

July 21, 2001

California State Senate  
California Legislature  
State Capitol  
Sacramento, CA 95814

Gregory Schmidt  
Secretary of the Senate  
State Capitol, Room 400  
Sacramento, CA 95814

**Re: Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market's Report to the Full Senate of Contempt by Enron**

Dear Senators and Secretary:

***I. EXECUTIVE SUMMARY***

The Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market ("the Select Committee") respectfully submits this report to the Senate, pursuant to the procedures set forth in Section 9407 of the California Government Code. This report concerns the Select Committee's motion finding Enron Corporation ("Enron") in contempt for failure to comply with a legislative subpoena served upon it on June 11, 2001, and the Select Committee's recommendations to the Senate regarding the contempt.

On June 28, 2001, the Select Committee passed a motion finding contempt against Enron for failure to comply with a subpoena duces tecum served on June 11, 2001. The motion provided that the Select Committee would prepare and submit a report to the full Senate reporting the contempt findings. The motion further stated that, if Enron came into compliance by the Select Committee's next hearing on July 10, 2001 (continued to July 11), the contempt findings would be expunged and a report would not be sent to the full Senate. (See Exhibit 1, The Select Committee June 28, 2001 Hearing Results, and Exhibit 2, Reporter's Transcript of Select Committee June 28, 2001 Hearing ("Reporter's Transcript-June 28"), both of which are attached hereto.)

The July 10, 2001 Select Committee hearing was continued to July 11, 2001. Prior to the hearing, Enron was advised that the Select Committee intended to review the status of Enron's compliance with the June 11 subpoena, rule on the objections Enron made to the subpoena, and consider whether to report the contempt findings to the full Senate. (See Exhibit 3, Select Committee July 6, 2001 letter to counsel for Enron and Mirant, attached hereto.)

At the Select Committee's July 11, 2001 hearing, a motion was made to adopt the Chair's recommended rulings on Enron's objections to the subpoena, to prepare and circulate for signature by Committee members a report to the full Senate regarding the contempt, and to find that, if at any time prior to forwarding the report to the full Senate, Enron came into compliance with the legislative subpoena, the report would not be sent to the Senate. (See Exhibit 4, Reporter's Transcript of Select Committee July 11, 2001

Hearing, ("Reporter's Transcript-July 11"), attached hereto, and Exhibit 5, The Select Committee July 11, 2001 Hearing Results, also attached hereto.) The motion passed on a unanimous vote. (See Exhibit 6, The Select Committee July 11, 2001 Hearing Rollcall, attached hereto.)

From the beginning of the document subpoena process, the Select Committee, both verbally and in writing, has repeatedly told Enron that the three steps the Committee requires for compliance are (1) signing the Committee's confidentiality agreement, (2) setting up a document depository convenient to the Capitol, and (3) producing in the depository documents responsive to the Committee's priority list of sixteen categories of documents (versus the 112 document requests in the subpoena). (See Exhibits 2, 4, and 12.)

Because Enron did not meet the Select Committee's three conditions for compliance and, thus, failed to purge itself of the Select Committee's June 28, 2001 contempt finding--and as more fully set forth below--the Select Committee recommends that the Senate order and adjudge Enron in contempt and impose an appropriate coercive sanction to bring the company into compliance.

The Select Committee recommends the Senate sanction Enron as set forth below in the Conclusion and Recommendation of this report.

## **II. STATEMENT OF FACTS**

From the start of the "energy crisis," which began with huge price spikes in the summer of 1998, the California Senate has been concerned about whether anti-competitive behavior by market participants is and has been the source of the crisis. In the summer of 1998, the California Independent System Operator's ("Cal-ISO") real-time market experienced prices spikes of \$5,000 up to \$9,999.99 per megawatt hour ("MWh"), when previously the average selling price was around \$10.00 per MWh. (See Exhibit 7, Dr. Frank Wolak's April 18, 2001 Testimony, attached hereto.) Between May and November 2000, wholesale electricity prices were "approximately 30% higher than one would expect in a competitive market."<sup>1</sup>

