

November 17, 2004

VIA HAND DELIVERY

Ms. Annette Taylor
Legal Secretary
Oregon Public Utility Commission
550 Capitol Street NE, Suite 215
PO Box 2148
Salem, OR 97308-2148

Re: UM 1121 - Oregon Electric's Opening Brief

Dear Ms. Taylor:

Enclosed for filing in the above-referenced docket please find the original and five copies of Oregon Electric's Opening Brief.

Please contact me with any questions.

Sincerely,



Lisa F. Rackner

Enclosure

cc: UM 1121 Service List

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UM 1121**

In the Matter of

OREGON ELECTRIC UTILITY COMPANY, LLC,
et al.,

Application for Authorization to Acquire Portland
General Electric Company

OREGON ELECTRIC'S OPENING BRIEF

November 17, 2004

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Oregon Electric Utility Company, LLC (“Oregon Electric”) respectfully submits this Opening Brief in support of its Application for authorization to acquire all the common stock of Portland General Electric Company (“PGE”) from Enron Corp. (“Enron”) (hereinafter the “Proposed Transaction”) under Section 757.511 of the Oregon Revised Statutes (“ORS”).¹ Oregon Electric is joined in its Application by those of its investors who will become affiliated interests of PGE within the meaning of ORS Section 757.015: TPG Partners III, L.P., TPG Partners IV, L.P., Managing Member LLC, Peter O. Kohler, M.D., Gerald Grinstein, Duane McDougall, Robert Miller, and Tom Walsh (collectively “Oregon Electric” or “Applicants”).²

I. INTRODUCTION

The question before the Commission is straightforward: *Will the Proposed Transaction serve PGE’s customers in the public interest?*³ Or, as that question has been interpreted by the Commission: *Will the Proposed Transaction provide a “net benefit” to customers and impose no detriment to the citizens of Oregon as a whole?*⁴ Based on the record, including Applicants’ proposed benefits and conditions, the answer is unequivocally yes.

Oregon Electric’s ownership will provide PGE and its customers with significant and concrete benefits that would not exist but for the Proposed Transaction. These benefits include:

- A guaranteed rate credit of \$43 million plus interest;
- Up to \$94 million in financial protection to PGE provided by contract indemnities against significant potential liabilities;
- Strong leadership and local representation on the new PGE Board of Directors;
- An immediate end to the uncertainty associated with Enron’s ownership; and
- A 10-year extension of the Service Quality Measures established in the Enron/PGE merger.

¹ *In the Matter of Oregon Electric Utility Company, LLC, et al., Application for Authorization to Acquire Portland General Electric Company*, OPUC Docket No. UM 1121 (March 8, 2004) (“Application”). See also *Application Amendment*, OPUC Docket No. UM 1121 (July 13, 2004).

² The Bill & Melinda Gates Foundation and OCM Principal Opportunities Fund III, L.P., are also investors in Oregon Electric. However, they are not included as Applicants because they are passive investors and will not exercise influence over PGE.

³ See ORS § 757.511, discussed in Section III, *infra*.

⁴ See *In the Matter of a Legal Standard for Approval of Merger*, OPUC Docket No. UM 1011, Order No. 01-778 (September 4, 2001), discussed in Section III, *infra*. Applicants do not believe that the statute requires a showing of “net benefits.” See Enron Corporation’s Opening Brief at *. Nonetheless, the Proposed Transaction satisfies the net benefit standard.

Oregon Electric also has offered to abide by a package of conditions of approval that will serve to protect PGE and its customers from any potential risks of the Proposed Transaction.⁵ Ring-fencing and other financial conditions will ensure that PGE's capital structure remains sound and that customers will not bear any costs attributable to Oregon Electric's capital structure.⁶ Other proposed conditions will provide this Commission with enhanced powers to monitor PGE's and Oregon Electric's activities. Collectively, these conditions – which are significantly more stringent than the conditions that protected PGE so effectively during Enron's bankruptcy – will grant the Commission unprecedented authority to monitor and control PGE and its owner.

II. THE APPLICANTS, THE TRANSACTION, AND THE FINANCIAL AND OPERATING FUTURE OF PGE

A. Introduction to Applicants and Passive Investors

After the closing of the Proposed Transaction, Oregon Electric will own 100% of PGE's common shares. Oregon Electric will, in turn, be owned by several investors: TPG Partners III, L.P., TPG Partners IV, L.P., the Bill & Melinda Gates Foundation, OCM Principal Opportunities Fund, III, L.P., and Managing Member LLC. Managing Member LLC will be owned by Peter O. Kohler, M.D., Gerald Grinstein, Duane McDougall, Robert Miller, and Tom Walsh.⁷

Oregon Electric. Oregon Electric will have 100% voting control and will own 100% of the equity in PGE. Oregon Electric is an Oregon limited liability company based in Portland, whose sole purpose is to own the shares of PGE. This is in stark contrast to recent proposed mergers in which an Oregon utility was to become part of a utility group or energy conglomerate

⁵ See Oregon Electric/501, Davis/1-9, for a list of all of the proposed conditions of approval. A copy of Oregon Electric's Exhibit 501 is attached for the Commission's convenience.

⁶ The term "ring-fencing" refers to those financial conditions designed to protect PGE and its customers from any adverse effect of Oregon Electric's capital structure and operations. The primary ring-fencing conditions are the "minimum equity" requirement and "hold harmless" obligations discussed in Section IV(B)(1)(d), *infra*. In addition, Oregon Electric has proposed other conditions designed to monitor finances at Oregon Electric and encourage accelerated pay down of debt, as discussed more fully in Section IV(B)(1)(d), *infra*.

