

**UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION**

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In the Matter of	:	
	:	
Applications of Enron Corp. for Exemptions	:	Administrative Proceeding
Under the Public Utility Holding Company Act	:	
of 1935, (Nos. 70-9661 and 70-10056).	:	File No. 3-10909

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**REPLY OF ENRON CORP. TO THE DIVISION OF INVESTMENT MANAGEMENT'S  
OPPOSITION TO THE PETITIONS FOR REVIEW**

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Dated: September 3, 2003

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## I. INTRODUCTION

The application of Enron Corp. ("Enron") for exemption as a holding company under Section 3(a)(1) of the Public Utility Holding Company Act of 1935 ("Act") depends on whether Portland General Electric Company ("PGE"), Enron's only public utility subsidiary company, is "predominantly intrastate in character" and whether it carries on its business "substantially" in Oregon where PGE and Enron are organized. As applied to a corporation, "character" is about a corporation's core business; its purpose, design and actions. The Commission's task in this proceeding is to discern the character of PGE from the substantial evidence in the record. It is not a simple task. Just as you cannot measure one dimension of a man to determine his character, one line on an income statement does not reveal the character of a corporation.

The evidence in this proceeding demonstrates, based on PGE's purpose, design and actions, that PGE is predominantly an Oregon utility operating substantially in Oregon, and that therefore Enron satisfies the statutory standards for an exemption under Section 3(a)(1) of the Act. Based on Congress' intent in adopting Section 3(a)(1), the presumption that follows from PGE's intrastate status is that PGE's state utility regulatory commission, the Oregon Public Utility Commission ("OPUC"), is capable of regulating PGE and protecting its consumers. That presumption has been validated in this proceeding by the OPUC which has filed briefs affirming its ability to regulate PGE and to discharge its duty under Oregon law to protect PGE's consumers. Accordingly, the Commission should summarily grant the exemption to Enron or proceed to Phase II of this proceeding if the Commission believes that other grounds are present to require a hearing on whether the exemption would be detrimental to the public interest and the interests of investors and consumers.

In addition, numerous policy arguments favor exemption. Exemption will permit Enron's Chapter 11 reorganization to proceed without the interruption and delay that would accompany registration under the Act and, accordingly, is in the interest of Enron's creditors. PGE's consumers and investors are currently well protected and would not be more secure if Enron was required to register. Exemption also is consistent with the Commission's practice of interpreting the Act from a practical perspective with regard to developments in the electric utility industry. The record demonstrates that PGE is simply an intrastate utility that uses the regional power markets, the development of which are encouraged by the Federal Energy Regulatory Commission ("FERC"), to support its Oregon business.

Although Enron is entitled to an exemption, the Commission has wide discretion under the Act to find the best solution; one that balances the interests of Enron's creditors in the prompt resolution of Enron's bankruptcy, through the implementation of the proposed plan of reorganization ("Plan"), with the public interest generally and the interests of PGE's investors and consumers. Conditions may be placed on the exemption, for example to limit its duration or to restrict affiliate transactions between Enron and PGE that are not approved by the OPUC. A Phase II hearing would allow the Commission to take evidence on whether certain conditions should be placed on the exemption.<sup>1</sup>

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<sup>1</sup> Rule 24 under the Act, 17 CFR § 250.24, provides that an order of exemption may contain conditions of virtually any kind. *See* testimony of Douglas Hawes, 21: 472-491. For example, in *Lykes Bros., Inc., Holding Co.* Act Release No. 20487 (April 6, 1978), the Commission granted what was effectively a temporary exemption pending Lykes Brothers' divestiture of its only public utility subsidiary.

**II. THE PREPONDERANCE OF EVIDENCE IN THE RECORD DEMONSTRATES THAT PGE IS PREDOMINANTLY AND SUBSTANTIALLY AN OREGON UTILITY.**

Although not easily defined, "character" is a quality of steadfast consistency rooted in solid beliefs that are demonstrated through many aspects of a person's existence in society.<sup>2</sup>

PGE's roots, its fundamental core and the branches that describe the scope of its utility business activities are demonstrated through the evidence in the record - all the evidence. Neither the Congress in Section 3(a)(1) nor this Commission has resolved that character is solely a question of gross revenues. The evidence is summarized below and discussed in the balance of this brief.

*Evidence of PGE's Oregon Character*

*Evidence of PGE's Interstate Character*

1. PGE is organized in Oregon and based in Portland.<sup>3</sup>
2. PGE's only state regulator is the OPUC and PGE is required by Oregon law to provide safe and adequate utility service at reasonable rates.<sup>4</sup>
3. PGE's service territory is located wholly within Oregon.<sup>5</sup>
4. PGE's residential, commercial and industrial customers are wholly within Oregon.<sup>6</sup>

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<sup>2</sup> "Character is like a tree and reputation like its shadow. The shadow is what we think of it; the tree is the real thing. I desire so to conduct the affairs of this administration that if at the end, when I come to lay down the reins of power, I have lost every other friend on earth, I shall at least have one friend left, and that friend shall be down inside me." *Lincoln's Own Stories*, collected and edited by Anthony Gross (New York: Harper & Brothers, 1912).

<sup>3</sup> Lesh, 3:3-4, 55.

<sup>4</sup> Lesh, 2:43; 3:63-64; 5:113-115.

<sup>5</sup> Lesh, 3:59, Exhibit PL-2.

<sup>6</sup> Lesh, 3:59-61.