As a result of the Senate's concern about the crisis, its cause(s) and possible legislative solutions, the Select Committee was formed by Senate Rules Committee Resolution No. 13, pursuant to Senate Rule 12.5, as authorized by Section 11 of Article IV of the California Constitution. The Rules Committee approved the formation of the Select

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<sup>1</sup> See March and April 2001 reports by Dr. Anjali Sheffrin, Director of the Cal-ISO's Department of Market Analysis, and Dr. Eric Hildebrandt, Department of Market Analysis. Dr. Hildebrandt concluded that the exercise of market power drove wholesale energy costs up over \$6.2 billion beginning in May 2000. Dr. Sheffrin concluded that the non-competitive California market could not be blamed on a flawed design or other factors, but rather on strategic bidding behavior by individual suppliers. She also concluded that "[a]s a result of market power, many suppliers earned extraordinary amounts of excess profit at huge cost to the consumer." (See Exhibit 9, Dr. Hildebrandt's and Dr. Sheffrin's April 26, 2001 Testimony, attached hereto.)

Committee on March 14, 2001. (See Exhibit 8, Rules Committee March 14, 2001 letter, attached hereto.) The Rules Committee adopted the Senate Rules Committee Resolution No. 13, outlining the Select Committee's jurisdiction on April 18, 2001. (See Exhibit 10, Senate Committee on Rules Resolution No. 13, attached hereto.)

The Select Committee's investigation is necessary to determine whether new legislation or statutory revision is needed or whether other appropriate legislative action is called for so that California can emerge from the energy crisis and prevent any future energy crises. (See Exhibits 2, 4, and 10.)

The Select Committee is "authorized and directed to investigate and examine all aspects of California's energy market" and "shall submit its report to the Senate, including recommendations for appropriate legislation, no later than November 30, 2002...." (Exhibit 10.)

The members of the Select Committee are Senator Dunn (Chair), and Senators Bowen, Chesbro, Escutia, Kuehl, Johannessen, Morrow and Sher.

The Chair of the Select Committee, on behalf of the Committee, met on March 20 and 21, 2001, with a number of market participant representatives. (See Declaration of Joseph L. Dunn ("Dunn Decl."), ¶ 2, attached hereto.) At each of those meetings, the subject of document retention and production was discussed and the representatives were told that the Committee's initial document request would be made without a subpoena duces tecum in an effort to conduct the investigation in a cooperative manner. (Dunn Decl., ¶ 2.)

On April 23, 2001, the Select Committee issued a request for documents to Enron. (See Exhibit 11, Document Request to Enron Corporation, and Exhibit 12, Record of Document Demand -- Enron, both attached hereto [Exhibit 12 applies to all of the following paragraphs regarding the chronology of events as to Enron].)

The materiality and pertinency of the Enron document request to the Select Committee's investigation of all aspects of the energy market and crisis is set forth in the attached Annotated Document Request -- Enron and Annotated Subpoena -- Enron. (See Exhibit 13, Annotated Document Request -- Enron, and Exhibit 26 attached hereto.) In summary, the documents requested go to bidding data and strategies, energy capacity and availability, information access and exchange, antitrust, coordinated and/or collusive conduct, the exercise of market power through economic and physical withholding and marketing and trading practices. (Exhibits 13, 26.) These categories of documents were requested because they will provide the information needed for the Select Committee to determine whether market participant conduct caused or contributed to California's ongoing energy crisis. The outcome of that determination will guide the Select Committee in what legislative solutions are necessary.

On May 2, 2001, Gary Fergus, counsel for Enron, sent a letter to the Select Committee, indicating that Enron could not estimate how long it would take to estimate how much material was called for in the document request and expressing concern regarding confidentiality. (See Exhibit 14, May 2, 2001 letter from Gary Fergus, attached hereto.)

On May 3, 2001, Senator Dunn, Senator Morrow, Special Counsel to the Select Committee (Laurence Drivon) and staff to the Committee met with counsel and representatives for Enron, among other market participants. This meeting lasted several hours and focused primarily on crafting a confidentiality agreement. Joel Kleinman, counsel for Duke Energy, accepted responsibility for drafting a proposed confidentiality agreement. (See Exhibit 15, Record of Document Demand – Duke Energy, attached hereto (Dunn Decl., ¶ 3.)