⁷ See Revised Exhibit 9 to the Application Amendment for a diagram of the proposed ownership structure.

operating many other businesses.⁸ After closing, Oregon Electric and PGE will concentrate solely on serving its customers, undistracted by business integration issues and the complexities of allocating costs across various businesses in a consolidated operating group.

TPG Applicants. TPG Partners III, L.P. and TPG Partners IV, L.P. (“TPG Applicants”) will have 5% voting control and will own a maximum of 79.9% of the equity in Oregon Electric.⁹ TPG Applicants are private equity funds managed by Texas Pacific Group (“TPG”).¹⁰ TPG is one of America’s leading private equity investment firms, managing investments on behalf of many of the country’s largest public and private pension funds, university endowments, and other investors. Two TPG principals will serve on PGE’s Board of Directors.¹¹ In addition, the resources of TPG’s other principals and professionals will be available to advise and assist the PGE Board at no cost to PGE.¹²

TPG is not a holding company or a conglomerate where multiple subsidiaries, often operating in different businesses, are part of a consolidated capital structure. Rather, each of the companies in which TPG invests is separately capitalized, overseen by dedicated, top-quality boards of directors, and managed by completely separate management teams.¹³

In the years since its founding in 1993, TPG has established a reputation for investing in high-quality businesses across many industries, some of which were in troubled or transitional circumstances at the time of the investment. TPG’s capital and sponsorship, coupled with hard work, strategic guidance, and active board involvement, have helped many such companies

⁸ See Docket UM 814 (Enron Corp./PGE), UM 918 (ScottishPower/PacifiCorp), UM 967 (Sierra Pacific Resources/PGE).

⁹ If Congress repeals the Public Utility Holding Company Act (“PUHCA”), Oregon Electric will continue to own all of the shares of PGE. However, voting control of Oregon Electric will be realigned to reflect the respective equity interests of TPG Applicants and Managing Member, which will give TPG Applicants voting control over PGE. No additional action by this Commission under ORS Section 757.511 would be necessary if PUHCA is repealed post-approval of this Application because this Application seeks approval of TPG Applicants as entities exercising influence over PGE under ORS Section 757.511.

¹⁰ Texas Pacific Group is the name under which Tarrant Partners L.P. does business. Throughout this brief, TPG will be used to refer to Texas Pacific Group or to all TPG-managed investment funds, as the context may imply.

¹¹ See Oregon Electric/3, Davis/8.

¹² See Condition 8, Oregon Electric/501, Davis/2.

¹³ See Oregon Electric/3, Davis/11.

stabilize and improve their performance by concentrating on their core values and mission.¹⁴ When TPG invests in a business, its goal is to give that business the financial and organizational tools it needs to be successful. TPG typically focuses on improvements in customer service, product enhancements, sound capital investment, stable labor relations, and recruiting first-class management and board members to oversee the company.¹⁵ As a major investor in over 30 companies, TPG has extensive experience helping companies improve their financial and operating performance.¹⁶

Managing Member. Managing Member LLC (“Managing Member”), will have 95% voting control and will own approximately 0.67% of the equity in Oregon Electric. Managing Member is the vehicle through which Local Applicants will invest in PGE.

Local Applicants. Peter O. Kohler, M.D., Gerald Grinstein, Duane McDougall, Robert Miller, and Tom Walsh (collectively referred to as “Local Applicants”) will have 100% voting control and ownership of Managing Member. Local Applicants will play a critical role in the future of PGE as members of the PGE Board of Directors. Dr. Kohler will serve as Chairman. Each of the five Local Applicants has demonstrated an uncommon dedication to the welfare of this region’s citizens.¹⁷ Their ties to the Oregon community ensure that PGE’s ownership and Board will be responsive and accountable to its customers and the citizens of Oregon.¹⁸

Peter Kohler is President of Oregon Health & Science University (“OHSU”) and is a leader in health policy, research, and education at the state and national levels.¹⁹ Gerald Grinstein is a long-time Seattle-based business leader. Mr. Grinstein is currently Chief Executive Officer and Board member of Delta Air Lines, Inc.²⁰ Duane McDougall, a native Oregonian, was Chief Executive Officer of Willamette Industries, an Oregon-based Fortune 400

¹⁴ A summary of select TPG investments is included as Exhibit 13 to the Application.

¹⁵ See Oregon Electric/3, Davis/11.

¹⁶ See Oregon Electric/500, Davis/11.

¹⁷ Detailed biographies of each of the Local Applicants are included in Exhibit 23 to the Application Amendment.

¹⁸ Application Amendment at 4-5.

¹⁹ Application Amendment at 2.

²⁰ Application at 8.

company, from 1998 to 2002. During his 23-year career with Willamette, he held numerous operating and finance positions.²¹ Robert Miller has been Rite Aid's Chairman of the Board since 1999 and was the Chief Executive Officer until 2003. Mr. Miller also served on the Boards of PacifiCorp and ScottishPower and was the Chief Executive Officer of Fred Meyer from 1991 to 1999.²² Tom Walsh is an Oregon business and civic leader in the areas of transportation, affordable housing, and environmental stewardship. Mr. Walsh is the President of Tom Walsh & Co., a Portland builder of affordable housing, and a former General Manager of Tri-Met.²³

Passive Investors. The Bill & Melinda Gates Foundation and OCM Opportunities Fund III, L.P. ("OCM") ("Passive Investors") will own the remaining equity interest in Oregon Electric (a minimum of 19.4%). Passive Investors will not have any voting control or exercise influence over PGE and, therefore, are not included as Applicants.²⁴

B. The Proposed Transaction

Oregon Electric has agreed to acquire 100% of the issued and outstanding common stock of PGE for a base purchase price of \$1.25 billion. This price will be adjusted by an amount equal to any change in the retained earnings from January 1, 2003 through the closing date. Through the purchase of PGE's stock, Oregon Electric will be assuming liability for PGE's existing debt, estimated to be \$1.1 billion.²⁵

Taking into consideration anticipated adjustments, it is estimated that total cash due Enron at closing will be \$1.4 billion.²⁶ Funding for the transaction will come from three sources:²⁷

²¹ Application Amendment at 3.

