deferred income taxes on revenue recognition	186.2	-	-	-	-	(501.2)	(501.2)	-	(186.2)	(13.1)	(186.2)	-	-	186.2
Total Non-Economic Hedges	(345.7)	-	-	-	-	(867.0)	(867.0)	-	(186.2)	(13.1)	(186.2)	-	-	(345.7)
Share Trust Transactions														
Martin	55.0	81.0	(375.0)	302.0	-	3,673.0	3,673.0	-	434.0	2,559.0	3,248.0	-	-	55.0
Whicwing	(25.3)	(492.0)	(352.0)	1,363.0	-	503.0	503.0	-	(14.0)	2,312.0	2,219.7	-	-	(25.3)
Total Share Trust Transactions	29.7	(418.0)	(727.0)	1,665.0	-	4,178.0	4,178.0	-	420.0	4,871.0	5,467.7	-	-	29.7
Minority Interest Transactions														
Rawhide	-	-	-	-	-	-	-	-	-	740.0	740.0	-	-	-
Zephyrus	-	-	-	-	-	-	-	-	-	500.0	500.0	-	-	-
Choclaw	-	-	-	-	-	-	-	-	-	500.0	500.0	-	-	-
Total Minority Interest Transactions	-	-	-	-	-	-	-	-	-	1,740.0	1,740.0	-	-	-
Prepay Transactions	-	(1,527.0)	-	1,527.0	-	-	-	(4,016.3)	-	-	-	-	-	-
Impact of the Six Accounting Techniques														
Net income as adjusted	\$ 47.3	\$ (153.9)	\$ (5,222.0)	\$ 5,116.4	\$ 20,504.8	\$ 49,121.7	\$ 69,626.5	\$ 15,901.7	\$ 2,235.8	\$ 22,059.7	\$ 59,284.8	\$ 970.4	\$ 904.0	\$ 47.3
Cash/Funds Flow as adjusted														
Balance Sheet amounts as reported														
Balance Sheet amounts as adjusted														

Basis of Presentation

The analysis presented above is not intended to illustrate how GAAP would have required the transactions to be reported. As discussed in detail in many of the other Sections of this Report, Enron's reported treatment was not supported by applicable GAAP in many cases, and in other cases it was. Thus, the Examiner's analysis of the effects of the six enumerated accounting techniques on the year 2000 financial statements is not intended to be a restatement of Enron's 2000 financial statements in accordance with GAAP or to provide comprehensive data from which such a restatement can be prepared. As described in the Report (See Section IV), it is not possible to fully understand Enron's use of structured finance transactions involving SPEs without consideration of the very purpose of those transactions—to manage Enron's financial statements. Accordingly, this analysis was undertaken solely as a tool to illustrate in a general way the extraordinary impact that Enron's use of structured finance involving SPEs had on Enron's reported results of operations, cash flows and financial position, and the attendant effects on the financial components of its key credit ratios and the key credit ratios themselves.

**Impact of Enron's Six Accounting Techniques on
Enron's 2000 Key Credit Ratios and Credit Ratio Components**

Credit Ratio Components	2000 <u>As Reported</u>	2000 <u>As Adjusted</u>
Total Obligations		
Balance sheet debt (short and long term debt)	\$ 10,229	\$ 22,060
Items added to liability profile:		
Guarantees (a)	213	213
Residual value guarantees of synthetic leases	556	556
Net liability from price risk management activities (b)	-	-
Debt exchangeable for EOG Resources, Inc. shares (c)	(532)	(532)
Debt of unconsolidated equity affiliates (d)	-	-
Firm transportation obligations (e)	-	-
Total Obligations	<u>\$ 10,466</u>	<u>\$ 22,297</u>
Shareholders' Equity and Certain Other Items		
Shareholders' Equity	\$ 11,470	\$ 8,467
Items added to shareholders' equity:		
Minority interests	2,414	971
Company-obligated preferred securities of subsidiaries	904	904
Total Shareholders' Equity and Certain Other Items	<u>\$ 14,788</u>	<u>\$ 10,342</u>
Funds Flow from Operations		
Net cash provided by operating activities	\$ 4,779	\$ -
Changes in working capital	1,769	-
Funds Flow from Operations	<u>\$ 3,010</u>	<u>\$ (154)</u>
Interest and Estimated Lease Interest Expense		
Interest incurred, as reported	\$ 876	\$ 876
Adjustments:		
FAS 140 Transactions	-	14
Non-Economic Hedges	-	(13)
Share Trust Transactions	-	309
Minority Interest Transactions	-	105
Prepay Transactions	-	215
Adjusted interest expense	876	1,506
Capitalized interest	(38)	(52)
Interest and Related Charges, net	<u>\$ 838</u>	<u>\$ 1,454</u>
Estimated Lease Interest Expense (f)	<u>\$ 106</u>	<u>\$ 113</u>

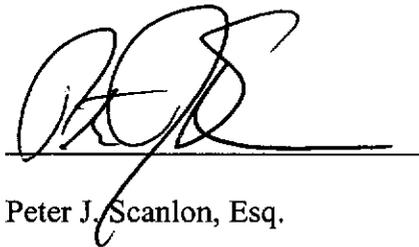
Basis of Presentation of Credit Ratios and Credit Ratio Components

The analysis presented above adjusts Enron's 2000 key credit ratios and credit ratio components to reflect the impact of the six accounting techniques on Enron's key credit ratios and their components. This analysis is not intended to illustrate how the proper GAAP accounting treatment would have affected the key credit ratios. This analysis was undertaken solely as a tool to illustrate in a general way the extraordinary impact that Enron's use of structured finance involving SPEs had on Enron's reported results of operations, cash flows and financial position, and the attendant effects on the financial components of its key credit ratios and on the key credit ratios themselves. See Basis of Presentation on preceding page for basis of presentation of impact of accounting techniques on Enron's 2000 financial statements.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on Enron Power Marketing, Inc. via air courier, upon Enron Corporation at 1221 Lamar, Suite 1600, Houston, Texas 77010 and, by hand delivery and air courier, upon Enron Power Marketing, Inc.'s counsel of record in various proceedings before the Commission: Charles A. Moore, Esq., LeBoeuf, Lamb, Greene & MacRae, L.L.P., 1000 Main Street, Suite 2550, Houston, Texas 77002 and Samuel Behrends, Esq., LeBoeuf, Lamb, Greene & MacRae, L.L.P., 1875 Connecticut Avenue, NW, Suite 1200, Washington, D.C. 20009.

Dated at Washington, D.C. this 2nd day of July 2004.



Peter J. Scanlon, Esq.