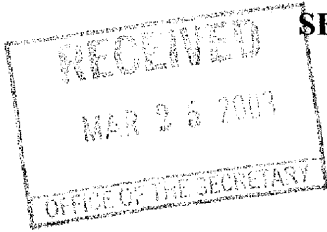


UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION



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In the Matter of )  
Applications of Enron Corp. for )  
Exemptions Under the Public Utility )  
Holding Company Act of 1935 )  
(Nos. 70-9661 and 70-10056) )  
\_\_\_\_\_)

Administrative Proceeding  
File No. 3-10909

RESPONSE OF THE  
DIVISION OF INVESTMENT MANAGEMENT  
IN OPPOSITION TO THE PETITIONS FOR REVIEW

In accordance with the order of the Securities and Exchange Commission (“Commission”) issued in this proceeding on March 11, 2003, the Division of Investment Management (“Division”) hereby submits its response to the petitions for review filed in this matter.

I. INTRODUCTION

On February 6, 2003, Chief Administrative Law Judge Brenda Murray issued a decision (the “Initial Decision”) denying the applications of Enron Corporation (“Enron”) for exemption under sections 3(a)(1), 3(a)(3) and 3(a)(5) of the Public Utility Holding Company Act of 1935 (“PUHCA” or “the Act”). Enron and each of the parties and

limited parties in this matter have since filed petitions pursuant to Commission Rule of Practice 411 seeking review of that decision by the full Commission. As Enron states in its petition, Rule 411 states that review may be granted when, among other things, the decision of the administrative law judge “embodies a finding or conclusion of material fact that is clearly erroneous,” “a conclusion of law that is clearly erroneous,” or involves a “decision of law or policy that is important and that the Commission should review.” These standards do not warrant further review of the Initial Decision.

As we argued in our Reply Brief of the Division of Investment Management (“Reply Brief”), Enron used the hearing largely to present a feel-good story in which it described what it is currently doing to achieve benefits for its creditors and for the customers of Portland General Electric (“Portland General”), Enron’s utility subsidiary. In support of its request for exemptions from the Act, Enron generally offered arguments that it claims are somehow supported by citations to prior exemptive decisions of the Commission. These decisions do not support its arguments and include citations to decisions under other statutory provisions that are inapposite in the exemptive context. The Administrative Law Judge concluded that Enron had not met its burden of proof, and had neither demonstrated why it is entitled to the exemptions it seeks under existing precedent, nor provided a compelling argument for why those precedents should be altered, sometimes radically so, to accommodate its facts.

Because Enron’s requests for exemption were outside existing precedent and thus properly rejected, and because Enron did not submit sufficient evidence to the record justifying a change in approach, the Initial Decision also does not involve a “decision of law or policy that is [so] important” as to warrant further review of the decision. Outside

the context of this particular case, the Division agrees that the scope of section 3(a)(1)'s exemption is important in light of anecdotal reports that many exempted public utility companies actively engage in wholesale power trading, many times through dedicated subsidiaries. Although the record below is devoid of evidence concerning the extent of this trend, the implications of this trend on section 3(a)(1) may ultimately present an important legal issue.<sup>1</sup> However, the Division believes that the facts in this particular case – which involves direct wholesale trading by a public utility company in amounts that go well beyond those recognized as appropriate for an exempted public utility company -- do not present the Commission with an appropriate situation in which to consider the effects, if any, of this trend on Commission precedent in this area.

With respect to other issues raised in the petitions for review, we strongly oppose further review of the administrative law judge's decision not to grant the stay sought by Enron and Southern California Edison ("SCE"). Enron's and SCE's efforts to settle their outstanding commercial disputes simply do not provide a basis for the Commission to delay determining whether Enron should be regulated as an exempt or registered holding company under the Act. We also strongly oppose further review of the decision denying

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<sup>1</sup> In this regard, Enron asserts that "Commission review is appropriate because the Initial Decision raises serious practical problems, not only for Enron, but for many of the approximately 100 other public utility holding companies that are exempt under Section 3(a)(1)." Enron Petition for Review at 9. However, there is simply no evidence in the record that even suggests that there are other exempt holding companies engaging in the volume of out-of-state sales of electricity in which Enron is engaging. It is therefore disingenuous for Enron to suggest that review is warranted in this matter because the Initial Decision's straightforward application of existing Commission precedent will somehow cause "problems" for other exempt holding companies – exempt holding companies that are presumably aware of the Commission's traditional approach to section 3(a)(1) and who are presumably structuring their activities to maintain their exemptions.