5. PGE's utility assets are located substantially (87%) within Oregon.<sup>7</sup>

PGE owns an interest in a generating plant located in Montana that represents 13% of its utility assets and 8% of its combined generation and firm power purchases on a MW basis.<sup>8</sup>

6. All of PGE's transmission assets (except for a small part ancillary to the Montana plant) are located and operating in Oregon.<sup>9</sup>

Some of PGE's transmission assets, notably the Pacific Northwest AC intertie, although located exclusively in Oregon are used to transmit power in interstate commerce.<sup>10</sup>

7. PGE is by design a capacity short utility. It generates power from its own plants but also must purchase power in the wholesale market, for example from hydro-electric facilities in Washington, to serve its retail customers, all of which are located in Oregon.<sup>11</sup>

PGE purchases power in the interstate wholesale power markets.<sup>12</sup>

8. All of PGE's employees and offices are located in Oregon.<sup>13</sup>

9. The overwhelming majority of PGE's taxes are paid to Oregon.<sup>14</sup>

10. PGE's charitable activities and civic connections are principally with Oregon entities.<sup>15</sup>

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<sup>7</sup> Lesh, 4:72-80. Turina, 9:196-202.

<sup>8</sup> Turina, 9:200-202.

<sup>9</sup> Ryan, 2:40-43.

<sup>10</sup> Ryan, 4:79-84.

<sup>11</sup> Lesh, 11:232-246. Piro, 10:209-222. Exhibit JP-5.

<sup>12</sup> Turina, 4:76-93.

<sup>13</sup> Piro, 2:27-28.

<sup>14</sup> Piro, 2:30-34.

<sup>15</sup> Piro, 2:36-43.

11. The revenues that PGE derives from providing service to residential, commercial and industrial (*i.e.*, retail) customers is wholly from Oregon.<sup>16</sup>

12. PGE's gross revenues, according to GAAP, are substantially (66% to 88% from 1998 to 2002) from Oregon.<sup>17</sup>

PGE's gross revenues, ignoring GAAP, from sales outside of Oregon are 34% on average from 1999 to 2001.<sup>18</sup> The sales outside Oregon are wholesale at power trading hubs.

13. Removing commodity cost distortions from the intrastate analysis, PGE's net revenues, *i.e.*, revenues from providing utility services to all customers - retail and wholesale - less the cost of the electricity commodity, are wholly from Oregon.<sup>19</sup>

When the evidence is laid side by side, it is hard not to see that the preponderance of the evidence supports Enron's claim that PGE is predominantly intrastate in character and that it operates substantially within Oregon. Enron has carried its burden of proof in this matter. The Division of Investment Management ("Division") ignores much of this evidence in its briefs. While ostensibly agreeing with Commission precedent that a variety of quantifiable factors should be considered to compare a company's out-of-state presence with its in-state presence, the Division really wants the Commission to focus on only one factor - gross utility operating revenues - as a measure of the relative size of in-state and out-of-state operations.<sup>20</sup> In addition, to reach its conclusion, the Division ignores recent Financial Accounting Standards Board

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<sup>16</sup> Piro, 8:157-159.

<sup>17</sup> Exhibit JP-4.

<sup>18</sup> Exhibit IM-5.

<sup>19</sup> Enron's Brief in Support of Petition for Review (July 21, 2003) ("Enron's Brief in Support") at 23, n. 46. Exhibit JP-4.

<sup>20</sup> Because, in the Division's opinion, PGE's gross revenues from out-of-state sales appear high, the Division sees the other evidence as secondary in importance or entirely irrelevant.



("FASB") accounting pronouncements on the proper accounting treatment for some of the PGE revenues at issue here as well as the fact that the fundamental purpose of much of the alleged out-of-state activity is nothing more than PGE taking the most expeditious and efficient course to minimize the costs of service to its retail customers, all of whom are located in Oregon.

Given the breadth of the record in this proceeding, the Division's narrow focus on gross revenues alone to determine PGE's character is a shortcut to trouble. Thankfully, the Division is alone in its view. The National Association of Regulatory Utility Commissioners ("NARUC"), the Edison Electric Institute ("EEI") and the OPUC, have objected to Judge Murray's application of Section 3(a)(1) of the Act and in particular the emphasis on gross revenues in the context of PGE's wholesale trading activity.<sup>21</sup> The FASB also has found that gross revenues are not the best measure of a power trading business and on numerous prior occasions the Commission has explicitly found that gross revenues produce misleading comparisons when comparing the in-state and out-of-state activities of combination electric and gas utilities and gas only utilities.

**A. The Service of Oregon Customers is at PGE's Core.**

PGE is organized in Oregon and the center of its operations are in Portland, Oregon.<sup>22</sup> The OPUC regulates numerous aspects of PGE's operations, including retail rates and conditions of service, the issuance of securities by PGE and the system of accounts to be kept by Oregon utilities.<sup>23</sup> PGE's service territory is located wholly within Oregon where it provides

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<sup>21</sup> See OPUC Motion to Intervene Out of Time (January 7, 2003); OPUC Reply Brief (January 14, 2003); OPUC Petition for Review (February 27, 2003); NARUC Motion for Leave to Intervene Out of Time (March 21, 2003); EEI Amicus Brief in Support of Petitions for Review (March 25, 2003); NARUC Amicus Brief in Support of OPUC Brief in Support of Petition for Review (July 21, 2003); EEI Amicus Brief on Review of Initial Decision (July 21, 2003). All the other participants in this proceeding have declined to take a view on Enron's entitlement to an exemption under Section 3(a)(1).

<sup>22</sup> Lesh, 3:55, Exhibits PL-1 and PL-2.

<sup>23</sup> Lesh, 5:103-107.

approximately 736,000 residential, commercial and industrial customers with electric utility service.<sup>24</sup> PGE operates under the constraints of Oregon law which requires PGE to provide safe and adequate service to its customers at reasonable rates.<sup>25</sup>

There is extensive information in the record regarding the jurisdiction of the OPUC over PGE and PGE's transactions with Enron.<sup>26</sup> The Division nevertheless claims that "the full extent of the OPUC's jurisdiction over Portland General is not in the record because the OPUC did not submit testimony on this (or any other) issue. Correspondingly, the Division was not afforded an opportunity to flesh out this issue through cross-examination."<sup>27</sup> The Division declined the opportunity to cross-examine any of Enron's witnesses, including witness Pamela Lesh, PGE's Vice President for Regulation. The testimony of Ms. Lesh, James Piro, PGE's Chief Financial Officer and Treasurer, and the submissions of the OPUC in this proceeding leave no doubt that the OPUC fully regulates PGE and Enron's dealings with PGE.