²² Application Amendment at 3.

²³ See Oregon Electric/2, Local Applicant Panel 3-4.

²⁴ OCM is an investment fund managed by Oaktree Capital Management, LLC. See Application at 12-13 for a detailed discussion of Passive Investors.

²⁵ See Application at 15-16.

²⁶ See Oregon Electric/3, Davis/15. The Stock Purchase Agreement between Oregon Electric and Enron is attached as Exhibit 6 to the Application.

²⁷ See Oregon Electric/3, Davis/15-16. See Exhibit 20 to the Application for a financial overview showing the sources and uses of funds for the transaction and the estimated capitalization for Oregon Electric and PGE.

Equity. Approximately 43% of the funds, or approximately \$525 million, will be provided to Oregon Electric by its equity investors. TPG Applicants will provide up to \$420 million, Passive Investors will provide a minimum of \$100 million, and Managing Member LLC will provide approximately \$3.5 million to be funded by Local Applicants from their own resources.²⁸

Debt. Oregon Electric will borrow approximately²⁹ \$707 million, consisting of bank debt in the form of senior secured term loan facilities with maturities ranging from 5 to 9 years (“Term Loans”), and bonds in the form of senior unsecured notes with a 10-year term (the “Notes”). The Term Loans will be secured by a priority lien on, and pledge of, the stock of PGE.³⁰

Dividend. The purchase price paid for PGE includes the value of unpaid dividends to Enron. PGE has not paid a dividend to Enron since 2001. At closing, a portion of PGE’s retained earnings, estimated at approximately \$240 million, will be dividended to Oregon Electric to help fund the purchase price to be paid to Enron, effectively providing Enron the benefit of the dividends it has not taken since 2001. Indeed, PGE is expected to pay a “catch-up” dividend to Enron even if the Proposed Transaction is not approved. PGE’s common equity to total capital ratio will remain above 48% after payment of the dividend.³¹

Immediately following closing, Oregon Electric’s total capitalization on a stand-alone basis will be approximately \$1.2 billion, comprised of \$525 million of equity and \$707 million of debt.³² PGE’s total capitalization will remain unchanged by the Proposed Transaction and is

²⁸ Application Amendment at 4.

²⁹ Numbers may vary at closing due to the purchase price adjustment discussed above.

³⁰ See Oregon Electric/3, Davis/17. The lenders could not foreclose on the stock without first obtaining approval of the Commission pursuant to ORS Section 757.511 and other regulators, including the Federal Energy Regulatory Commission and the Nuclear Regulatory Commission.

³¹ See Enron/2, Bingham/2; Hearing Tr. at 20-21; PGE/100, Piro/11-12.

³² See Oregon Electric/3, Davis/17; Application at 17-18; Exhibit 20 of the Application.

expected to consist of approximately \$2.1 billion, consisting of \$1.0 billion of equity and \$1.1 billion in long-term and short-term debt.³³

C. A Prudent Capital Structure

Oregon Electric has proposed a prudent capital structure that protects PGE's financial integrity, while allowing for substantial pay down of Oregon Electric's debt.

1. *PGE's Capital Structure and Financial Management Will Remain Unchanged*

PGE's long-term debt and preferred securities will remain unaffected by the Proposed Transaction. Oregon Electric will not take dividends unless PGE's common equity ratio is at or above 48%.³⁴ No assets of PGE will be pledged to secure loans of Oregon Electric. To be perfectly clear, the utility itself will *not* be responsible for Oregon Electric's debt, and PGE's assets will *not* be pledged to secure Oregon Electric's debt. PGE's corporate credit rating is expected to remain investment grade and its secured debt rating is not expected to change.³⁵

PGE will manage its short-term working capital requirements and long-term capital expenditures in the same manner as they have historically been managed. PGE's \$150 million revolving credit facility will be refinanced with a new unsecured \$250 million revolving credit facility ("PGE Revolver"), which will bring the amount of the revolver closer to historic levels.³⁶ PGE will use the PGE Revolver to finance its working capital needs³⁷ and will use a combination of long-term debt and retained earnings to finance ongoing capital projects.³⁸

³³ *Id.*

³⁴ See Oregon Electric/13, Davis/17-18; Exhibit 20 of the Application.

³⁵ See Section IV(B)(1)(b), *infra*.

³⁶ See PGE/400, Piro/4-5. The revolver size has been smaller for the last two years because PGE has been using the retained earnings to finance working capital. This is an aberration from PGE's historical practice and is not an efficient way to finance working capital under normal circumstances. See *id.* See also Hearing Tr. at 20-21.

³⁷ Hearing Tr. at 21.

³⁸ *Id.* at 26.

2. *Oregon Electric Will Have Sufficient Cash Flow to Meet its Fixed Obligations and to Pay Down Debt*

The proposed capital structure is designed so that the amount of debt incurred by Oregon Electric is appropriately sized given PGE's earnings profile and capital requirements. In other words, the amount of leverage can be comfortably supported by the expected range of dividends that should be available from PGE.