SCE the opportunity to use the Commission's hearing process to determine whether Enron's initial applications for exemption under sections 3(a)(3) and 3(a)(5) of the Act were filed in good faith. SCE is raising this issue to achieve goals under different laws – laws administered by the Federal Energy Regulatory Commission ("FERC") rather than those administered by this Commission – for largely commercial reasons. Permitting SCE to litigate this issue therefore risks turning the Commission's administrative process into a forum for private litigation, a result that would clearly hinder the Commission's ability fairly and efficiently to administer the Act. Challenging the good faith of a filed application should be a matter that is instead limited to the Commission and its staff, presumably through the Commission's existing enforcement process.

## II. THE INITIAL DECISION REGARDING SECTION 3(A)(1)

The Initial Decision in this matter correctly rejected Enron's request for an exemption under section 3(a)(1) of the Act. A holding company is entitled to exemption under this section if:

The holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized....

To qualify for this exemption, an applicant holding company must establish that: (1) it is incorporated in the same state as each of its material public-utility company subsidiaries; and (2) it and each of its material public-utility company subsidiaries is "predominantly intrastate in character and carries on its utility business substantially in a single State."<sup>2</sup>

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When determining whether a holding company is predominantly intrastate in character and carries on its business substantially in a single state, the

The only issue in dispute between the parties is whether Portland General, Enron's key public utility subsidiary, satisfies the second of these requirements.

Historically, the Commission has evaluated a number of quantifiable factors to compare a company's out-of-state presence with its in-state presence. Some of the most common indicia have included gross operating revenues, net operating revenues, utility operating income, net utility income, and net utility plant. The Initial Decision, which focuses on the percentages of Portland General's gross revenues derived from interstate sales during 1999, 2000 and 2001, as well as Portland General's out-of-state utility plant and other out-of-state utility assets and activities, thus falls squarely within existing Commission precedent.<sup>3</sup> The Initial Decision does characterize its approach to analyzing whether Enron was entitled to this exemption through use of the terms "interstate commerce" and "intrastate commerce" and it is true that the Commission has not

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Commission does not take into account its nonutility operations. *See Millville Manufacturing Co., Holding Co. Act Release No. 489 (December 21, 1936).*

<sup>3</sup> In essence, the Division argued consistently throughout the hearing that the record in this matter amply demonstrates that Portland General sells a substantial amount of electricity outside of Oregon, the state in which it is incorporated, and also owns significant generating assets that are located outside of Oregon. Indeed, as the Administrative Law Judge found, the percentage of Portland General's gross operating revenues derived from out-of-state sales of electricity during 1999, 2000, 2001 and the first nine months of 2002 were 11.26%, 32.17%, 45.55% and 29%. Initial Decision at 19. Given that the highest percentage that the Commission has ever found permissible in granting an exemption under section 3(a)(1) was 13.2%, *see NIPSCO, Holding Co. Act Release No. 26975 (February 10, 1999)*, it is little wonder that the Initial Decision rejects Enron's claim for exemption. The Division continues to believe that under existing Commission precedent, which looks to quantifiable factors such as the percentage of the utility's revenues that are generated outside its state of incorporation and the percentage of its utility assets that are outside its state of incorporation, Enron is clearly outside the established criteria for an exempt intrastate holding company under section 3(a)(1).

typically used these terms as part of its usual approach of looking at the location of the holding company's utility activities. Nonetheless, Enron's argument that the use of these terms represents an error of sufficient magnitude to require review of the Initial Decision does little more than make a simple case appear difficult. A careful reading of the Initial Decision shows that, although a slightly different vocabulary may have been used, Chief Judge Murray nonetheless focused on the appropriate facts in determining whether Enron was predominantly intrastate or interstate in character. No matter how the decision is phrased, Chief Judge Murray simply did not, as Enron suggests, "appl[y] general Commerce Clause analysis to the determination of whether a holding company is predominantly intrastate in character."<sup>4</sup> Instead, as noted above, by relying on a number of facts, including, most importantly, Portland General's exceptionally large volume of out-of-state sales of electricity, Chief Judge Murray properly concluded that Portland General was not predominantly intrastate in character and thus denied Enron's request for an exemption under section 3(a)(1).<sup>5</sup>

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<sup>4</sup> Enron Petition for Review at 18.

<sup>5</sup> Enron also suggests that the Initial Decision improperly determines where electricity sales take place by looking at where title to that electricity is transferred. *See* Enron Petition for Review at 30-32. However, as we pointed out, the Commission has always determined where a sale of electricity occurs (for purposes of section 3(a)(1) as well as other sections) by looking at where title transfers. *See* Post-Hearing Brief of the Division of Investment Management ("Brief") at 14 and cases cited therein. This is simply the only logical way to determine where a sale occurs. As we have consistently argued, an approach that looks at *why* the sales take place rather than *where* they take place is an illogical way of determining whether a utility is predominantly intrastate.

