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Joan Claybrook, President

September 30, 2002

Ernest F. Hollings, Chairman
Committee on Commerce, Science and Transportation
U.S. Senate
Washington, D.C. 20510-6125

Dear Mr. Chairman,

Public Citizen believes that the testimony of Army Secretary Thomas White before your committee on July 18, 2002, raised more questions than were answered, and urges your committee to conduct a further investigation. During his sworn testimony, Secretary White emphasized that Enron Energy Services (EES) which he headed until March 2001 was not involved in energy trading, since his division was totally separate from Enron's wholesale operations. White therefore argued that he had no responsibility for Enron's admitted manipulation of the California market and the resulting price increases and financial burdens to taxpayers in the state. He insisted that he was primarily responsible for retail operations. Public Citizen believes that an examination of the facts disputes White's testimony. There are three specific issues on which Public Citizen believes the Committee should request further information from Secretary White.

First, White consistently downplayed the size of EES power marketing operations, arguing that Enron's Wholesale Services and Energy Services divisions were completely separate and that his retail division was at "arm's length" from the wholesale energy traders. But, in fact, under White's tenure, EES became one of the fastest growing energy traders in the country, with wholesale sales jumping nearly 300%, from selling 2.8 million megawatts of electricity in 1998 to 11.1 million megawatts by 2000. In 1998, the year Thomas White became its Vice-Chairman, EES was America's 61st largest energy trader. By the time White left EES to become Secretary of the Army, his division was the 28th largest energy trading firm in the country. Until March 2001, the trading operations of EES were completely separate from the Wholesale Energy unit—meaning Thomas White was responsible for a huge trading operation that played a significant role in California. In fact, White's original biography on the Army web site listed *commodity management*—which refers to energy trading— among his duties while at EES.

Second, White failed to describe the reasons why EES severed at least two large retail contracts in California in January/February 2001 during the height of the energy crisis. Based on the evidence on hand, it appears that EES took the power that had been obligated to serve these retail consumers and sold it in the wholesale market, where EES could fetch higher prices than it could by continuing to sell power at lower, fixed rates to retail customers. This significant wholesale trading operation, combined with White's decision to break retail contracts in California, made the division a major player in California's deregulated wholesale market.

Third, Public Citizen has documented three examples of how EES and Enron Power Marketing worked closely together developing business strategies through joint filings at the Federal Energy Regulatory Commission (FERC) and through joint white papers outlining proposed deregulation policies. This close collaboration belies White's contention that the two divisions were at "arm's length" from each other.

Details of these three general concerns are outlined below.

Enron Energy Services was a Significant and Separate Energy Trader

EES has been a registered wholesale power marketer since it was granted market-based rate authority by FERC on November 28, 1997.[1] Enron had a total of four power marketing divisions that all registered separately: Enron Power Marketing, Enron Energy Services, Enron Energy Marketing, and The New Power Company. EES was the 2nd largest of the four in terms of sales volume, behind Enron Power Marketing.

Power marketing is a new concept, invented to coincide with electric utility deregulation. A registered power marketer is an energy trader, meaning that the company buys and sells energy contracts. This type of activity was central to Enron's business strategy, as the company knew that in a deregulated marketplace Enron would make far more money speculating on energy trades than by actually producing electricity at a power plant.

Power marketers have two primary strategies for energy trading. A division like Enron Power Marketing buys and sells power contracts with the goal of controlling significant market share without owning any power plants. By commanding a chunk of the day-ahead and long-term energy market simply by owning the rights to that energy via a contract, Enron Power Marketing could more easily manipulate supplies and prices for its own benefit without the burden of major capital investment.

The second primary strategy is utilized by a retail division like Enron Energy Services. With large retail consumers to serve, White's division had to have access to affordable power in order to make consistent profits in volatile markets. While White testified that Enron Power Marketing supplied EES with some of its power needs, under White's leadership EES developed into one of the largest energy traders on the west coast, allowing EES to better coordinate its power needs. While it is true that Enron Power Marketing served as the retail scheduling coordinator for EES in the California market (Enron Power Marketing officially coordinated EES' retail obligations with state officials),[2] it is a fact that EES had separate and significant power trading operations under White's leadership.

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[1] "FERC Grants Market-based Rate Authority to Enron Energy Despite Protests by PECO Energy," *Foster Electric Report*, December 3, 1997.

[2] See <www.caiso.com/docs/09003a6080/0c/04/09003a60800c04d2.pdf> and <www.caiso.com/docs/09003a6080/0c/03/09003a60800c03bd.pdf>.