**B. To Be Predominantly and Substantially Intrastate in Character Does Not Mean that a Utility May Not Engage in Interstate Commerce.**

To serve its customers, PGE owns distribution, transmission, generation, and other assets, and also contracts for various services, including power generation and natural gas transportation. Although the record does not indicate where PGE purchases the various

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<sup>24</sup> Lesh, 3:58-63, Exhibit PL-2.

<sup>25</sup> Lesh, 3:63-64.

<sup>26</sup> See e.g., Lesh, 5:109-111 ("The OPUC has access to the utility's books, records, personnel and facilities and the ability to monitor and control the costs and terms of utility service. In addition, any sale of Portland General must be approved by the OPUC."). See also, Piro, 4-6:87-121 and Exhibit JP-1 (citing numerous restrictions imposed by the OPUC on transactions between Enron and PGE and provisions of Oregon law providing the OPUC with jurisdiction over PGE's operations).

<sup>27</sup> See Division's Brief in Opposition to Petitions for Review (August 20, 2003) ("Division's Brief") at 38, n. 84.

resources that it needs to run its business,<sup>28</sup> it is reasonable to assume that a substantial part of the materials, fuel and supplies used to serve PGE's customers is procured through interstate commerce, a circumstance that is no different for PGE than for any other utility in the country.

PGE purchases or self-generates significant amounts of power in Oregon, but it also relies on out-of-state sources. The company owns a 20% interest in two units of the Colstrip generating plant in Montana, together with associated transmission lines. Colstrip is a mine-mouth plant - located directly next to its fuel source. PGE energizes the transmission grid from Montana, rather than carrying the coal to PGE's service territory to energize the grid locally. PGE's Boardman coal plant, in contrast, uses rail to transport coal from Wyoming that is burned in the Boardman, Oregon plant to produce power for PGE's native load.<sup>29</sup> The Colstrip interest was approved by the OPUC for inclusion in PGE's retail rate base, which is a key component of the revenue requirement the OPUC determines as the basis for PGE's rates.<sup>30</sup> Both Boardman and Colstrip burn out-of-state coal to produce electricity for PGE's Oregon customers under OPUC regulation. PGE's Colstrip interest is an asset dedicated to serving its Oregon customers.

Long-term power purchase contracts with four hydro-electric projects located in Washington, on the Columbia River, provide another significant source of PGE's power.<sup>31</sup> While defending Judge Murray's belief that PGE's out-of-state power purchases are indicative of interstate character, the Division concedes that "Out-of-state *purchases* of electricity are not part of a Section 3(a)(1) analysis given that the statutory definition of electric utility company under

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<sup>28</sup> PGE purchases various products, including natural gas, coal, and oil, as well as equipment and materials used in constructing and maintaining distribution, transmission and generating facilities. Lesh, 3:64-69.

<sup>29</sup> Lesh, 4:76-85.

<sup>30</sup> Lesh, 6:122-124.

<sup>31</sup> Lesh, 4:86-88.

the Act speaks to distribution of electric energy for *sale*."<sup>32</sup> PGE plant locations and purchased power sources depend on whether it is more efficient to transport the raw material (coal), or the finished product (electricity), over the distance between the fuel source and the Oregon load, and the simple geography of where the low-cost hydro-electric resources are located.

Notably, PGE has little choice in where it purchases and sells power. Trading hubs develop where major transmission lines intersect and these hubs have evolved as common points for commercial purchase and sale contracts to settle. Major hubs have fewer transmission constraints, better assuring receipt and delivery of schedules. Purchasing and selling at a market hub allows purchaser and seller to obtain a better and less volatile price and avoid risks associated with trading in less liquid markets.<sup>33</sup>

The fundamental issue that must be resolved when making a character determination under Section 3(a)(1) is not whether a company is engaged in interstate commerce, but whether the utility is capable of being effectively regulated in a single state.<sup>34</sup> For this reason, the Commission has never looked at the source of a utility's fuel, supplies or other inputs in performing the intrastate analysis under Section 3(a)(1).<sup>35</sup> To perform the analysis properly, the Commission must focus on the nature and extent of PGE's utility activities in the states PGE's

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<sup>32</sup> See Division's Brief at 23.

<sup>33</sup> Turina, 5: 96-119.

<sup>34</sup> See the statement of David Smith, Associate Director of the Division of Investment Management, Tr., 79:18-23 ("Congress included the 3(a)(1) exemption in the Act on the grounds that a holding company meeting these requirements could usually effectively be regulated by the single state, and that the overlay of federal regulation provided by PUHCA was generally not necessary in these circumstances.")

<sup>35</sup> If a utility is attributed interstate character under Section 3(a)(1) based on general connections to interstate commerce, rather than factors such as service territory, customers and utility plant engaged in serving those customers, no utility holding company in the U.S. is likely to be able to qualify for an exemption under Section 3(a)(1). "It is clear that the operations of even the most insular electric utility affect interstate commerce in many ways, including purchasing power, fuel, equipment and supplies from out-of-state sources as well as the transmission of electricity and selling securities. But operating in interstate commerce is not synonymous with out-of-state utility operations for purposes of Section 3(a)(1)." EEI Amicus Brief on Review of Initial Decision (July 21, 2003) at 9.

operations touch, not with the utility's general activities in interstate commerce.<sup>36</sup> From this perspective, it is clear that the roots of PGE's character tree are in its Oregon service territory. PGE's objective of providing service to the customers in that service territory is the common denominator in all its activities, even though some of them may be conducted outside of Oregon.