At the May 3 meeting, the Select Committee specifically requested that the market participants, including Enron, enter into a non-destruction agreement as to all relevant and potentially relevant documents to the Committee's investigation. As of the date of this report, Enron has refused to enter into a non-destruction agreement. (Dunn Decl., ¶ 4.)

Michael Molland, counsel for Enron, sent the Select Committee a letter on May 9, 2001, regarding Enron's document retention policy. The letter indicates that Enron would only produce its document retention policy subject to a confidentiality agreement. (See Exhibit 16, May 9, 2001 letter from Michael Molland, attached hereto.)

On May 10, 2001, the Select Committee received a proposed confidentiality agreement from Joel Kleinman. (See Exhibit 17, Proposed Confidentiality Order, attached hereto.) The Select Committee, on May 14, 2001, sent a letter to Mr. Kleinman and counsel for all interested parties notifying them that the proposed confidentiality agreement was not acceptable to the Committee and why. (See Exhibit 18, May 14, 2001 letter to Joel Kleinman and other counsel from the Select Committee, attached hereto.)

In response to a legislative subpoena served upon the Cal-ISO, on May 18, 2001, the Cal-ISO accepted the Select Committee's proposed confidentiality agreement and thereafter complied in part with the Committee's subpoena duces tecum. (See Exhibit 19, Select Committee May 14, 2001 letter to Jeanne Sole, Cal-ISO counsel, with Confidentiality Agreement, attached hereto.) The Select Committee entered virtually the same confidentiality agreement with the California Power Exchange ("Cal-PX") on May 15, 2001. (See Exhibit 20, Select Committee May 15, 2001 letter to Lisa Urick, counsel for Cal-PX, attached hereto.)

The Select Committee, through Special Counsel Laurence Drivon, sent a letter to Joel Kleinman and counsel for all interested parties, including Enron, memorializing discussions regarding a confidentiality agreement on May 16, 2001. (See Exhibit 21, Laurence Drivon's May 16, 2001 letter, attached hereto.)

On May 30, 2001, the Select Committee sent a letter to counsel for all interested parties, including Enron, expressing the Committee's concern regarding the companies' document retention policies, the companies' failure to enter into a standard non-destruction agreement, and that documents may be being destroyed. (See Exhibit 22, Select Committee May 30, 2001 letter, attached hereto.)

On June 4, 2001, the Rules Committee approved the Select Committee's request to issue a legislative subpoena duces tecum to Enron. (See Exhibit 23, Rules Committee June 4, 2001 letter, attached hereto.)

On June 11, 2001, Enron, through its agent for service of process in California, National Registered Agents, Inc., was served with the Select Committee's subpoena, with the Rules Committee's permission. (See Exhibit 24, Select Committee's Subpoena Duces Tecum to Enron, and Exhibit 25, Senate Rules Committee's Motion re Enron Subpoena, both attached hereto.)

The materiality and pertinency of the documents requested in the subpoena duces tecum served upon Enron is set forth in the attached Annotated Subpoena -- Enron. (See Exhibit 26, Annotated Subpoena--Enron, attached hereto.) In summary, the documents requested go to bidding data and strategies, energy capacity and availability, information access and exchange, coordinated, antitrust and/or collusive conduct, the exercise of market power through economic and physical withholding and marketing and trading practices. (Exhibit 26.) The documents are required in order that the Select Committee may answer the question of whether wholesale energy market participants' conduct and activities, lawful or not, resulted in the non-competitive, dysfunctional energy market in California. Further, the documents are needed for the Select Committee to determine what legislative solutions to recommend to the Legislature.

On June 14, 2001, the Select Committee agreed with counsel for all interested parties, including Enron, to meet on June 19 to discuss the subpoenas duces tecum and to continue the subpoena compliance date to the Committee's June 28, 2001 hearing. (See Exhibit 27, Joel Kleinman June 14, 2001 letter [signed by Laurence Drivon on June 19], attached hereto.)