Enron's domestic operations were divided into two broad categories: Wholesale Services and Energy Services. Enron defines Wholesale Services as "commodity sales and services, risk management products and financial services to wholesale customers; development, acquisition and operation of power plants, natural gas pipelines and other energy-related assets," and describes Energy Services as "sales of natural gas and electricity and related products directly to end-use customers, particularly in the commercial and industrial sectors, and the outsourcing of energy-related activities."[3] White testified that this division of labor meant he was not responsible for Enron's wholesale trading.[4] But in fact, White's EES carried out its own, separate trading operations under White's control.

EES was well-known on Wall Street as the crown jewel of Enron's Energy Services, signing high-profile consumers of energy—from big universities to retail stores like 7-Eleven to pharmaceutical manufacturers—to long-term retail contracts. But EES complemented its retail operations with "commodity management" and "risk mitigation" services—otherwise known as power marketing. Central to the EES business strategy was having the ability to augment its fixed-price retail contracts with freewheeling energy trading operations. And the EES energy trading functions were directly under the control of Lou Pai and White, EES co-chairs. According to the official transcript, White admitted during his July 18 Senate testimony that "our [EES'] commodity trading operation was based in Houston."[5]

In fact, EES had full control of its trading operations up until the time White left Enron. In March of 2001—*after* White left as Vice-Chairman of EES but stayed at Enron—the energy services division merged its wholesale trading operations with Wholesale Services. On May 15, 2001, Enron disclosed in its first quarter 10-Q report with the Securities and Exchange Commission that "beginning in 2001, the commodity-related risk management activities of Retail Energy Services' North American customer contracts were transferred to the Wholesale Services segment, consolidating all energy commodity risk management activities within one operating segment." In January 2001, the media reported that EES executive Dave Delainey held meetings with dozens of EES employees to inform them of their impeding transfer from EES to Wholesale Services in March 2001.[6] This all means that up until March 2001, the energy trading functions of EES were firmly under the control of division co-chairs White and Pai. This contradicts statements White made when he appeared before your Committee.

It is important to note that White failed to inform regulators at the Securities and Exchange Commission that at the time of this significant accounting change (transferring EES' trading operations to Wholesale Services), one of the biggest reasons for making the transfer was that EES was bleeding money from losses on its retail contracts. By combining EES wholesale trading operations with Wholesale Services, Enron could more easily hide the losses through accounting.

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[3]Enron 10-k filed with the Securities and Exchange Commission on April 2, 2001.

[4]On page 25, lines 1 through 4 of Mr. White's July 18 testimony, he states, "…the traders in their scheduling at wholesale level were never under our control in the retail business. We dealt with them on an arm's length basis."

[5]Page 25, lines 20 through 21.

[6]Tom Fowler, "Division's Motive for Hiding Losses May be Unlawful," *Houston Chronicle*, January 26, 2002.

Prior to the March 2001 accounting change, the financial reasons for EES's involvement in energy trading operations, were enormous. In a footnote to the division's April 16, 2001, earnings summary, EES restated revenues for 2000 without the risk management, or power trading, operations included. Before the restatement, EES had 2000 revenues of $4.6 billion, but with the risk management operations removed, the division had revenues of only $1.7 billion. This clearly demonstrates how important energy trading was to White's bottom line.

While much has been made of how White helped transform EES into a formidable retail powerhouse, White has been silent on how EES also became a major energy trader under his watch. When White joined EES in 1998, the division was America's 61st largest energy trader. By 1999, EES had become the 42nd largest trader. By 2000, EES was the 34th largest. And during the first three months of 2001, just before White left to become Army Secretary, EES had become the country's 28th largest trader, selling most of its energy in the California market.

From 1998 to 2000, the wholesale energy trading arm of White's EES increased its volume of sales nearly 300%, from selling 2.8 million megawatts of electricity in 1998 to 11.1 million megawatts by 2000. Although the volume of EES trading was less than 4% of the volume traded by Enron Power Marketing at the end of the first quarter of 2001, White's division was still one of the largest in the country.