To reach this conclusion, during due diligence TPG built a detailed financial model using information and assumptions taken directly from PGE's financial plans at the time.³⁹ The model allowed TPG to vary key assumptions and forecast PGE's future financial performance under a variety of different circumstances. The model runs assumed capital expenditures and O&M expenditures based on PGE's own projections and assumed that PGE's equity ratio would remain at or above 48%.⁴⁰ However, TPG modeled a multitude of scenarios and modified certain variables, including capital expenditures and O&M expense levels, in order to gain a thorough understanding of the broad range of possible outcomes. The model runs showed that Oregon Electric's capital structure will allow for substantial ongoing investment in PGE's infrastructure and operations while, at the same time, allowing sufficient dividends to Oregon Electric. The efficacy of TPG's model was unchallenged by intervenors and confirmed by Staff economist Thomas Morgan:

In Staff's assessment, the myriad of models that TPG developed to "stress test" the potential performance of PGE, and the residual impact on the finances at OEUC, indicate a high level of sophistication. The model and the runs that were created appear to be high quality and detailed and the model instills confidence in the overall results.⁴¹

³⁹ See Oregon Electric/200, Wheeler/4. The financial model was built on information taken directly from PGE's financial plans in 2003 and early 2004, including the PGE financial forecast that was disclosed publicly in Enron's Plan of Reorganization in July 2003. PGE's financial plans have changed and will change from time to time. These model runs were intended to be a tool for assessing a range of possibilities, not as a predictor of actual future performance.

⁴⁰ See Oregon Electric/200, Wheeler/6.

⁴¹ See Staff/200, Morgan/34-35.

The base case model runs projected that PGE will have between \$80 and \$100 million available to be paid each year as dividends to Oregon Electric.⁴² Under the proposed capital structure, Oregon Electric will require approximately \$33 million each year to meet estimated operating expenses and debt service requirements. Thus, under these base case scenarios, the model runs demonstrated that Oregon Electric would be able to meet its operating expenses and debt service obligations *and* pay down substantial debt principal by 2009.⁴³

Even if there is a shortfall in PGE's earnings or an increase in capital expenditures affecting the payment of dividends to Oregon Electric or timing differences between cash disbursements (*e.g.*, Oregon Electric's debt service obligations) and cash receipts (*i.e.*, dividends from PGE),⁴⁴ Oregon Electric will have a \$100 million senior secured revolving credit facility ("Oregon Electric Revolver") to assure liquidity to meet operating expenses and debt service. This conclusion was further supported by extreme "stress testing" of the model conducted at Staff's request. These "downside" scenarios assumed sustained declines in earnings up to 30% for five consecutive years.⁴⁵ PGE's earnings have fallen that far only once in the past 15 years, and even then only in one year.⁴⁶ This stress testing demonstrated that even under highly unlikely circumstances, Oregon Electric would have sufficient liquidity to meet its obligations.⁴⁷ Indeed, in the virtually implausible scenario that no dividends could be paid for consecutive years, the Oregon Electric Revolver would ensure Oregon Electric's ability to meet its obligations for several years.⁴⁸

⁴² See Oregon Electric/3, Davis/18.

⁴³ Note in this context "base case" refers to model Scenarios 3 and 23; see Oregon Electric/200, Wheeler/6, Confidential Staff/202, Morgan/230-305 and Staff/206, Morgan/306-382 (model printouts for baseline model Scenarios 3 (build new generation) and 23 (do not build new generation). Page 16 of each model printout provides details regarding projected annual dividends of \$80 to \$100 million and consolidated debt pay down of over \$250 million under the debt schedules and buildup section. In Scenario 3, approximately \$255 million of consolidated debt is paid down over the first five years after closing. See Oregon Electric/203, Wheeler/28-29, for further discussion.

⁴⁴ See Application at 18.

⁴⁵ See Section IV(B)(1)(a), *infra*.

⁴⁶ See PGE/100, Piro/5.

⁴⁷ See Oregon Electric/200, Wheeler/7-9.

⁴⁸ See Oregon Electric/200, Wheeler/6.

D. A Prudent Plan for Operation of PGE

Oregon Electric's plan is simple and straightforward: to make PGE's core business of providing safe, reliable, and efficient electric service to its customers its sole focus.⁴⁹ PGE management has been laboring for some time under the distractions and burdens of Enron's ownership. After closing of the Proposed Transaction, Oregon Electric intends to help PGE enter a period of stability and health.⁵⁰

1. Board of Directors

Upon closing of the Proposed Transaction, all current members of PGE's Board of Directors will resign and a new Board of Directors will assume leadership.⁵¹ Oregon Electric has committed that the PGE Board will always include at least five Oregonians. As discussed above, Peter O. Kohler, M.D., will become Chairman, and Gerald Grinstein, Duane McDougall, Robert Miller, and Tom Walsh will become Board members. Two of TPG's principals, David Bonderman and Kelvin Davis, will also join the Board. The balance of the Board will include:

- **Peggy Fowler** – PGE's Chief Executive Officer
- **Kirby Dyess** – Principal, Austin Capital Management; former Corporate Vice President and Director of Operations, Intel Capital
- **Maria S. Eitel** – President, Nike Foundation; Senior Advisor, Nike, Inc.
- **Jerry Jackson** – former Arkansas Public Utility Commissioner; former senior utility executive at Entergy Corporation
- **M. Lee Pelton, Ph.D.** – President, Willamette University⁵²

The new PGE Board includes seven Oregon business and civic leaders and three members with utility experience. All of the future Board members are accomplished business and community leaders who will bring a wealth of experience to help lead PGE into a stronger, more stable future.