Enron's only new arguments with respect to the factors themselves focuses on the recent decision in *C&T Enterprises, Inc.*<sup>6</sup> Essentially, Enron attempts to transform *C&T Enterprises* into an endorsement by the Commission of its novel argument that the differing natures of its electricity sales occurring in Oregon as compared with those occurring in Washington warrant distinct legal treatment for the purpose of section 3(a)(1) analysis. Enron thus urges the Commission to disregard its precedent and use a net revenue approach in analyzing Portland General's activities. Specifically, Enron argues that because Portland General's electric distribution and transmission systems are primarily within the State of Oregon, the Commission should analyze Portland General's net revenues as opposed to gross revenues in order to be consistent with the rationale underlying its decision in *C&T Enterprises*.<sup>7</sup> Enron urges that Portland General's out-of-state gross electric utility sales should be disregarded. Enron's proposition is a canard.

*C&T Enterprises* applies the same analysis as the Division cited in its supporting briefs and applicable precedent regarding its predominantly/substantially legal standard. *C&T Enterprises* explicitly states that although in certain circumstances, net utility operating revenues may be a more appropriate basis for comparison "[t]he Commission has generally assigned the most weight to a comparison of gross utility operating revenues as a measure of the relative size of in-state and out-of-states operations."<sup>8</sup> The

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<sup>6</sup> See Enron Petition for Review at 24-30 (discussing *C&T Enterprises, Inc.*, Holding Co. Act Release No. 27590 (October 31 2002)).

<sup>7</sup> Enron's reliance on *C&T Enterprises* has not been previously put forth in its prior pleadings. Significantly, Enron has not presented facts supporting its assertions based on *C&T Enterprises* given that the evidentiary record long ago closed in this matter.

<sup>8</sup> *C&T Enterprises* at 16.

circumstances recognized by the Commission requiring an evaluation of net utility revenues for predominantly/substantially purposes is the one presented in *NIPSCO*: comparisons of combination material gas and electric utility subsidiaries.<sup>9</sup> Both *NIPSCO* and *C&T Enterprises* involved these combination gas-electric systems. The nature or purpose of out-of-state versus in-state sales was not dispositive.<sup>10</sup>

Portland General, however, is a pure electric utility system. The Commission has not accepted the proposition put forth by Enron that the cost of electric power production should be subtracted from gross revenues when the holding company system has only one material electric utility subsidiary such as Portland General. The additional

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<sup>9</sup> As noted in the Brief, the Commission has recognized that, in acquisitions of gas utilities by electric utilities, a more accurate measure of the relative size of the utility operations may be determined by comparing net operating revenues rather than gross revenues. The Commission has recognized the difficulty of making size comparison between an electric company and a natural gas distribution company based upon gross revenues. *AES Corporation, Holding Co. Act Release No. 27063 (1999)*; *Houston Industries, Inc., Holding Co. Act Release No. 26744 (1997)*; *NIPSCO, supra n.2*. In *NIPSCO*, involving an acquisition of a gas utility by a combination gas-electric utility, the Commission noted that “pass-through costs” (e.g., purchased gas and fuel for electric generation) constitute a larger portion of gross revenues for a gas utility than for an electric utility. The Commission then concluded that where a predominately electric system (*NIPSCO*) acquired an exclusively gas system (*Bay State*), a reliance on gross revenues comparison distorts the gas utility’s relative size and gross revenues when comparing them with those of an electric utility, and that it is appropriate to examine net data such as net operating revenues.

<sup>10</sup> Only after the decision was made in *C&T Enterprises* to employ a net revenue analysis based upon the fact that a combination gas-electric system was under scrutiny did the Division go on to discuss the fact that changes in the cost of gas have a greater effect on gas utility gross revenues and that the cost of delivered gas may distort a comparison based upon gross revenues under the specific circumstances at issue in *C&T Enterprises*. It was noted that the applicants asserted that revenue from Valley’s (the gas utility being acquired) Pennsylvania operations depended to a much greater extent on gas transportation services only, whereas New York customers paid for the gas commodity itself in addition to gas transportation services.



discussion in *C&T Enterprises* regarding distortions caused by the gas utility markets at issue in that case was not material to the granting of the exemption. Enron attempts to rely on this *dicta* as a vehicle to expand greatly the Commission's use of utility net revenues beyond that accepted in *NIPSCO*.