White's own bio on the Army's web site listed commodity management—which includes energy trading—as one of his many responsibilities while with Enron. The conservative American Enterprise Institute notes that White's original biography on the Army web site described his duties while at Enron: "Mr. White was responsible for the ***delivery component of energy management services***, which included ***commodity management***; purchasing, maintaining, and operating energy assets; developing and implementing energy information services; capital management; and facilities management" (emphasis added). In fact, the original bio went on for

Under Thomas White, Enron Energy Services Becomes a Major Energy Trader

Electricity Sales, Megawatthours

Enron Trading Division	1998	1999	2000	1st Quarter 2001
Enron Power Marketing	400,232,097	376,563,143	293,767,876	193,459,476
US Rank	1	1	1	1
Enron Energy Services	**2,828,501**	**7,286,583**	**11,137,287**	**7,409,685**
US Rank	**61**	**42**	**34**	**28**
Enron Energy Marketing	0	0	97,360	0
US Rank	-	-	110	-
The New Power Co.	0	0	174,176	51,200
US Rank	-	-	100	196

SOURCE: Data compiled by Public Citizen from Power Marketer Quarterly Reports filed with the Federal Energy Regulatory Commission, www.ferc.gov/electric/pwrmkt/pm.htm

115 words describing White's responsibilities at Enron.[7] But after Enron declared bankruptcy, the Army edited White's online bio, slashing reference to Enron down to just one sentence: "From 1990 to 2001, Mr. White was employed by Enron Corporation and held various senior executive positions."[8] Public Citizen believes that White's decision to scale back the description of his responsibilities reflects legitimate concern about being held accountable for his actions at Enron. Specifically, Public Citizen notes that White's original bio listed "commodity management" as one of his duties, which would have placed him in charge of managing energy trading at EES.

At the same time that White's division was increasing its trading activities, Enron exercised tremendous influence over the Bush Administration's hands-off policy towards the California energy crisis.[9] While White was still at the helm of EES, Enron paid the DC lobbying firm Quinn Gillespie more than half a million dollars in the first seven months of 2001 to lobby the "Executive Office of the President" on the "California electric crisis", according to the lobbying disclosure report filed with Congress on April 10, 2001. Ed Gillespie, the "Gillespie" in Quinn Gillespie and former communications director at the RNC, was a top Bush campaign advisor and ran the U.S. Department of Commerce for the first 30 days of the Bush presidency. Enron lobbied against bi-partisan efforts to re-regulate the Western electricity market through price controls.

Just as Enron was paying Gillespie $75,000 a month lobbying Congress and the White House against price controls, the Bush Administration aggressively took Enron's position. On numerous occasions, President Bush, Vice-President Cheney, their various spokespeople and cabinet officials took an aggressive stance against price controls. In fact, the Bush Administration held firm against price controls even against the advice of top Republicans in Congress. Tom DeLay told Bush in early June 2001 that Bush "shouldn't count" on Republicans in the House to continue to block price controls. That's because bipartisan pressure was mounting by California's delegation to support price controls. Trent Lott "warned Bush aides" that the energy crisis "could infect" 10 western states, endangering Republicans.[10]

At the height of the California energy crisis, Gillespie formed the 21st Century Energy Project. It was generally acknowledged that Gillespie initiated this project in conjunction with the Bush White House. "Administration officials generally don't ask for support directly," American Conservative Union president David Keene told Newsweek, "It's more a wink and a nod. Everyone knows Ed is close to

[7] According to the American Enterprise online magazine "Hot Flash" item for February 20, 2002 <www.americanenterprise.org>, following is the original White bio on the Army's web site referencing his Enron stint: "Prior to his appointment as Secretary of the Army, Secretary White served as Vice Chairman of Enron Energy Services, the Enron Corporation subsidiary responsible for providing energy outsource solutions to commercial and industrial customers throughout the United States. Mr. White was responsible for the delivery component of energy management services, which included commodity management; purchasing, maintaining, and operating energy assets; developing and implementing energy information services; capital management; and facilities management. Secretary White also served as a member of Enron's Executive Committee and was Chairman and Chief Executive Officer for Enron Operations Corporation. He was also responsible for the Enron Engineering and Construction Company, which managed an extensive construction portfolio with domestic and international projects."

[8] http://www.army.mil/leaders/Secarmy/bio.htm

[9] See the February 2001 Public Citizen report, *Got Juice? Bush's Refusal to End California Electricity Price Gouging Enriches Texas Friends and Big Contributors* for more information www.citizen.org/cmep

[10] American Political Network, *The Hotline*, June 18, 2001, Vol 10, No. 9.