The use of PGE's transmission assets located in Oregon also does not cause PGE to be an out-of-state utility. Although PGE's high-voltage transmission grid is integrated into the grid in the western United States, Canada and Mexico,<sup>37</sup> such integration is common to every utility that owns transmission lines in the region and improving such interconnectedness is a national energy policy objective. Under the FERC's open access requirements, to improve the efficiency of regional wholesale power markets, PGE's transmission facilities, like those of other utilities, must be available for third parties to transmit power in interstate commerce.<sup>38</sup> A character determination based on such a universal attribute, particularly when the asset in question is wholly within the state of Oregon, would be essentially meaningless; tantamount to asserting that mere utility status conveys interstate character within the meaning of Section 3(a)(1).<sup>39</sup> What is meaningful, however, is that, with the exception of a small segment of transmission dedicated to transmitting Colstrip power, PGE's entire power transmission and distribution network is located in Oregon and is used principally to serve PGE's Oregon customers.<sup>40</sup>

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<sup>36</sup> For example, if a utility had a significant number of retail customers, transmission and distribution lines or generating facilities in a second state that were not subject to effective regulation in the first state, this would indicate sufficient out-of-state character precluding the granting of the exemption.

<sup>37</sup> Ryan, 1-2:17-35.

<sup>38</sup> Revenues earned from this function offset PGE's cost of serving its Oregon customers. Lesh at 322-324.

<sup>39</sup> Ryan, 4:82-84 ("The use of the AC Intertie is no different from the use of other high voltage lines within the Pacific Northwest and the Western Interconnection.")

<sup>40</sup> Ryan, 3-4:61-70.

**C. Other Quantifiable, Objective Criteria Indicate that PGE is Predominantly and Substantially an Oregon Utility**

It stands to reason that (i) if a utility's residential, commercial and industrial customers are located in one state, and (ii) its distribution system and essentially all its transmission lines are located in the same state, and (iii) virtually all of its generating plant is also located in that state, then the utility's offices and employees also would be located in the same state, and the utility's headquarters, with local management and books and records, also would be found there. In addition, the principal incidence of taxation would mirror where the economic activity takes place. The record indicates that in PGE's case this is all true.

Enron witness James Piro testified that all of PGE's offices are located in Oregon and that all of PGE's approximately 2,800 employees work in Oregon.<sup>41</sup> PGE maintains its books and records in Oregon separate from Enron.<sup>42</sup> PGE paid Oregon tax bills for income, property, franchise fees and other taxes in the amount of approximately \$76.5 million in 2001 and only \$5 million, principally in property taxes, to Montana during 2001.<sup>43</sup> In addition, PGE contributes to charities and civic organizations located in Oregon.<sup>44</sup> These facts all contradict the Division's view of PGE as an interstate utility and the Division makes no effort to explain how an interstate utility could have such a one-sided Oregon presence.<sup>45</sup> The facts are wholly consistent with the character of PGE as a utility operating in Oregon.

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<sup>41</sup> Piro, 2:27-28.

<sup>42</sup> Piro, 3:54.

<sup>43</sup> Piro, 3:48-70.

<sup>44</sup> Piro, 2:36-37.

<sup>45</sup> In judging the intrastate character of a public utility company, the Commission has considered the geographic areas served, the location of the utility's retail customers, transmission lines and generating capacity, and the location of the utility's net utility plant generally. *See e.g., N.W. Electric Power Coop., Holding Co. Act Release No. 24497 (Nov. 10, 1987); Wisconsin Energy Corp., Holding Co. Act Release No. 24267 (Dec. 18, 1986).*

**D. The Division's Gross Revenues Method is Misleading and, Following Commission Precedent, a Net Revenues Comparison is More Probative.**

The Division bases its case under Section 3(a)(1) almost entirely on a comparison of PGE's revenues from in-state sales and out-of-state sales. But their case resides on an even narrower plank than that. Adamant that a comparison of PGE's gross operating revenues from in-state and out-of-state sales is required under the Act, the Division struggles to keep its balance while fighting off FASB accounting requirements and the Commission's own precedent which has held repeatedly that a gross revenues comparison can be misleading and that net revenues should, in those cases, be the preferred measure.<sup>46</sup>

First, recall that all of PGE's revenue from out-of-state sales comes from wholesale power trading. All of PGE's retail customer revenue is from Oregon.<sup>47</sup> PGE's wholesale revenue comes from two types of transactions. Wholesale activity in the "retail book" is conducted to manage supplies and load for the benefit of PGE's retail customers in Oregon. As Mary Turina, PGE's Vice President of Risk Management explained, PGE has a variable customer load and it must maintain and acquire generating capacity and power to meet that load reliably. PGE's use of power purchase contracts that have no variable cost (*i.e.*, the hydro-electric contracts) means that the substantial majority of its wholesale sales of electricity are part of normal utility power supply management - the sale of excess power - conducted to further the Oregon utility business.<sup>48</sup> The other important point to remember about the retail book is that only a small

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<sup>46</sup> See *NIPSCO Indus., Inc.*, Holding Co. Act Release No. 26975 (Feb. 10, 1999) ("*NIPSCO*"); *AES Corp.*, Holding Co. Act Release No. 27063 (Aug. 20, 1999) ("*AES I*"); *C&T Enterprises, Inc.*, Holding Co. Act Release No. 275690 (Oct. 31 2002) ("*C&T Enterprises*").

<sup>47</sup> Piro, 8:156-159.

<sup>48</sup> "It would be a mistake to view Portland General's interstate wholesale sales out of the context of its effort to achieve the lowest possible cost of power supply for its native load. In essence, wholesale sales are simply how Portland General manages its inventory in support of its business as a retailer of electricity." Turina, 7:149-156.

proportion of the transactions PGE enters into ever result in physical delivery of power; most are "booked out," a term that refers to the practice of netting out transactions that effectively cancel each other out. The practical implication of this fact is that the vast majority of PGE's retail trading activity is made up of what are essentially financial transactions; hardly the type of activity that is the equivalent of operating a regulated utility system in another state.