⁴⁹ An overview of Oregon Electric's plan for the operation of PGE can be found in the Application at 19-22; *see also* Oregon Electric/22, Davis/4-8.

⁵⁰ *See* Oregon Electric/3, Davis/7-8.

⁵¹ A diagram of the proposed Board structure for PGE was included as Exhibit 21 to the Application.

⁵² *See* Application Amendment at 1-2.

2. *Oregon Electric's Plan of Operation*

Upon closing, the new PGE Board will take responsibility for the general oversight of PGE's management and operations. Consistent with this responsibility, the new Board will take a fresh look at the company and its operations in order to begin working toward the goal of helping PGE become an even better company. After closing, the new PGE Board, in conjunction with PGE management, will conduct a systematic and comprehensive review of PGE. This review will serve as the first step in informing the new PGE Board about PGE's current strategic plan, the critical issues facing the company, and how PGE is currently performing and projected to perform financially and operationally. The results of the review will allow the Board to consider changes to PGE's strategic plan, to assess PGE's current organizational structure, and to identify areas where PGE may be able to improve efficiency and productivity. This review ultimately will serve as the blueprint from which PGE's Board will formulate and implement performance improvement plans.⁵³

3. *Investment in PGE*

Prudent ongoing capital investment in PGE will allow the Company to serve customers more effectively, which in turn will make PGE a stronger company and enhance its value to investors. PGE is entering a period of a historically high need for capital due to the construction of Port Westward and other projects. Oregon Electric intends to support these substantial increases in investment by PGE. A significant portion of this funding will come from Oregon Electric's reinvestment of PGE's earnings in the Company.⁵⁴ This is a meaningful commitment to the long-term health of PGE for the benefit of its customers.

4. *PGE's Headquarters*

The Proposed Transaction ensures that PGE's headquarters will stay in Portland, jobs will stay in Oregon, and PGE will continue its charitable leadership in the community.

⁵³ See Oregon Electric/22, Davis/4.

⁵⁴ ICNU Exhibit 806 at 44.

5. Energy Efficiency, Renewable Resources, the Environment, and a Competitive Energy Market

Under the direction of Oregon Electric, PGE will continue to support the efforts of the Energy Trust of Oregon to invest wisely in energy efficiency and renewable resources. In addition, Oregon Electric has committed to vigorously pursue a goal of meeting 10% of capacity with renewable resources by 2012, if economical.⁵⁵ Oregon Electric also has committed to appoint a manager within PGE with the appropriate responsibility and authority to work with advocacy groups for renewable energy sources, sustainability, energy efficiency, and environmental matters.⁵⁶ In addition, Oregon Electric intends to work with PGE toward the objective of establishing a competitive electric energy market in Oregon.⁵⁷

6. Regulatory Affairs

Oregon Electric is mindful of the important relationship between a regulatory body and the utilities it regulates. Oregon Electric understands that it must earn the trust and confidence of the Commission and its Staff every day to best serve its customers and investors. For this reason, Oregon Electric will place particular emphasis on maintaining and enhancing the relationship between this Commission and PGE.⁵⁸ It should be noted that Oregon Electric has agreed to conditions of approval that give the Commission unprecedented access to the books and records of Oregon Electric and enhance the Commission's ability to regulate PGE's operations.⁵⁹

E. Oregon Electric's Proposed Conditions of Approval

The Proposed Transaction includes a comprehensive package of conditions of approval. This package includes a set of conditions designed to guarantee the benefits of the transaction to

⁵⁵ See Oregon Electric/22, Davis/12; see also Section IV(A)(5), *infra*.

⁵⁶ See Oregon Electric/22, Davis/11-12.

⁵⁷ Oregon Electric/3, Davis/15.

⁵⁸ See Oregon Electric/100, Davis/39-40; Oregon Electric/300, Jackson/6-7.

⁵⁹ See Section IV(B)(3), *infra*, for a description of these conditions.

PGE's customers. Among other things, these conditions guarantee: (a) a \$43 million rate credit; (b) indemnifications against liabilities; and (c) an extension of service quality measures.

In addition, the Proposed Transaction includes a set of conditions designed to protect PGE and its customers. Taken as a whole, these protective conditions are broader and stronger than those imposed by the Commission in any prior Section 757.511 docket. They include:⁶⁰

Ring-fencing Conditions.⁶¹ Oregon Electric has agreed to conditions designed to protect PGE and its customers from risks associated with Oregon Electric's capital structure. Specifically: (a) Oregon Electric and PGE will maintain separate debt ratings; (b) PGE will not make any distributions to Oregon Electric that would cause the common equity portion of PGE's total capital structure to fall below 48%; and (c) Oregon Electric will hold PGE's customers harmless if PGE's cost of capital or revenue requirement rise due to Oregon Electric's ownership of PGE.⁶²

Other Financial Conditions. Oregon Electric has agreed to conditions designed to monitor Oregon Electric's finances and encourage accelerated pay down of debt. Specifically: (a) after paying operating expenses and debt service, Oregon Electric will use all dividends it receives from PGE to pay down debt principal on an accelerated basis until debt is reduced by \$250 million; (b) Oregon Electric will not re-leverage (*i.e.*, take on new debt after the pay down of acquisition debt) unless the equity ratio is at or above 30% equity on a consolidated basis; and (c) Oregon Electric and PGE will not acquire or organize any subsidiary or enter into substantially new lines of business without Commission approval, until the total long-term debt at Oregon Electric is less than 70% of total consolidated capital.⁶³

⁶⁰ The following is a brief statement describing some of the conditions to which Oregon Electric is willing to agree and is not intended to alter the language of the conditions as presented in Oregon Electric/501, Davis/1-9. To the extent the language below differs from the language in the condition itself, the language in the condition is controlling.