[Bush], so a wink and a nod is all it takes." Gillespie's group was funded almost entirely by his corporate lobbying clients. Newsweek claims that Enron laundered $50,000 to Gillespie through Grover Norquist's Americans for Tax Reform. Gillespie used the Enron money to run print and TV ads in July 2001 attacking Jimmy Carter and environmentalists and supporting the Enron-supported proposals found in Bush's energy plan. The TV ads featured background music and footage of people's faces taken directly from Bush's presidential run—which is not surprising, considering the ads were written by Russ Schriefer, who worked with Gillespie on the Bush campaign and jointly formed Mosaic Media with Quinn Gillespie in February 2001 to help produce advocacy ads for republicans. The ads ran on ABC, Fox and CNN.[11]

Enron provided significant financing of President Bush's campaign while White was in charge of EES, giving more than $1.7 million to Bush and the RNC for the 2000 race and since he took office.[12]

Enron Energy Services Drops Retail Customers at Height of California Energy Crisis

White's division had a retail portfolio that was heavily composed of California-based contracts.[13] Beginning in January and February 2001, EES began unilaterally dropping their California retail clients. Before EES abandoned them, these customers had been receiving energy at prices lower than what the state's utilities were providing to their customers. When White approved of this action to dump his California clients, what did EES do with the power that was originally scheduled to be delivered to their California retail clients? Since the price of electricity began skyrocketing in the beginning of 2001, Public Citizen believes that EES saw an opportunity to make far more money selling this electricity into the wholesale market through the power marketing arm of EES. An analysis of EES power trading data shows that EES actually sold *more* power after discarding its retail clients—indicating that EES increased its power sales at the height of the crisis. Indeed, it is no surprise that soon after White left the division, EES merged its wholesale trading operations with Wholesale Services, to more fully concentrate on price-gouging the California wholesale market.

According to statements made by EES executive Marty Sunde when White was still Vice-Chairman of the division, EES unloaded all of its California retail clients,[14] sticking most of the obligations with California's taxpayers (since the state by then had assumed most of the utilities' responsibilities for purchasing expensive power in the wholesale market). The move affected EES California clients like 880 of 7-Eleven's California franchises, Cisco Systems, Clorox, Genetech, GTE, IBM, International Paper, Kaiser Permanente, McDonald's, Patagonia, Safeway, SBC Communications and the entire University of California and California State University system. At least two of these clients, the University of California and the California State University, filed a high-profile lawsuit challenging White's decision to end service.

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[11] Michael Isikoff, "Winks, Nods & Corporate Cash; One Wired GOP Lobbyist's Playbook for Wielding Influence," *Newsweek*, February 25, 2002.

[12] Data compiled by Public Citizen from the Center for Responsive Politics, <www.opensecrets.org>.

[13] "Enron Turns California Customers Back to Utilities, Reduces its Risk," *Retail Services Report*, February 9, 2001.

[14] James Sterngold and Matt Richtel, "Power Source Ends Direct Flow to California Businesses," *The New York Times*, February 1, 2001.

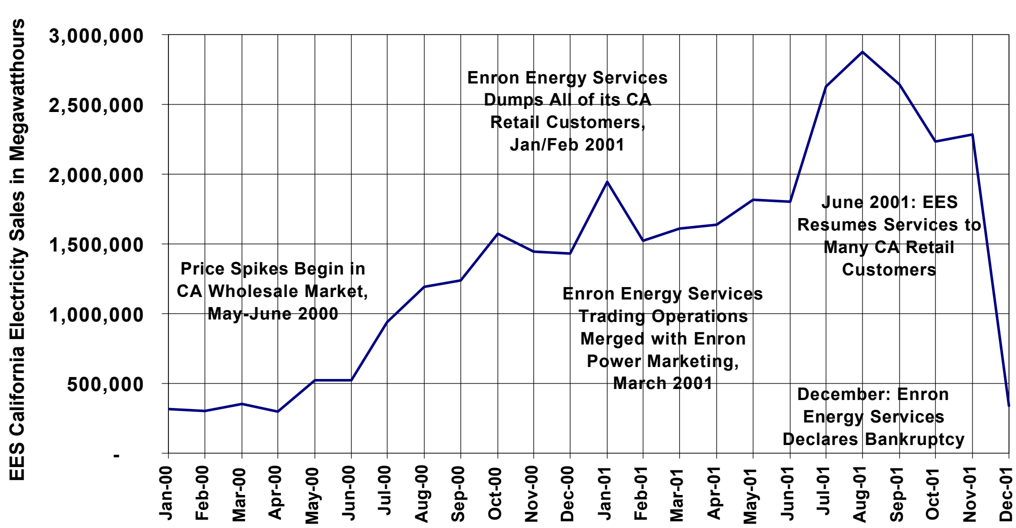
In 1998, White's EES signed a Direct Access contract with the University of California and California State University system. As a retail supplier of electricity, EES qualified to purchase power at a discount from the state's Power Exchange. The agreement called for EES to deliver power for the entire University of California and California State University systems. But in January/February 2001, White's division abruptly and unilaterally pulled the plug on the contract by refusing to continue providing power. As a result, electric services for the public schools were turned over to the incumbent utilities that were under state regulation (Southern California Edison, PG&E and San Diego Gas & Electric). While this did not result in the disruption of the delivery of power, Enron's decision denied the universities access to the low-cost power deal negotiated between the three parties in 1998.