The second part of PGE's wholesale revenue comes from transactions in the "non-retail trading book." While the purchases and sales in the retail book sometimes result in the actual delivery of electricity in keeping with PGE's power inventory management function, the non-retail trading book transactions are almost always netted out with purchases matched to sales and vice versa.<sup>49</sup> The non-retail trading book activity is essentially a brokerage or market making business that does not involve inventory. "It makes a minor contribution to earnings and enables us to stay on top of wholesale markets so that we can better perform our inventory management function on behalf of retail customers."<sup>50</sup>

The FASB has required that all gains and losses on energy trading contracts (PGE's non-retail trading activity) be shown net in the income statement whether or not settled physically.<sup>51</sup> "Netting results in a more accurate reflection of those transactions, showing the net gain or loss in revenue and eliminating from MWh sold those financially settled transactions."<sup>52</sup> Netting allows investors and, in this case, the Commission, to see more clearly the margin that PGE

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<sup>49</sup> Piro, 8:163-170.

<sup>50</sup> Turina, 8:161-164. As witness Lesh has stated, "Because short-term resources acquired from the Western wholesale market currently make up such a significant portion of our retail resource system, good market intelligence is critical. One can acquire such intelligence most easily and reliably by participating in the market as a buyer and seller." Lesh, 11:246-250.

<sup>51</sup> FASB EITF Issue No. 02-3, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, Issue Summary No. 2, Supplement No. 2, p. 4. Piro at 182-183.

<sup>52</sup> Piro, 9:186-188.



earns on its non-retail trading book energy transactions. Netting demonstrates the impact of this business on PGE's bottom line.

Exhibit JP-4 shows the effect of netting on PGE's financial statements. Gross revenues from the sale of power in the non-retail trading book, before GAAP adjustments, were \$578 million and \$289 million for the year 2001 and the first nine months of 2002, respectively. The Division includes these revenues in its Exhibit IM-5 to arrive at its 34% average interstate sales figure. After subtracting the cost of power purchased in the non-retail trading book, *i.e.*, the other side of the sales, the net revenues under GAAP, reflecting the FASB requirement, were -\$11 million and -\$1 million for 2001 and the first nine months of 2002, respectively.<sup>53</sup>

Given the nature of the non-retail trading book -- entering into financial transactions which rarely if ever result in the actual delivery of electricity -- including revenues and costs of power purchased in PGE's financial statements on the same basis as revenues and expenses of its traditional regulated utility operations would dramatically overstate the significance of the trading activities. The FASB-mandated approach reveals that the trading operations are relatively minor operations that would not have a dramatic impact on PGE's operations or financial condition if they were discontinued. PGE's activities in the wholesale power markets in connection with the non-retail trading book are, therefore, not a core part of its business and do not preclude PGE from being predominantly and substantially intrastate in character.<sup>54</sup>

The practice of netting commodity costs is supported by several Commission cases that

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<sup>53</sup> Under GAAP, for 2001 and the first nine months of 2002, revenue from interstate wholesale sales as a percent of total revenue is reduced to 33% (from 45%) and 14% (from 29%), respectively.

<sup>54</sup> Businesses generate a profit by providing a service that adds value. Revenues less the cost of goods sold reveals what value has been added. If no value is added a business cannot exist for long. PGE's non-retail trading book activity produced no net revenue in 2001 and the first nine months of 2002 and so it should not be viewed as a substantial interstate business.

involved whether gross operating revenues properly reflected the nature and size of the underlying utility business of the applicant companies. In *NIPSCO, AES I and C&T Enterprises*, the Commission acknowledged that gross revenues comparisons can cause "distortions."<sup>55</sup>

*NIPSCO* involved an acquisition by NIPSCO, the owner of three Indiana combination gas and electric utility companies, of Bay State Gas Company, a Massachusetts gas utility. The issue under Section 3(a)(1) in *NIPSCO* was whether NIPSCO would remain predominantly and substantially an Indiana utility after acquiring Bay State's Massachusetts utility operations. Noting that "Section 3(a)(1) does not provide any guidelines for a determination that a company is "predominantly intrastate in character" and operates 'substantially in a single State'",<sup>56</sup> the Commission found that "net operating revenues provide the most appropriate basis for comparison in this matter."<sup>57</sup>

The Commission went to significant efforts to understand the operating and financial differences between the electric and gas components of the NIPSCO and Bay State systems and even took notice of the difference in the commodity price of gas between NIPSCO and Bay State.<sup>58</sup> Just as in PGE's case where non-retail book trading has an obvious impact on gross

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<sup>55</sup> See *NIPSCO* at 50, *AES I* at 44-45, and *C&T Enterprises* at 22.

<sup>56</sup> *NIPSCO* at 55-56. "To determine whether the predominantly/substantially requirement is met, the Commission usually evaluates a variety of quantifiable factors in order to compare a company's out-of-state presence with its in-state presence." *Id.*

<sup>57</sup> *NIPSCO* at 58.

<sup>58</sup> "Whereas the NIPSCO System is predominantly electric -- in 1997, electric revenues accounted for approximately 56% of the combined gross utility revenues of the NIPSCO Operating Companies -- the Bay State System is exclusively gas. In this regard, it is relevant to consider that the components of gross revenues are different for electric and gas utilities. Retail rates often contain automatic adjustment clauses that provide for the relatively current pass-through to customers of the actual cost of gas, in the case of gas utilities, and of fuel for generation and purchased power, in the case of electric utilities. These pass-through costs represent a larger part of revenues in the gas utility business than in the electric utility business."

"In addition, changes in the cost of gas have a significantly greater effect on gas utility gross revenues than on electric utility gross revenues. The cost of delivered gas may thus distort the comparison. Bay State's delivered cost of gas has historically been significantly higher than NIPSCO's. As noted above, the cost of gas is essentially a

revenues, but little impact on net operating revenues, the Commission found the same with regard to transactions in commodity gas in the NIPSCO matter.

Notably, by subtracting the cost of gas, fuel for generation, and purchased power costs from gross revenues to arrive at net revenues, the Commission was fostering a more level comparison between the underlying utility service provided by NIPSCO and Bay State. The Commission was comparing in-state and out-of-state revenues derived from electric generation, transmission and distribution services and gas distribution services without the distortions associated with the sale of energy commodities, be they electricity or gas. NIPSCO and Bay State each used hard assets and employees to deliver a commodity, electricity or gas, to a consumer. By stripping away the commodity cost, the Commission was able to understand the actual size of the delivery business in each state for purposes of determining where the combined utility predominantly operated.