⁶¹ The ring-fencing and financial conditions are discussed in detail in Section IV(B)(1)(d), *infra*. See also Oregon Electric/600, Wheeler/3-21.

⁶² See Oregon Electric/600, Wheeler/3-11; Oregon Electric/500, Davis/35.

⁶³ See Oregon Electric/600, Wheeler/11-21; Oregon Electric/500, Davis/35.

Transparency Conditions. Oregon Electric has agreed to a comprehensive set of conditions designed to provide the Commission with an unprecedented level of information regarding Oregon Electric’s and PGE’s finances and unrestricted access to books and records. For instance, Oregon Electric has agreed to provide SEC-type filings to the Commission and other interested parties on an annual and quarterly basis. In addition, Oregon Electric’s shareholders have agreed to pay up to \$400,000 for an independent auditor, approved by the Commission, to review PGE’s O&M and/or capital construction plans and expenditures.⁶⁴

Acquisition Adjustments, Goodwill, and Transaction Cost Conditions. Oregon Electric has agreed to exclude goodwill, costs, and fees resulting from the acquisition from PGE’s utility accounts so that PGE’s customers will not bear these costs.⁶⁵

Enforcement Conditions. Oregon Electric and PGE have agreed to specific provisions regarding enforcement of the conditions of approval and a process for expedited resolution of disputes between the Commission and Oregon Electric or PGE regarding access to information.⁶⁶

Taken together, these conditions give the Commission unprecedented authority to monitor and control PGE’s and Oregon Electric’s finances and operations.

III. LEGAL STANDARD

ORS Section 757.511 requires the Commission to approve a proposed transaction if it “will serve the public utility’s customers in the public interest.”⁶⁷ The Commission has interpreted this directive to require a two-step assessment: Does the proposed acquisition (1) provide a “net benefit” to the utility’s customers, and (2) impose “no harm” on the public at large?⁶⁸

⁶⁴ See Oregon Electric/500, Davis/25-29.

⁶⁵ See Oregon Electric/500, Davis/35-36.

⁶⁶ See Oregon Electric/500, Davis/36.

⁶⁷ See ORS § 757.511(3).

⁶⁸ See *In the Matter of the Legal Standard for Approval of Mergers*, OPUC Docket No. UM 1121, Order No. 01-778 (September 4, 2001) (hereinafter “Order 01-778”), at 11.

A transaction will provide a “net benefit” to a utility’s customers if, considering the total set of benefits and risks presented, it is “more than neutral” with respect to those customers.⁶⁹ The Commission has explained that the “net benefit” standard is flexible and need not be reduced to economic considerations.⁷⁰ Although recent orders approving acquisitions have included monetary settlements as a means of demonstrating that customers will receive a net benefit from a proposed acquisition, the Commission has held that “[t]his need not always be the case.”⁷¹ With respect to the standard of imposing “no harm” on the public at large, the Commission must find that a proposed transaction does “not impose a detriment on Oregon’s citizens as a whole.”⁷²

IV. THE COMMISSION’S STANDARD HAS BEEN MET

Oregon Electric’s proposal meets the “net benefit” standard and does not impose a detriment on Oregon’s citizens. First, the Proposed Transaction offers substantial and concrete benefits to PGE and its customers. The rate credits, indemnification provisions, and increased commitment to low income customers provide quantitative economic benefits, while the extension of Service Quality Measures, strong local focus, first-class Board of Directors, and stable and known ownership benefit PGE’s customers by making PGE a stronger, more responsive utility. Oregon Electric’s increased commitment to renewable resources and low income assistance will benefit the entire state.

Moreover, any potential risks associated with the Proposed Transaction are more than adequately mitigated by the financial and other conditions of approval proposed by Oregon Electric. If the Proposed Transaction is approved, the end result will be a financially secure utility, backed by experienced and talented investors and Board members, that will be subject to the most stringent ring-fencing and regulatory oversight of any electric utility under the

⁶⁹ *Id.* at 10.

⁷⁰ *Id.* at 11.

⁷¹ *Id.*

⁷² *Id.*

Commission's jurisdiction. Thus, the Proposed Transaction does not impose a detriment on Oregon's citizens and provides an unequivocal "net benefit" to PGE's customers.

A. The Proposed Transaction Provides Substantial and Concrete Benefits to PGE's Customers

1. Rate Credit Proposal

Oregon Electric has agreed to provide PGE's customers a guaranteed rate credit of \$43 million over five years, beginning in 2007.⁷³ This credit is based in large part upon what Oregon Electric hopes may be an achievable level of prudent savings in PGE's operations. Regardless of actual savings, however, customers will receive the guaranteed amount of \$8.6 million per year. In addition, the proposal calls for the annual rate credit to be credited to a balancing account that will accrue interest for the benefit of customers. Oregon Electric estimates interest could add as much as \$2 million to the overall rate credit.⁷⁴

Because the rate credit is based in part on potential cost savings at PGE, to the extent PGE demonstrates savings in O&M and other expenses in its next general rate case, the proposal provides that such savings, passed along to customers in PGE's base rates, shall be treated as an offset of the guaranteed rate credit obligation. This ability to offset will provide PGE with added incentive to find savings where prudent. Importantly, in the event that actual savings are less than \$8.6 million annually, PGE would continue to pay the difference between \$8.6 million and the realized savings amount to PGE's customers.⁷⁵ Either way, the Proposed Transaction results in at least \$43 million in savings to PGE's customers.