EES claimed it made the unilateral move because it feared mounting losses since the price of wholesale power vastly exceeded the prices it was charging its retail customers. EES also blamed the demise of the California Power Exchange, since that was the venue where Enron bought and sold much of the power it delivered to customers. But White and EES's gain was the taxpayers' loss, as the immediate impact of Enron's move was that the state of California assumed the responsibility for serving Enron's clients.

The universities demanded that EES continue providing the service it had promised, but White's division refused. The University of California and California State University then sued EES in Federal District Court in the Northern District of California for breach of contract. EES settled the lawsuit in June 2001 (just after White became President Bush's Army Secretary), agreeing to immediately resume providing energy to the University of California. The University of California eventually replaced EES with APS Energy Services in March 2002, after EES had declared bankruptcy in December 2001.

Another large EES California client, SBC Communications, also threatened EES with a lawsuit after the company was unilaterally dropped as a client by EES in February 2001. SBC had been with Enron since 1998, covering over 6,200 SBC accounts. EES finally gave in to all of SBC's demands on June 24, 2001, after SBC threatened litigation.

Under White, Enron Energy Services Expands California Energy Trading During Power Crisis



It is important to note that EES agreed to resume service to these three clients only after FERC enacted price controls over the entire West Coast electricity market on June 19, 2001. Since FERC's order effectively re-regulated the market, it was now safe for EES to resume service to its former retail customers.

But what did EES do with its power commitments from January/February 2001 until June 2001? Given the tremendous wholesale trading operations of EES, Public Citizen considers it highly likely that White's division realized it could make more money selling the universities' power into the deregulated wholesale market than by selling it to its retail customers.

An analysis of trading sales volume by EES shows that the division actually increased West Coast wholesale trading sales by 18% from February 2001 (when it had dumped all of its California retail clients) to June 2001 (when it resumed service after price controls were enacted).
After dropping its major California retail clients, why did EES' West Coast wholesale trading volume actually increase, even though the division had fewer retail obligations?

Enron Energy Services Works Closely with Enron Power Marketing
During his testimony, White claimed that the Wholesale Services and Energy Services divisions were completely separate, and that his retail division was at "arm's length" from Wholesale Services. But on at least three separate occasions while White was Vice-Chairman, Public Citizen has documented that Enron Power Marketing and EES jointly filed motions and reports with FERC. These joint filings were no trivial matter, as they represented Enron's core response to significant regulatory issues of concern at FERC at the height of the energy crisis. The decision for EES to team up with Enron Power Marketing suggest close policy and legal coordination between the two divisions. The most significant collaborative effort between Enron Power Marketing and EES was a policy paper describing Enron's vision for how to address the California energy crisis. The fact that these divisions were working on these policy issues together indicates a closer collaboration than White acknowledged in his Senate testimony.

On October 20, 2000, EES and Enron Power Marketing jointly filed a 68-page white paper with FERC (Docket # EL00-95-000) called *Fixing What is Broken: What Steps Are Needed to Complete California's Power Markets?* The paper was written for Enron by two individuals with direct experience in the early development of the California energy market, Seabron Adamson and Carl Imparato. The paper outlines four broad regulatory fixes that both EES and Enron Power Marketing sought: removing CA ISO board members who are accountable to politicians and consumers and replacing them with a "board comprised of industry experts"; increasing reliance on forward, or long-term, contracts; improving market transparency; eliminating the use of price controls; and requiring consumers to pay the full cost of wholesale energy prices. These detailed policy proposals demonstrate that EES and Enron Power Marketing worked together to develop a framework for the California market that would benefit Enron (and would hurt consumers).