In addition, Enron selectively culls data from the financial information provided in *C&T Enterprises* in order to support its assertion that a holding company can have a significant out-of-state presence and continue to qualify for a section 3(a)(1) exemption. In its table of out-of-state revenue presented in its Petition for Review, Enron inexplicably uses a 6-month measuring period when assessing Valley's New York operations.<sup>11</sup> The Commission has never used such an abbreviated time frame within which to evaluate out-of-state utility revenues for the purpose of a predominantly/substantially analysis.<sup>12</sup>

Apart from this new emphasis on *C&T Enterprises*, Enron's petition for review rehashes a number of arguments Enron made during the hearing in an attempt to defeat this standard application of Commission precedent and substitute a new approach to section 3(a)(1) analysis. The approaches that Enron suggests cannot be adopted without hopelessly distorting the language and purpose of the section 3(a)(1) exemption. Most prominently, Enron again urges that the Commission focus on the reason underlying its out-of-state utility activities rather than on the fact of those out-of-state activities. Specifically, Enron urges a change in the focus on where the sales take place (and hence

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<sup>11</sup> *C&T Enterprises* at 25-26.

<sup>12</sup> Rather, out-of-state sales have generally been measured over a 3-year time frame as in the leading case, *NIPSCO*. In *C&T Enterprises*, the Division used a slightly longer period of 3.5 years.

where the utility's revenue is generated) to the purpose of the transaction. Because Enron claims that all of Portland General's wholesale trading activities are focused on meeting its obligations to its Oregon retail customers, it claims that these transactions can be described as "intrastate in character" and hence that Portland General is also "intrastate in character."<sup>13</sup>

For purposes of the Act, however, the assumption that all of Portland General's wholesale trading is designed to support Portland General's retail operations cannot convert transactions that occur outside of Oregon into transactions that are somehow "Oregon" in character and hence intrastate in character.<sup>14</sup> Enron's arguments seem to

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<sup>13</sup> As the Division argued in the proceeding below, this argument simply ignores that certain of the transactions – those that occur in the "non retail trading book" are purely speculative in nature and do not have any true nexus to Portland General's retail operation. Characterizing Portland General's arbitrage business as an activity designed to improve Portland General's "market intelligence" does not establish any nexus whatsoever. Likewise, Enron's argument that many of these "non retail trading book" transactions can be ignored because they should be netted together with certain purchases of power must fail. In particular, Enron's reliance on the Financial Accounting Standards Board's accounting standards also does not warrant ignoring any of Portland General's wholesale electricity transactions. Accounting standards are intended to provide a company's current investors and potential investors an accurate picture of the company's financial condition. A company's financial condition, however, generally has nothing to do with where a company conducts its business. Thus, although netting of certain wholesale trades may help to determine the financial condition of a company, it is not relevant to where a company conducts its business. Failing to net these transactions for purposes of section 3(a)(1) does not, as Enron asserts, result in distortions in the comparison of Enron's activities inside and outside Oregon. Enron states that the objective of these trades is to maximize profit, which is likely true, but that does not make the revenues realized in connection with these trades irrelevant for purposes of section 3(a)(1) – the transactions are still real, and still are occurring outside of Oregon.

<sup>14</sup> During the hearing, Enron suggested a number of reasons in support of interpreting section 3(a)(1) in this manner, some of which it repeats in its petition for review. The Division continues to believe that, given the language of the statute as well as its purpose, these arguments are unconvincing. Rather than

amount to the contention that, in determining whether it and Portland General are intrastate in character, the Commission should look only to where Portland General's retail customers are located. Although Enron does not expressly frame its argument in this way, its assertion that Portland General's out-of-state sales of electricity and out-of-state generating plant should effectively be ignored for purposes of the analysis because they are used to support its Oregon-based retail activities amounts to the same argument. But to reinterpret the Act in this way would not be equivalent to the type of "flexibility" that Enron claims the Commission granted NIPSCO and to which it claims entitlement.<sup>15</sup> If Congress had intended section 3(a)(1) to be interpreted solely on the basis of where a company's retail customers were located, it could easily have written the section to say so. Likewise, had the Commission ever thought interpreting section 3(a)(1) in that manner was appropriate, it could have said so long ago, rather than developing a series of tests, which focus primarily on where revenues are generated and where utility assets are located. Enron's proposed interpretation would not add flexibility to the Act, but would rather eviscerate the key distinction between intrastate and interstate activity that is embodied in section 3(a)(1). As such, Enron's arguments cannot be accepted.