2. Indemnification

During negotiations with Enron for the purchase of PGE, Oregon Electric secured contractual indemnifications that protect PGE and Oregon Electric from significant potential

⁷³ See Condition 20, Oregon Electric/501, Davis/5.

⁷⁴ See Oregon Electric/500, Davis/23.

⁷⁵ See Oregon Electric/500, Davis/23.

liabilities currently facing PGE.⁷⁶ In response to concerns raised by Staff, Oregon Electric proposed a condition which guarantees that, to the extent PGE incurs a loss that is subject to the right to indemnification under the Stock Purchase Agreement, Oregon Electric will direct Enron to pay the benefit of the indemnification directly to PGE.⁷⁷ The indemnification provisions of the Stock Purchase Agreement, in conjunction with this proposed condition of approval, provide significant financial protection to PGE.

The indemnification provisions protect PGE from up to \$94 million in losses incurred as a result of certain liabilities facing PGE.⁷⁸ These liabilities are *not* due to Enron's ownership and are currently borne solely by PGE.⁷⁹ Absent the Proposed Transaction, Enron is under no obligation to indemnify PGE for any of these matters and has stated that it does not anticipate doing so.⁸⁰ To support this indemnification obligation, \$94 million in cash will be set aside in an escrow account at closing from sales proceeds that would otherwise be paid to Enron.⁸¹

The indemnification provisions also protect PGE from up to \$1.25 billion in losses related to Enron's "control group" liabilities.⁸² The control group liabilities consist of: (1) certain tax liabilities relating to the period when PGE was a member of the Enron consolidated tax group; and (2) certain liabilities relating to Enron's benefit plans.⁸³ These indemnifications are for liabilities that are related to Enron's ownership and ensure that PGE is protected from a potentially harmful result of Enron's ownership after the Proposed Transaction closes.

⁷⁶ See Oregon Electric/100, Davis/33. See also Exhibit 6 to the Application (Stock Purchase Agreement). The indemnification provisions of the Stock Purchase Agreement apply to four different categories of liabilities. See Oregon Electric/100, Davis/34-36 for a description of the various categories of indemnification. A chart listing the known liabilities or losses currently facing PGE and describing PGE's and Oregon Electric's rights to indemnification under the Stock Purchase Agreement can be found at Oregon Electric/102, Davis/1-4.

⁷⁷ See Oregon Electric/500, Davis/21. See also Oregon Electric/100, Davis/39.

⁷⁸ See Oregon Electric/100, Davis/34-35.

⁷⁹ See *id.*

⁸⁰ See Enron/2, Bingham/3-4; Enron/3, Bingham/1-2.

⁸¹ See Oregon Electric/500, Davis/21.

⁸² See Oregon Electric/100, Davis/36.

⁸³ See *id.*

Although it is impossible to predict to what extent PGE may incur indemnified losses, the indemnification provisions are a significant benefit and provide substantial financial protection to PGE that would not exist but for the Proposed Transaction.

3. *Local Focus and First-Class Board of Directors*

The Proposed Transaction brings a variety of benefits that ensure PGE will have a strong local focus and an exceptional Board of Directors. First, Oregon Electric has committed to having Oregonians fill at least five seats on the PGE Board at all times and to having an Oregonian serve as the Chair of the Board.⁸⁴ These commitments will result in local representation that far exceeds that which presently is enjoyed by PGE and its customers.⁸⁵ Additionally, such a strong local presence on the Board will bring to PGE a higher degree of accountability and greater sensitivity to local issues.⁸⁶

Second, Oregon Electric will bring to PGE the unique talents and diverse experience of the professionals at TPG and the business, industry, and community leaders selected for the PGE Board of Directors. This first-class Board of Directors will ensure that PGE management will have thoughtful guidance regarding long-term strategy, capital investment decisions, and operational excellence, while gaining the best advice on how to navigate any challenges the utility may face. The contributions these individuals bring to PGE provide a clear benefit that would not be present in the absence of the Proposed Transaction.⁸⁷

In response to many interested parties who expressed their desire to provide input on certain issues directly to PGE's Board of Directors, Oregon Electric has agreed to provide periodic access to the Board to various customer and environmental advocacy groups. No such

⁸⁴ See Oregon Electric/22, Davis/13.

⁸⁵ Only one Oregonian, Peggy Fowler, currently serves on the PGE Board.

⁸⁶ See Oregon Electric/100, Davis/57-58; Oregon Electric/2, Local Applicant Panel/5-6, 8, 10-11, 12-13; Oregon Electric/300, Jackson/9.

⁸⁷ See Application at 23-24; Oregon Electric/22, Davis/13-15.

guarantee presently exists, and in the absence of this guarantee, these groups cannot be assured that they will be able to present their views directly to PGE's Board.⁸⁸

Finally, the Proposed Transaction ensures that PGE's headquarters will stay in Portland, jobs will stay in Oregon, and PGE will continue its charitable leadership in the community.⁸⁹ In various ways, each of these commitments and guarantees ensure that PGE and its customers will benefit from a renewed focus on PGE's core mission, exceptional leadership, and a responsive Board of Directors.