Of course, the white paper places none of the blame for high prices on the manipulation strategies employed by Enron. In August 2002, FERC formally launched an investigation into violations of the

Federal Power Act by Enron and other energy traders.[15]

In addition to this major policy report, EES and Enron Power Marketing shared legal counsel before FERC as federal regulators began their inquiry into the actions of companies like Enron. The Washington, D.C., law firm Bracewell & Patterson jointly represented both EES and Enron Power Marketing in several official filings before FERC.

On November 22, 2000, Bracewell & Patterson attorneys Ronald Carroll, Andrea Seltanni, Michael Henry and Kimberly Curry filed a motion before FERC representing both EES and Enron Power Marketing. The two Enron divisions were responding to FERC's handling of the escalating California energy crisis. In this filing, Enron argued that FERC shouldn't be "looking for scapegoats" and blasted FERC's proposed refund order: "EPMI and EES applaud the Commission's overarching conclusion in the November 1 Order that the high prices experienced this summer in the California wholesale markets…[are not the result of] improper behavior by sellers of electricity, as has been alleged by some. EPMI and EES also applaud the Commission's recognition that the focus must be on correcting these market flaws rather than looking for scapegoats." EES and Enron Power Marketing also self-servingly called for an increased reliance on forward contracts while at the same time asking FERC to not apply any price controls to the forward market: such a combination would leave Enron in the catbird's seat to dictate the futures market.

On December 4, 2000, Bracewell & Patterson's Ronald Carroll filed a joint response on behalf of EES and Enron Power Marketing to questions FERC posed to several energy traders in the California market. The two divisions defended Enron from FERC suggestions of manipulation.

After reviewing these facts, Public Citizen concludes that the Senate Commerce Committee should investigate Secretary White's sworn testimony to the Committee more thoroughly. It is apparent that White was not entirely truthful about his role in the California energy crisis, including the independence and size of his division's energy trading operations, his responsibilities in overseeing wholesale energy trading services, his decision to dispose of California retail contracts and stick taxpayers with the liabilities, and the collaborate legal and policy efforts between EES and Enron Power Marketing. Given the enormous costs incurred by West coast consumers and taxpayers at the hands of Enron's manipulations, Public Citizen believes it is essential for Secretary White to again serve as a witness before your committee to explain these discrepancies, and/or respond in writing to specific questions raised in this letter as a result of Public Citizen's research regarding his July 18th, 2002 testimony. Below is a list of suggested questions he should be required to answer.

Sincerely,

Joan Claybrook, President

[15] "Initial Report on Company-Specific Separate Proceedings and Generic Reevaluations; Published Natural Gas Price Data; and Enron Trading Strategies: Fact-finding Investigation of Potential Manipulation of Electric and Natural Gas Prices," Docket # PA02-2-000, the Federal Energy Regulatory Commission, August 2002.

Suggested Questions for Secretary Thomas White:

1. Why did Enron Energy Services (EES) become one of the largest wholesale energy traders in the West coast energy market during your tenure as Vice-Chairman?
2. Is it true that the wholesale energy trading functions of EES were wholly separate from Enron Power Marketing until March 2001?
3. Is it true that without the inclusion of the revenue-producing wholesale trading of EES, the revenues and income for your division would have been substantially lower?
4. Was the wholesale trading of EES a key component of profitability for your division?
5. While Enron Power Marketing traded substantially larger volumes of electricity than did EES, is it true that EES became a significant energy trader on the west coast during your tenure as Vice-Chairman?
6. Were you aware of Enron's lobbing activities at the White House in February 2001 regarding the California energy crisis?
7. Did you have any discussions with officials from the Bush Administration, lobbyists with connections to the Administration, or with Bush campaign officials regarding the California energy crisis?
8. Did you or your staff, at your request or agreement, edit your biography on the Army's web site to eliminate references to commodity management? Did members of the Bush Administration outside the Army request such an edit?
9. Please explain why EES unilaterally began dropping its major California retail clients—including the University of California. Were you aware of the hardship your action created at California's public universities?
10. After dumping these retail clients—and after the trading operation of EES were merged with those of Enron Power Marketing—why did EES' West coast wholesale trading volume actually increase, even though the division now had fewer retail obligations?
11. Were you aware of the joint legal representation and policy proposals prepared on behalf of Enron Power Marketing and EES?
12. Why did you attempt to misleadingly disassociate yourself from the wholesale power marketing activities of EES during your testimony of July 18, 2002?

cc Senator Byron Dorgan, Chairman
Subcommittee on Consumer Affairs, Foreign Commerce and Tourism
Senator Barbara Boxer