Finally, in an attempt to reach its desired result, Enron focuses again and again in its petition on the fact that the Oregon Public Utility Commission ("OPUC") has stated that it can effectively regulate Portland General and that regulation under PUHCA is

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repeat our specific arguments here, we instead incorporate by reference our Reply Brief in the hearing below. *See* Reply Brief at 3-8.

<sup>15</sup> *E.g.*, Enron Post-Hearing Brief at 26 ("It is unfair and inconsistent with Commission precedent and Congress' intent under the Act to deny Enron and Portland General the flexibility advocated in *NIPSCO*.").

therefore not necessary. *See, e.g.*, Enron Petition for Review at 4, 5, 7, 22. OPUC's separate petition for review makes a similar argument. It is certainly true that the Division and the Commission seek to work closely with state commissions and take seriously what state commissions say about their ability to regulate the utilities in their states. But the acquiescence of a state regulator can only go so far. The Commission recognized this fact in *NIPSCO* in which it allowed a holding company to derive a relatively high 13.2% of its revenues from out-of-state sources and retain a section 3(a)(1) exemption in part because of the support of state regulators. As the record shows, however, Enron's out-of-state revenues are at a much higher level than those permitted in *NIPSCO* – and, as we have stated before, it was in *NIPSCO* that the Commission indicated it saw little justification for permitting higher levels of out-of-state revenues in any circumstances.<sup>16</sup> In spite of the importance of state regulators in the context of the Act, to grant an exemption in this case based on the statements of the OPUC would strip section 3(a)(1) of substantive meaning.

In conclusion, the Initial Decision focused on the correct factors and properly denied Enron's request for an exemption under section 3(a)(1) of the Act. The Division believes that the Commission should affirm this conclusion. As we have said before, however, our opposition to granting Enron an exemption under section 3(a)(1) of the Act does not mean that we believe that Enron and Portland General should not seek to provide the lowest cost power possible to Portland General's customers, including using the wholesale electricity markets to achieve this goal. They should. We are not arguing that wholesale trading of electricity should be prohibited or otherwise seeking to

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<sup>16</sup> *See* Brief at 21-22.

stigmatize activities of this sort. Rather, we are simply arguing that Portland General's out-of-state activities render it an interstate utility, and that Enron therefore does not qualify for an intrastate exemption under section 3(a)(1) of the Act.

### **III. THE INITIAL DECISION REGARDING SECTIONS 3(A)(3) AND 3(A)(5)**

The Initial Decision also denied Enron's request for temporary exemptions under sections 3(a)(3) and 3(a)(5), concluding that Enron had not met its burden of proof. In particular, given that Enron has effectively conceded that it does not currently qualify for the exemptions,<sup>17</sup> the Initial Decision concluded that Enron offered no persuasive reason for nonetheless granting it a temporary exemption under either of these sections.

Enron focuses little on this request in its petition. Most importantly, rather than making any argument that it meets the substantive requirements of either of these sections,<sup>18</sup> Enron continues to do little more than assert that that it should be granted a temporary exemption under one of these two sections to facilitate the resolution of its bankruptcy proceeding. *See* Enron Petition for Review at 10-14, 37-38.

Enron's arguments should be rejected and simply fail to warrant review of the Initial Decision. The Commission has granted temporary exemptions very rarely during the history of its administration of the Act. Because a company that obtains a temporary

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<sup>17</sup> For example, in its petition for review, Enron concedes that "Enron does not comfortably fit within the generally accepted view of a company that qualifies for exemption under Sections 3(a)(3) and 3(a)(5) of the Act." Enron Petition for Review at 13.

<sup>18</sup> The Division argued in the proceeding below that Enron thus had failed to carry its burden of proof of showing that it now or ever met the substantive requirements for exemption under either section 3(a)(3) or 3(a)(5). *See* Brief at 25-32; *see also* Reply Brief at 10-15. The Initial Decision reaches the same conclusion. *See* Initial Decision at 23-24.

exemption is one that likely does not qualify for a permanent exemption – otherwise, the company would seek and be granted the permanent exemption – the effect of granting a temporary exemption is to deny utility customers and investors the protections of the Act to which they otherwise have a clear entitlement. Temporary exemptions should therefore be rare and be granted only under extremely narrowly defined circumstances. In our view, temporary exemptions should effectively be limited to situations like that in *AES Corp., Holding Co. Act Release No. 27363* (March 23, 2001) (“*AES IP*”), in which a holding company very narrowly misses qualifying for the exemption but is poised to requalify for it in the very near future.

Enron does not make this case; instead, it argues that it should be granted the exemption because it intends to sell those assets that make it a holding company in the first place. This argument, however, contains no limiting principle. Were it true, any holding company could obtain a temporary exemption based on an expressed intent to sell all of its jurisdictional assets, with the only penalty for failing to do so being a requirement to reregister. The effect of this argument is to deny the utility customers and investors the protection of the Act.