Special Counsel to the Select Committee and Committee staff met with counsel for Enron, among other market participants, on June 19, 2001, to further discuss the subpoenas duces tecum and a proposed confidentiality agreement.

At the June 19 meeting, Special Counsel also verbally notified all present, including Enron, of the Select Committee's list of 16 priority document requests. The same list was e-mailed to all interested parties that same day. (See Exhibit 28, June 19, 2001 e-mail, attached hereto.) On June 27, 2001, the Select Committee sent further written confirmation to all counsel regarding the priority list. (See Exhibit 29, June 27, 2001 Select Committee letter, attached hereto.)

On June 26, 2001, counsel for Duke sent the Select Committee another draft of a proposed confidentiality agreement. (See Exhibit 30, June 26, 2001 Joel Kleinman letter, attached hereto.)

Also, on June 26, 2001, the Select Committee sent written notification to all counsel, including Enron's, that the June 28, 2001 date for compliance with the subpoenas would not be further extended, as set forth in the June 11, 2001 legislative subpoenas duces tecum, the Committee would hold a hearing on June 28, 2001, to review the status of compliance, and failure to comply with the subpoenas would result in consideration by the Committee of a contempt report to the full Senate. (See Exhibit 31, June 26, 2001 Select Committee letter, attached hereto.)

On June 27, 2001, the Select Committee sent a letter to all counsel, including Enron's, acknowledging receipt of the further draft of a confidentiality agreement and the Committee's position that the draft agreement is unacceptable to the Committee. The letter outlines a number of the Select Committee's concerns with the proposed agreement and again offers to enter into a confidentiality agreement similar to those the Committee entered into with the Cal-ISO, the Cal-PX and the Department of Water Resources. (See Exhibit 32, June 27, 2001 Select Committee letter, attached hereto.)

Also on June 27, 2001, the Select Committee sent written notification via facsimile and e-mail to all counsel notifying them that the June 28 hearing would be held upon adjournment of the Senate Floor Session in Room 112, in the State Capitol. (See Exhibits 33 and 34, June 27, 2001 Select Committee letter and e-mail, both attached hereto.)

As of the June 28, 2001 Select Committee hearing, Enron had not produced any documents responsive to the original April 23 request, the June 11 legislative subpoena or the Select Committee's priority list of sixteen document categories.

On June 28, 2001, the Select Committee held a hearing to review the status of compliance with the subpoenas duces tecum served upon Enron.

Just as the June 28 hearing began, counsel for Enron faxed a four-page letter to the Select Committee summarizing Enron's various objections to the June 11 legislative subpoena. (See Exhibit 35, Michael Kirby June 28, 2001 letter, attached hereto.) Enron's primary objection to the subpoena is that the Federal Regulatory Energy Commission ("FERC") has exclusive jurisdiction to investigate, regulate and administer the California wholesale energy market. (Exhibit 35; Reporter's Transcript-June 28, p. 20-26.)

During the course of the hearing, the Select Committee received a 37-page facsimile from counsel for Enron entitled "Objections to Subpoena to Attend and Testify and to Produce Certain Documents." (See Exhibit 36, Enron's Objections to Subpoena to Attend and Testify and to Produce Certain Documents, attached hereto.) The 37-page

document lists 17 separate objections and applies a number of the 17 objections to each document request. (Exhibit 36.)

No one representing Enron or with the authority to act on its behalf appeared at the June 28 hearing.

A motion was made for the Select Committee to find that Enron had failed to comply with the legislative subpoena, that Enron be found in contempt, that Enron be given an opportunity to purge the contempt finding and that a further hearing be held to consider reporting the contempt finding to the full Senate. (Reporter's Transcript-June 28, pp. 104-105, 108, 119-120, 128-129.) The Select Committee passed the motion on a unanimous vote.

On July 3, 2001, the Select Committee faxed and mailed a letter to all counsel, including Enron's, summarizing the actions taken at the June 28 hearing, setting forth the Committee's requirements for compliance with the subpoenas and notifying the subpoenaed companies that any company sending a representative to future Committee hearings must send an individual authorized to bind the company. (See Exhibit 37, Select Committee July 3, 2001 letter, attached hereto.)