PGE's business is not fundamentally different. Applying the policy of *NIPSCO*, not only should the Commission follow the FASB requirement and net revenues in the non-retail trading book, but it also should look more closely at the nature of the retail-book transactions. As a net importer of power, PGE's out-of-state sales are more than offset by its out-of-state purchases.<sup>59</sup> When you strip way the electricity commodity costs associated with the retail book, you see that PGE's bricks and mortar electric utility business is just an Oregon business.

In *AES I*, AES Corporation sought an exemption under Section 3(a)(5) of the Act in connection with the acquisition of CILCORP Inc., the parent of an Illinois combination gas and

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pass-through to customers; it has an obvious impact on gross revenues, but little effect, if any, on net operating revenues." *NIPSCO* at 49-50 (footnote omitted).

<sup>59</sup> Exhibit JP-5.

electric utility, Central Illinois Light Co. ("CILCO"). The issue in *AES I* was whether CILCO would be "material" to AES and that analysis involved the comparison of various financial measures between AES and CILCO. The Commission built on the *NIPSCO* precedent that comparing dissimilar businesses, electric and gas, required a financial measure that removed the distortion of commodity costs. It also reasoned that the businesses were different because CILCO was subject to rate regulation and AES largely was not, resulting in different operating margins.<sup>60</sup> The Commission then took an additional step to make the revenue comparison more probative by adjusting AES's GAAP income statement to reflect the revenues of AES's many minority held unconsolidated subsidiaries.<sup>61</sup>

In *AES I*, like *NIPSCO*, the Commission took great care to adjust the comparison of financial measures to account for real differences in the manner in which the subject companies operated to better reflect the character of their underlying businesses. PGE's non-retail trading activity is a competitive business with margins that are much different from the regulated returns provided in PGE's Oregon utility business. Without netting, PGE's non-retail book wholesale trading activity is overstated. PGE's retail book wholesale trading activity also is overstated without netting. As noted, PGE is a net purchaser/importer of power to service its Oregon customers because it has insufficient owned generating capacity to meet its Oregon load. A focus on gross revenues alone, however, gives the incorrect impression that PGE is a net exporter of power to Washington and elsewhere outside Oregon.

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<sup>60</sup> *AES I* at 18 (footnote omitted).

<sup>61</sup> Under GAAP, these interests were reflected as equity in earnings of affiliates under the equity method of accounting. The Commission observed: "We have taken this approach in other contexts if the adjustments allow us to make a more accurate analysis of the pertinent criteria relevant under the Act." *AES I* at 20-21 (footnote omitted). The Commission's choice to depart from AES's GAAP financial statements to improve the accuracy of its analysis is in stark contrast to the Division's objection to a net revenues measure in this case to more accurately describe PGE's underlying utility business.

In *C&T Enterprises*, the Commission found that C&T Enterprises, Inc. ("C&T"), a Pennsylvania holding company of a Pennsylvania electric utility company, could acquire Valley Energy, Inc. ("Valley"), a gas utility, and qualify for an intrastate exemption under Section 3(a)(1) of the Act. Because Valley provided gas utility service in both Pennsylvania and New York and would be a material subsidiary of C&T, the issue in the case was whether Valley was predominantly and substantially a Pennsylvania utility in character.<sup>62</sup>

Valley was engaged in the business of selling and distributing gas to approximately 5,000 customers in Pennsylvania and 1,300 customers in New York. Unlike PGE, due to its retail operations Valley was subject to regulation as a public utility company in two states. The Commission considered information about Valley's gross operating revenues, net operating revenues, utility operating income, net utility income and net utility plant and compared the amounts derived in New York to Valley's total business to determine whether Valley was intrastate in character.

The Division attempts to distinguish *C&T Enterprises* from the PGE facts and states that Enron has "misread" the case.<sup>63</sup> It is the Division that has misread the case. The predominantly and substantially intrastate analysis in *C&T Enterprises* was applied to Valley which is a gas only utility operating in two states. The parallel with PGE, an electric only utility with sales in Oregon and Washington is clear. Once Valley was shown to be predominantly and substantially

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<sup>62</sup> This case is analyzed in detail in Enron's Brief in Support.

<sup>63</sup> See Division's Brief at 18. The Division states: "[T]he net revenue analysis in *C&T Enterprises* is applied to cases involving comparisons of material gas and electric utility subsidiaries to prevent a distorted picture of the combination utility's out-of-state activities that may arise by virtue of the fact that the gross revenues contributed by the natural gas component will likely be larger than the gross revenues contributed by the electric power component. By netting out the costs of the fixed costs of gas power and electric power, the net revenue analysis attempts to filter out the distortion that would be caused when comparing a gas utility, which has a greater proportion of its gross revenues attributable to the pass-through costs of the commodity, natural gas, when compared to the electric utility business." Division's Brief at 19-20.

a Pennsylvania utility in character, it followed *automatically* that C&T would be predominantly and substantially a Pennsylvania holding company because C&T's only other utility business was a wholly Pennsylvania electric utility company.

The Division states that in PGE's case, a net revenues comparison is not warranted because there is "no concern that differing types of commodities involved might provide an inaccurate picture of the utility's true character."<sup>64</sup> But the Division contradicts *C&T Enterprises*, because there the Commission was concerned that Valley's true intrastate utility character could be obscured by a gross revenues comparison of Valley's sales of only one commodity (gas) in both Pennsylvania and New York. The Valley intrastate analysis did not involve the difficulties of trying to evaluate a gas utility in comparison to a separate electric utility.