Hence, a temporary exemption cannot be granted to Enron merely because being exempt may allow it to achieve more efficiently other goals that could otherwise count as public benefits.<sup>19</sup> For example, there is little doubt that maximizing the value of its assets

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<sup>19</sup> Similarly, in its Petition of FPL Group, Inc. for Review of Initial Decision, FPL Group, Inc. (“FPL”) argues that there is insufficient evidence to show that Enron’s current exempt status has produced any of the abuses identified in section 1 of the Act. FPL maintains that any harms resulting from Enron’s exempt status is outweighed by the harms to be incurred by FPL should Enron be denied its exemption requests under sections 3(a)(3) and 3(a)(5). In a sense, FPL requests that the Commission engage in a “balancing of harms.” FPL thus urges that its

and thereby making the largest possible repayments to its creditors in its bankruptcy proceeding is a public good that Enron should work to achieve. However, ignoring the requirements of the Act to achieve that goal is not, as Enron suggests, a pragmatic solution, but would instead amount to a dereliction by the Commission of its duty to administer the Act. Most fundamentally, while the grant of exemption might benefit Enron's creditors, it would ignore -- and indeed potentially expose Portland General's other investors and consumers to -- the types of harms the Act was intended to prevent, in spite of the fact that they are equally intended to be protected under the Act. Moreover, as exemplified by section 11(f) of the Act, Congress assigned the Commission a central role in the bankruptcy of a registered holding company, and thus did not intend for the supervision of a bankruptcy court to substitute for the Commission's regulatory program. Thus, the bankruptcy court's supervision of Enron says little about whether the company should be exempt. Instead, the question is whether the company qualifies for the exemption.

In this context, Enron is simply not the type of company for which the section 3(a)(3) and section 3(a)(5) exemptions were intended. As we argued in the proceeding, Enron's acquisition of Portland General, a large retail utility, to complement its other electricity- and natural resource-oriented activities creates a relationship between Enron and Portland General far removed from that traditionally thought central to section 3(a)(3) analysis. Similarly, Enron's argument that it is only "incidentally a holding

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own economic "harm" warrants the Commission's disengagement from enforcing the Act. However, as mentioned, ignoring the requirements of the Act in order to resolve a matter of economic detriment is not the role of the Commission. FPL has remedies for such economic harm outside the purview of the administrative process.

company' because of its "transitional" nature,<sup>20</sup> is little more than a clever repackaging of Enron's other arguments about the relationship between the Bankruptcy Code and the Act. Were Enron's assertions true, however, section 11(f) would be unnecessary, for all bankrupt holding companies would qualify for an exemption on this basis.

Enron does not own the type of utility that is within the scope of section 3(a)(5), even as that section was expanded in the Commission's decision in *AES II*. *AES II* provided an appropriate principle for limiting the scope of a section 3(a)(5) exemption. Put simply, this exemption should be limited to those holding companies with non-material domestic utility operations, whose other activities fall within the definition of utility under the Act, but are of little regulatory interest, either because they are foreign or because they are within the categories of utility activities that Congress has expressly exempted from the Act. Anything else opens the door to a huge number of types of companies acquiring utilities and qualifying for the exemption merely because the applicant's domestic utility operations are small, a result clearly not intended by the Act.<sup>21</sup>

Based on the above, we therefore believe that the Initial Decision correctly rejected Enron's request for a temporary exemption under sections 3(a)(3) and 3(a)(5), and does not warrant further review.

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<sup>20</sup> Enron Petition for Review at 13.

<sup>21</sup> Indeed, such an interpretation would convert the section 3(a)(5) exemption into a *de minimis* exemption available to any applicant able to pass the relative and absolute size tests. This would have the effect of writing section 3(a)(3) out of the statute. Unlike section 3(a)(3), section 3(a)(5) requires no functional relationship between an applicant's utility and nonutility businesses. Therefore, any section 3(a)(3) applicant that could satisfy the size tests, but not the functional relationship test, could evade section 3(a)(3) by utilizing section 3(a)(5).



#### IV. PETITION TO REVIEW DENIAL OF STAY

In addition to seeking review of the denial of its requests for exemption under sections 3(a)(3) and 3(a)(5) of the Act, Enron briefly renews its request that this portion of the proceeding be stayed. *See* Enron Petition for Review at 19. Because, however, there was never any basis for granting the stay, its denial provides no reason whatsoever for the Commission to grant further review of the Initial Decision.