On July 5, 2001, the Select Committee faxed and mailed a follow-up letter to its July 3 letter to all counsel, including Enron's. The letter outlined some agreed upon modifications to the Committee's compliance requirements. (See Exhibit 38, Select Committee July 5, 2001 letter, attached hereto.)

On July 6, 2001, the Select Committee notified counsel for Enron via facsimile and mail that the July 10 hearing was continued to July 11, 2001. (See Exhibit 39, Select Committee July 6, 2001 letter to counsel for Enron and Mirant, attached hereto.)

Also on Friday, July 6, 2001, Michael Kirby, counsel for Enron, faxed to the Select Committee a 12-page document entitled, "Legal Authorities in Support of Objections by Enron Corporation to Subpoena Duces Tecum." (See Exhibit 40, Legal Authorities in Support of Objections by Enron Corporation to Subpoena Duces Tecum, attached hereto.)

On July 9, 2001, the Select Committee received a letter from Michael Kirby, asking that the July 11 hearing be continued to July 16, 2001. (See Exhibit 41, July 9, 2001 letter from Michael Kirby, attached hereto.) Mr. Kirby said he was misinformed over the weekend by other counsel that there was no hearing scheduled for July 11.

On July 9, 2001, both Select Committee staff and Special Counsel had telephone conversations with Mr. Kirby informing him that, as set forth in the July 6, 2001 facsimile and e-mail from the Committee to counsel for Enron, the July 11 hearing would go forward as scheduled as to Enron. Also, on July 9, 2001, the Select Committee faxed a response to Mr. Kirby's letter of that same day, chronicling events since the June 28 Committee hearing and reiterating that the July 11 hearing would go forward as to

Enron as scheduled. (See Exhibit 42, Special Counsel July 9, 2001 letter to Michael Kirby, attached hereto.)

On July 10, 2001, the Select Committee again sent counsel for Enron a letter with the Committee's Document Depository Protocol attached. (See Exhibit 43, Select Committee July 10, 2001 letter to counsel for Enron and Mirant, attached hereto.)

The Select Committee held a hearing on July 11, 2001, to further review the status of Enron's compliance with the subpoenas duces tecum. At the hearing, the Chair and other members emphasized that the Committee's investigation is fundamentally different from the litigation process and concomitant court proceedings. The purpose of the Committee's investigation is not to determine guilt or innocence or civil liability, but rather to gather sufficient information to set sound public policy and craft informed legislation.

At the July 11, 2001 hearing, the Chair made recommended rulings on all of Enron's objections. In general, the Chair recommended that the objections be overruled and gave the bases for the recommended rulings. However, the Chair recommended that a number of the objections be sustained.

A motion was made to adopt the Chair's recommended rulings on Enron's objections to the subpoena, to prepare and circulate for signature by Select Committee members a report to the full Senate regarding the contempt against Enron, and to find that, if at any time prior to sending the report to the full Senate, Enron comes into compliance with the subpoena, the report will not be forwarded to the Senate. The motion passed on a unanimous vote. Enron was again reminded of the Committee's three requirements for compliance. Enron has not completed any of the three conditions to compliance.

On July 11, 2001, Enron Corporation filed a lawsuit in Sacramento County Superior Court against the Select Committee and the Rules Committee to resolve legal questions as advocated by Enron. (See Exhibit 44, Enron Corporation's Complaint, attached hereto.)

On July 16, 2001, the Select Committee and committee staff met with counsel for Enron and an Enron representative (via telephone). The three conditions required for compliance with the legislative subpoena were discussed again, as were other issues raised by Enron. No resolution or agreement was reached with Enron. (Exhibit 12.)