In *C&T Enterprises*, the Commission found that Valley's Pennsylvania customers included more industrial consumers that purchased only gas transportation service, not the underlying commodity. In New York, by contrast, Valley's customers tended to purchase both gas and transportation service, thus exaggerating the revenues from New York. By subtracting the cost of gas from utility revenues in both states, a net operating revenues comparison allowed the underlying utility service (*i.e.*, the provision of gas delivery service through the pipes, compressors and meters owned by the utility) in Pennsylvania and New York to be compared on an equal basis. *C&T Enterprises* extends the *NIPSCO and AES I* line of cases because in considering the intrastate character of a stand-alone utility (not just a combination system) the Commission looked to the financial measures (in this case, net operating revenues) that revealed

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<sup>64</sup> See Division's Brief at 20.

the utility's true character.

The logic followed in *C&T Enterprises* with respect to a gas-only utility is equally applicable to an electric-only utility such as PGE. In PGE's case, Washington wholesale customers purchase only commodity electricity, while Oregon retail customers purchase transmission and delivery service with the commodity electricity. PGE's sales outside of Oregon in the wholesale power markets are of a dramatically different nature than those to PGE's retail customers in Oregon. The revenues that PGE derives from its wholesale sales exaggerate the importance of this business to the company. A net revenues comparison, by contrast, would reveal the underlying character of PGE's utility business, unshrouded by commodity electricity costs. PGE's net revenues, *i.e.*, gross revenues less the cost of purchased power, would demonstrate, consistent with all the other facts in the record, that PGE's core electric utility business is solely an Oregon business.<sup>65</sup>

In reviewing *NIPSCO*, *AES I* and *C&T Enterprises*, one must conclude that, despite the Division's exhortations, a comparison based on gross revenues is not the gold standard, is not sacrosanct, and is not required when common sense, applied to a full understanding of the operating realities of the utility business concerned, would require the use of another more probative financial measure. PGE's character is determined by all the factors that describe the nature, quality and extent of its public utility business. The Commission should consider all these factors in deciding whether PGE is predominantly and substantially an Oregon utility.

**E. Restructuring PGE is a Poor Path to an Exemption.**

The Division suggests that the Commission should not be concerned about the signals

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<sup>65</sup> See Enron's Brief in Support at 23, n. 46, and associated text for the net revenues calculation.

that it is sending to the utility industry regarding the impact of wholesale trading revenues on the intrastate exemption. According to the Division, PGE could simply restructure its wholesale power trading activities so that the revenues from out-of-state transactions would be accrued by a subsidiary, not PGE.<sup>66</sup> PGE would then be intrastate in character and Enron would qualify for the intrastate exemption. That a simple structural change could dramatically change the applicability of the exemption demonstrates that wholesale power trading activity is not indicative of a business's utility character in the way that distributing energy to retail customers indicates utility character.<sup>67</sup> Such a restructuring also would reduce the OPUC's jurisdiction over PGE's trading operations, providing the strange result that by making state regulation of public utility companies less effective, the intrastate exemption would become more available.<sup>68</sup>

### **III. ENRON'S APPLICATION UNDER SECTIONS 3(a)(3) AND 3(a)(5) OF THE ACT FORMS AN APPROPRIATE BASIS UPON WHICH TO GRANT THE TEMPORARY EXEMPTION THAT ENRON HAS REQUESTED.**

Enron has fully briefed its case with regard to the exemptions under Sections 3(a)(3) and 3(a)(5) of the Act. See, in particular, Enron's Brief in Support of its Applications for Exemption Under Sections 3(a)(1), 3(a)(3) and 3(a)(5) of the Public Utility Holding Company Act of 1935 (January 7, 2003). Enron will continue to rely on those arguments here. The Division characterizes Enron's Section 3(a)(3)/(5) exemption application disparagingly as one intended to

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<sup>66</sup> See Division's Brief at 24, n. 55.

<sup>67</sup> In registered holding company systems power trading subsidiaries are non-utility companies exempt from most regulation under the Act by Rules 52 and 58. The FERC would exercise primary regulatory authority over wholesale power trading activities. Accordingly, PGE's wholesale trading cannot be the principal basis for regulating Enron as a registered holding company under the Act.

<sup>68</sup> "The Commission should not adopt a policy that creates an incentive for utilities to sell their excess power within the state, which may not be the most effective location for the utility that needs power (or at prices most beneficial to customers), especially in this situation where all parties agree that the OPUC has adequate regulatory oversight of Portland General to protect Oregon customers. Clearly, creating an incentive for such behavior would negatively affect both the customers who receive the benefit of the excess power sales netted against the utilities' power costs and those customers in areas that have a need for the excess power." OPUC Petition for Review (February 27, 2003) at 3.



take an advantage of a "loophole" under the Public Utility Regulatory Policies Act ("PURPA").<sup>69</sup> The application was a legitimate effort, based on substantial facts and a reasonable argument under the law, to obtain an exemption under the Act that also would provide benefits under PURPA. Enron's application was no more based on a "loophole" than the application of AES Corp. that preceded the *AES I* decision or, for that matter, the follow-on decision in *AES II*.<sup>70</sup>

**IV. EVEN IF ENRON DID NOT SATISFY THE OBJECTIVE CRITERIA FOR EXEMPTION PRECISELY, THE COMMISSION COULD STILL FASHION FLEXIBLE RELIEF THAT WOULD BE CONSISTENT WITH THE ACT.**

The Division argues that Enron is seeking "special" treatment in this case that is inappropriate and inconsistent with both the standards and the policy of the Act. Nothing could be further from the truth. In the Initial Decision, Judge Murray used a literal, mechanistic analysis, reaching a conclusion that is not only inconsistent with the facts of this case but which also failed to take any of the compelling policy issues into account. The Division has similarly cast a blind eye to the serious policy issues present here. All that Enron asks of the Commission is that it objectively assess the facts of this case in light of the Commission's established precedent and then determine the appropriate course of action based on the facts, the law and the Commission's view of the correct policy in these circumstances.