The request for stay was based on a tentative settlement between Enron and SCE of issues relating to the rates Enron charged SCE for electricity it generated at certain facilities that SCE was required to buy. However, the status of certain generating facilities – or, more specifically, the rates that those facilities will be able to charge pursuant to other statutes not administered by the Commission – in which Enron has interests, is irrelevant to the issue in this phase of the proceeding: whether Enron has met its evidentiary burden to satisfy the statutory exemptions the Act. The Act is most fundamentally concerned with offering protection to investors and utility consumers who have invested in, or are purchasing power from, utility holding companies that do not qualify for any of the statutory exemptions. In contrast, as the Division argued in the proceeding below, ignoring the Act in order to give Enron time and flexibility to resolve problems related to its ownership of these generating facilities is not an appropriate basis for denying utility consumers and investors protections to which they are entitled. Staying the proceeding at this point – especially given that the Initial Decision properly rejected Enron’s attempts to obtain the exemptions – will accomplish nothing more for purposes of the Act than denying those protections for an additional period of time. Hence, facilitating settlement of rate-related issues between Enron and other parties is

simply not good cause to stay this proceeding. The denial of the stay request in the Initial Decision thus does not require further review by the Commission.

#### V. POTENTIAL REVIEW OF ENRON'S GOOD FAITH

In its petition, SCE also seeks further review of the decision not to permit it to litigate whether Enron's original applications under sections 3(a)(3) and 3(a)(5) were filed in good faith. Section 3 of the Act permits an applicant to treat itself as exempt until the Commission acts on its application so long as the application was filed in good faith. SCE asserts that Enron did not file its applications in good faith, and that it was harmed by Enron's ability to continue to function as an exempt holding company following the filing of the applications.

In the hearing below, the Division did not take a position on whether the Enron applications were filed in good faith. Irrespective of whether they were filed in good faith, we believe that this proceeding is not an appropriate place for that question to be litigated by a private party. SCE's concern is not with how the Commission has regulated Enron since it filed its applications for exemption under sections 3(a)(3) and 3(a)(5).<sup>22</sup> Instead, it focuses on the impact of Enron's filing under on other statutes not administered by the Commission. Specifically, because the FERC permits owners of qualifying facilities such as Enron who are clearly holding companies under PUHCA to retain certain benefits under the acts it administers if they have either obtained an exemption under sections 3(a)(3) or 3(a)(5) or have filed an application in good faith

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<sup>22</sup> Indeed, since Enron had separately claimed exemption under rule 2 under the Act at the time that it applied for the exemptions under sections 3(a)(3) and 3(a)(5), Enron was not regulated differently by this Commission as a result of that filing.

pursuant to those sections, SCE argues that it was forced to pay higher rates for electricity generated by certain Enron-owned plants than it otherwise would have.<sup>23</sup> See SCE Petition for Review at 3. In an attempt to recover those costs, SCE now seeks to challenge the good faith of Enron's filings here so that it can more easily seek a refund of its payments in a separate proceeding at the FERC.

Determining whether to develop information about (or otherwise investigate) the issue of an applicant's good faith in filing for an exemption under the Act is a decision uniquely within the Commission's discretion in the administration of the Act and related securities laws.<sup>24</sup> The Order Scheduling Hearing did not identify the "good faith" issue

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<sup>23</sup> See SCE Petition for Review at 3. Specifically, Enron has long owned interests in "qualifying facilities" ("QFs"), a type of generator that receives favorable rate treatment under the laws and regulations administered by the FERC. QFs were created by Congress in 1978 as part of the Public Utility Regulatory Policies Act of 1978 ("PURPA"). One of the goals of PURPA was to create conditions that would induce non-traditional industry participants to build smaller, more efficient generating plants. In order to accomplish this, among other things, PURPA requires that existing utilities buy the power generated by QFs at rates favorable to the QF and limits the ability of existing electric utilities to own QFs. Because of this, ownership of QFs can be highly profitable. In order to bring new entrants into the generation market, PURPA also limits the ability of electric utilities and electric utility holding companies to themselves own QFs. Specifically, the FERC's regulations prevent anyone that is an electric utility company, anyone that falls within PUHCA's definition of holding company because of their ownership of an electric utility, or anyone that is a subsidiary of either an electric utility or electric utility holding company from owning an equity interest of 50% or more in a QF. See 18 C.F.R. §§ 292.202(n), 292.206(b). The regulations then create an exception from this prohibition for "an electric utility holding company which is exempt by rule or order adopted or issued pursuant to section 3(a)(3) or 3(a)(5) of the Public Utility Holding Company Act of 1935." See 18 C.F.R. § 292.206(c)(1).