The Select Committee e-mailed copies of the Confidentiality Agreement and Document Repository Protocol to counsel for Enron on July 17, 2001. The e-mail reiterated the Select Committee's three conditions for compliance with the legislative subpoena. (See Exhibit 45, Select Committee July 17, 2001 e-mail to counsel for Enron, attached hereto.) On July 18, 2001, the Select Committee again e-mailed and faxed the Confidentiality Agreement and Document Depository Protocol. (See Exhibit 46, Select Committee July 18, 2001 e-mail to counsel for Enron, attached hereto.)

### **III. DISCUSSION**

To date, the Select Committee has held nine investigative hearings. Throughout those hearings, the Select Committee has emphasized that the primary purpose for the investigation is to educate itself (and the Legislature) regarding all aspects of the energy crisis in order to craft public policy through future legislation. The Committee has underscored that it is conducting the investigation solely to recommend legislative solutions. (Exhibit 4, Reporter's Transcript-July 11, pp. 65-67, 77-79.)

Enron is and has been an active participant in the California wholesale energy market. The subpoenaed documents are pertinent to the Select Committee's investigation. The documents go to answering the question of whether the market participants' conduct and activities, lawful or not, caused or contributed to the huge price spikes, emergency stage alerts, rolling blackouts and non-competitive market California has experienced over the last three and one-half years.

The Select Committee's investigation into all aspects of the California energy market and crisis is clearly a matter of public concern. Electricity is a vital commodity, without which the people and businesses of the state cannot survive. Since February 2001, the Department of Water Resources, a public agency, has expended almost \$8 billion to purchase electricity.

The materiality and pertinency of the documents requested in the legislative subpoena duces served upon Enron is detailed in the attached Annotated Subpoena--Enron and the Annotated Document Request--Enron. (Exhibits 13, 26.) The documents requested include bidding data and strategies, energy capacity and availability, information access and exchange, evidence of coordinated, antitrust and/or collusive conduct, the exercise of market power through economic and physical withholding and marketing and trading practices. (Exhibit 26.) The documents go to educating the Select Committee as to whether energy market participant conduct and activities, including that of Enron, lawful or not, resulted in the huge price spikes, emergency stage alerts, rolling blackouts and non-competitive market California has experienced over the last three and one-half years. The Select Committee will then be in a position to make informed and well-founded recommendations for legislative action and solutions.

At the Select Committee June 28, 2001 hearing, part of the motion made and passed was that, if Enron should come into compliance with the June 11 subpoena by the July 10, 2001 (continued to July 11) hearing, the Committee would not forward the report to the full Senate and the contempt finding would be expunged.

As of the July 11, 2001 Select Committee hearing, at which Michael Kirby, counsel for Enron appeared, Enron had not complied with the Select Committee's three conditions for compliance with the legislative subpoena. However, Enron was granted a further opportunity to purge itself of the contempt finding. "[I]f at any time prior to that report [contempt report to the full Senate] being referred to the full Senate, Enron comes into

compliance by agreeing to do what the other market participants have done thus far, which is establish a document depository, ... provide the priority documents, and sign the confidentiality agreement, that the report will not be referred to the full Senate for further action in this contempt process; ...." To date, Enron has failed to comply with the Senate Committee's three conditions.

#### ***IV. CONCLUSION AND RECOMMENDATION***

The Select Committee recommends that the Senate order and adjudge or otherwise find Enron in contempt for its failure to comply with the legislative subpoena served upon it on June 11, 2001. The Select Committee further recommends that the Senate consider the imposition of coercive sanctions available to the Senate, as necessary and appropriate to compel Enron to comply with the subpoena. For example, as a suggested coercive sanction pending that compliance, the Senate could fine Enron \$1,000 on the first day following the Senate order, with a progressive fine for each subsequent day in an amount double that of the day preceding.

Respectfully submitted,

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JOSEPH L. DUNN  
Select Committee Chair  
On behalf of the Select Committee

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DEBRA BOWEN  
Select Committee Member

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WESLEY CHESBRO  
Select Committee Member

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MARTHA ESCUTIA  
Select Committee Member

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K. MAURICE JOHANNESSEN  
Select Committee Member

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SHEILA KUEHL  
Select Committee Member

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BILL MORROW  
Select Committee Member

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BYRON SHER  
Select Committee Member

JLD/am  
Exhibits attached