The Commission, perhaps more so than Judge Murray and the Division, is in a position to assess the policy implications of this case and to craft an appropriate remedy. The history of the Commission's interpretation of the Act is one of flexibility. Virtually all of the cases cited by the parties in their briefs in this proceeding represent situations where the Commission has interpreted the Act flexibly to reach an appropriate outcome in circumstances that were unique or

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<sup>69</sup> See Division's Brief at 3.

<sup>70</sup> *AES Corp., Holding Co.* Act Release No. 27363 (Mar. 23, 2001) ("*AES II*") (Section 3(a)(5) applications predicated on relief from PURPA restrictions).

unusual.

Enron respectfully submits that even if the Commission cannot find that PGE is predominantly intrastate in character, there is no policy objective that will be served by requiring Enron to register as a holding company. Enron is already well along in the Plan process that will soon result in it no longer being a holding company. Enron is extensively regulated by the bankruptcy court and its only public utility subsidiary is extremely well protected and supervised by the OPUC as well as protected by the ring-fencing provisions that have been put into place to separate PGE from Enron financially. Each of the regulators with jurisdiction over Enron and PGE are already protecting the interests of the very same constituencies that the Commission would be charged with protecting if Enron were required to register as a holding company under the Act. Finally, the Commission can take judicial notice of the fact that both houses of Congress have passed legislation that would, with the support of the Commission, repeal the Act. Under these circumstances, there would be no point in requiring Enron to register even if it did not qualify for exemption.

**V. APPLY THE ACT TO PROMOTE THE INTERESTS OF THE PUBLIC, INVESTORS AND CONSUMERS, NOT TO CAUSE ADDITIONAL HARM.**

The Division asks the Commission to disregard the collateral effects of registration on Enron's creditors and the delay that it may cause in the implementation of the Plan. The Division's heavy-handed approach, however, is not required by the Act. Enron is already committed to, and engaged in the process of divesting PGE - the ultimate remedy under the Act. PGE's investors and consumers, meanwhile, are protected by the OPUC. PGE's debt is investment grade and even if Enron were to register as a holding company, debt issued by PGE

under OPUC authority would be exempt from Commission authorization under Rule 52(a).<sup>71</sup>

Although PGE operates under effective OPUC regulation and Enron is operating under the supervision of the bankruptcy court and the creditors' committee under Chapter 11, the Commission need not cede its jurisdiction over Enron. But the Commission should recognize that the full panoply of regulation under the Act is not appropriate under such circumstances and, if it does not feel that an unconditional exemption is appropriate for any reason, it can craft a narrowly tailored solution by imposing appropriate conditions in an order of exemption, for example, by requiring the divestiture of PGE by a date certain (thus addressing the Division's characterization of the Plan's divestiture requirement as speculative) or requiring that the Commission approve affiliate transactions with PGE that the OPUC has not approved. A conditional exemption could provide appropriate protections without imposing the heavy burden of registration in a context where nothing would be gained and much would be lost.<sup>72</sup> The Act can and should be used with appropriate regard for the current status of Enron's reorganization under Chapter 11 to support that process, not to impede it.

The Act was intended to provide supplemental federal regulatory oversight where it was likely that state public utility commission regulation would not be adequate to control multi-state holding company systems.<sup>73</sup> Thus, public utility holding companies with significant utility operations regulated by more than one state regulatory commission generally are subject to

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<sup>71</sup> 17 CFR §250.52(a).

<sup>72</sup> *See generally*, the testimony of Enron's witness Douglas Hawes.

<sup>73</sup> The Commission has traditionally viewed the Act as legislation intended to supplement, not supplant, effective state regulation. It is alarming, therefore, that the Division takes the objections of the OPUC so lightly. That NARUC and EEI, two organizations with national scope and membership, also support the views of the OPUC should counsel caution in disregarding these views.

regulation as registered holding companies under the Act.<sup>74</sup> The Act was not directed at circumstances like this where there is no question as to the adequacy of state regulation.

**VI. ORAL ARGUMENT ALLOWS THE COMMISSION TO ASK QUESTIONS AND CLARIFY ISSUES THAT ARE NOT APPARENT BASED ON THE PAPERS FILED.**

The Division opposes Enron's request for oral argument and states that this is a straightforward case. The Division is eager to begin to administer the Commission's "statutorily mandated role in Enron's bankruptcy."<sup>75</sup>

Oral argument would be beneficial to further illuminate the issues in this case. For example, the Division and Enron view Commission precedent on the predominantly and substantially intrastate standard differently. The Commission similarly may have questions about this case or the relevant precedent that could be addressed in an oral argument.<sup>76</sup> These and other issues all could be further addressed in oral argument in a fashion that adds to the Commission's understanding of the issues, rather than duplicating points already addressed in the papers.

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<sup>74</sup> There are twenty-eight holding companies registered under the Act today. All but one, a foreign organized registered holding company, have significant public utility operations in several states. *See*, Holding Companies Registered Under the Public Utility Holding Company Act of 1935, *available at* <<http://www.sec.gov/divisions/investment/regpubucacompanies.htm>> (last modified Oct. 31, 2002) visited on July 18, 2003.

<sup>75</sup> Division's Brief at 45. The Division believes that the Plan and disclosure statement would need to be authorized by the Commission under Section 11(f) of the Act, after an opportunity for a hearing, prior to its submission to the bankruptcy court and the solicitation of creditor consents to the Plan. Division's Motion to Expedite (June 18, 2003) at 6. A full discussion of the Commission's jurisdiction over the Plan if Enron becomes a registered holding company is premature, but Enron wishes to note that it does not concede any aspect of Commission jurisdiction over the Plan under the Act and reserves the right to present its position on these issues to the bankruptcy court and the Commission at a future date.

<sup>76</sup> The Commission also may inquire into how the wholesale power markets function in the Pacific Northwest, or it may explore what conditions on Enron's exemption may be required to assure the protection of investors, consumers and the public interest.

**VII. CONCLUSION**

Wherefore, for the foregoing reasons, Enron respectfully requests that the Commission grant its applications for exemption.

Respectfully submitted,

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Dated: September 3, 2003

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