<sup>24</sup> Cf. e.g., *Block v. SEC*, 50 F.3d 1078 (D.C. Cir. 1995) (declining to require the Commission to institute a hearing under section 2(a)(19) of the Investment Company Act of 1940 in response to a petition filed by a third party challenging the disinterested status of an investment company's directors). Among other things, the *Block* court concluded that an agency's decision whether to enforce a

raised by SCE as appropriate for determination in this proceeding, and the hearing officer consequently properly refused SCE's request to enlarge the scope of the hearing to include factual and legal issues beyond those set for the hearing by the Commission.

It simply does not make sense to permit SCE to litigate that issue in this proceeding. The Commission's administrative forums are not designed for private parties to seek relief for alleged violations of the statutes the Commission administers. Permitting the Commission's administrative processes to become a forum for private litigation will divert staff and Commission resources from administering PUHCA (and the other securities laws) to monitoring and, when necessary, participating in private actions.

In addition to the above policy concerns, the Act does not provide any express means by which any person can formally challenge the good faith of a filed application. Thus, SCE could not file a formal application seeking a Commission determination of the good faith of Enron's filing. Given that, there is no reason to permit SCE to raise the issue in the context of a hearing instituted for the purposes of determining whether Enron is entitled to the exemptions.

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statute it administers in the face of an alleged violation of the statute is a decision committed to the agency as a matter of law:

The SEC's decision not to initiate an investigatory hearing under § 2(a)(19) of the 1940 Act was in effect a decision not to enforce that provision in this particular instance. Because neither the Congress nor the Commission itself has provided any standard constraining the Commission's discretion to make such a decision, and there is no sign that the Commission has abdicated its statutory responsibility to enforce § 2(a)(19) generally, the Commission may decide not to initiate a proceeding free from judicial supervision.

Finally, although not obviously relevant to this question, denying SCE the opportunity to litigate the question of good faith in this proceeding does not eliminate its ability to seek a remedy for any alleged abuses it perceives. As noted above, to the extent that SCE has been harmed, it has been harmed not by how the Commission has chosen to regulate Enron, but rather because of how the FERC has independently chosen to treat the filing of an application for exemption at this Commission under its regulations.<sup>25</sup> SCE presumably can challenge this result at the FERC; indeed, the FERC recently instituted a proceeding designed to examine whether Enron properly claimed QF status for the generating projects about which SCE is currently complaining.

For these reasons, there is no reason to grant SCE's petition for review to permit further consideration of whether Enron's applications were filed in good faith. In addition, once it is determined that SCE's petition should not be granted for this purpose, there is no reason to reconsider earlier decisions denying SCE party status in this matter, for the only other substantive result it has sought – denial of the exemptions itself – was the result of the Initial Decision. Because SCE will thus not be harmed by the failure to grant it party status, there is little reason to grant its petition for review on this issue.

## VI. CONCLUSION

For the reasons outlined above, and for the reasons discussed in the Division's post-hearing briefs below, the Chief Administrative Law Judge's Initial Decision in this

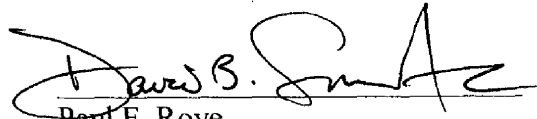
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<sup>25</sup> The FERC's treatment of holding companies that have filed applications for exemption under either section 3(a)(3) or 3(a)(5) arises out of its decision law. *See, e.g., Doswell Limited Partnership & Diamond Energy Inc.*, 56 F.E.R.C. ¶ 61,170 (July 31, 1991) ("In our view, treating a pending good faith SEC application differently than the SEC 'rule or order' language in the regulations ... would be inconsistent with the intent of the [regulations].")

proceeding reached the correct result. The Division believes therefore that the petitions for review should be denied.

Dated: March 25, 2003


Respectfully submitted,

A handwritten signature in black ink, appearing to read "Paul F. Roye". The signature is stylized with a large, sweeping initial "P" and a long, horizontal flourish extending to the right.

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CERTIFICATE OF SERVICE

I certify that on March 25, 2003, I caused true and correct copies of the foregoing document captioned "Response of the Division of Investment Management in Opposition to the Petitions for Review," to be hand-delivered to the Office of the Secretary of the Commission and Hon. Brenda P. Murray, Chief Administrative Law Judge, 450 Fifth Street, N.W., Washington, D.C. 20549, and to be sent federal express, overnight delivery, to counsel for Enron Corp. at the addresses indicated below, and by federal express, overnight delivery, to the other counsel listed below.

  
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