4. *Extension of Service Quality Measures*

Oregon Electric has committed to a 10-year extension of the Service Quality Measures established in the Enron/PGE merger.⁹⁰ In addition, it has agreed to develop and, if approved by the Commission, implement a billing accuracy service quality measure.⁹¹ These commitments clearly leave PGE's customers better off as a result of the Proposed Transaction because they will enjoy 10 additional years of exceptional service quality guaranteed by standards that far exceed statutory requirements.⁹² Staff agreed in its testimony that the extension of the Enron Service Quality Measures for 10 years is a benefit of the Proposed Transaction.⁹³

5. *Increased Commitment to Renewable Resources*

In recognition of the importance of renewable resource development to PGE's customers and the region at large, Oregon Electric has committed to vigorously pursue a goal of meeting 10% of capacity with renewable resources by 2012, if economical.⁹⁴ Oregon Electric also has

⁸⁸ See Oregon Electric/22, Davis/10-11; Oregon Electric/100, Davis/58.

⁸⁹ See Application at 23; Oregon Electric/22, Davis/21.

⁹⁰ See Condition 5, Oregon Electric/501, Davis/1.

⁹¹ See Condition 29, Oregon Electric/501, Davis/7.

⁹² See Oregon Electric/100, Davis/57.

⁹³ See Staff/100, Conway/26-27.

⁹⁴ See Oregon Electric/100, Davis/48-49. The term "economical" refers to the Least Cost Planning Process in which PGE already engages when making long-term resource decisions. This process, under the Commission's current guidelines, explicitly requires that PGE consider the many risks of non-renewable resources and the many benefits of renewable resources in identifying a least cost resource plan. Thus, under the terms of this condition, PGE will work towards an ambitious renewable resource goal while remaining consistent with Commission requirements that its resource decision take into account relevant economic considerations.

committed to appoint a manager within PGE with appropriate responsibility and authority to work with advocacy groups for renewable energy sources, sustainability, energy efficiency, and environmental matters.⁹⁵

6. Commitment to Address Issues Faced by PGE’s Low Income Customers

Oregon Electric has proposed a 10-year extension of PGE’s cash and in-kind donations to Oregon HEAT and a doubling of the cash portion of the donation. This commitment increases PGE’s total annual cash donation to \$100,000 per year. These contributions will be paid from shareholder, not customer, funds.⁹⁶ In addition, Oregon Electric has committed to work on additional programs for low income assistance through a work group led by PGE.⁹⁷ Oregon Electric recognizes the need for assistance to low income groups and the importance of working towards sustainable solutions to their needs, and it has provided a concrete benefit to those customers.

7. Stability and Known Ownership

Although there has been discussion by various parties in this docket about what will happen to PGE if the Proposed Transaction does not close,⁹⁸ the fact is that Oregon Electric provides the only immediate end to Enron’s ownership of PGE. The Proposed Transaction will result in stable, known, and respected ownership. This certainty will benefit PGE’s customers by allowing utility managers to concentrate solely on providing exceptional utility service, rather than continuing to face the distractions and uncertainty posed by continued Enron ownership.⁹⁹ In addition, PGE’s business customers will be more likely to invest in the region with a strong, stable utility as their partner.

⁹⁵ See Oregon Electric/22, Davis/11.

⁹⁶ See Oregon Electric/100, Davis/49.

⁹⁷ See Oregon Electric/500, Davis/37.

⁹⁸ See, e.g., Staff/200, Morgan/55-56 (discussing potential “spin” of stock to Enron’s creditors).

⁹⁹ See Application at 23.

B. The Proposed Transaction Results in No Material Risks to PGE's Customers

Through a combination of financial and other conditions of approval more stringent than any used in past utility mergers, Oregon Electric has mitigated any potential risks to PGE's customers that could result from the Proposed Transaction. Staff and intervenors argue, however, that certain risks remain. These alleged risks are chiefly related to uncertainties arising from: (1) the leverage associated with Oregon Electric's proposed capital structure; (2) TPG Applicants' intent to sell their interest in Oregon Electric within 12 years;¹⁰⁰ and (3) Oregon Electric's alleged lack of transparency. In fact, these alleged risks are either nonexistent, exceedingly remote, not unique to the Proposed Transaction, or have been adequately mitigated.

1. *Alleged Risks Regarding the Proposed Capital Structure Asserted by Staff and Intervenors Are Not Material or Are Adequately Mitigated by Proposed Conditions*

Despite the strength of Oregon Electric's proposed capital structure, Staff and some of the intervenors have raised concerns regarding the amount of leverage at the holding company. Specifically these parties have argued that the leverage may: (1) exert pressure on PGE to imprudently cut costs in order to fund dividends; (2) result in a downgrade in PGE's credit rating and an associated increase in PGE's cost of capital; and (3) increase the risk of bankruptcy at Oregon Electric. Oregon Electric's response to each of these concerns follows.

a. *The Proposed Capital Structure Will Not Create Undue Pressure on PGE to Pay Dividends*

Staff's and various intervenors' basic argument is that the proposed level of debt at Oregon Electric will result in large debt service requirements that will exceed PGE's ability to fund dividends to Oregon Electric and that, as a consequence, Oregon Electric will pressure PGE

¹⁰⁰ TPG's mandate from its limited partners permits it to hold investments for up to 12 years. See Oregon Electric/3, Davis/12. For that reason, TPG will be required to sell its interest in Oregon Electric within that time period. However, as pointed out by Tom Walsh, TPG could sell its equity interest and its piece of the capital structure could simply be replaced by another investor, leaving Oregon Electric as owner of the company; this is conceptually different than the sale of the company. See Hearing Tr. at 163.

to engage in imprudent cost cutting to produce sufficient cash to service Oregon Electric's debt.¹⁰¹

At the outset, it should be noted that Staff and intervenors appear to assume that an obligation for PGE to pay dividends to shareholders is unique to the Proposed Transaction. This assumption is incorrect. Dividends are the primary means by which utilities provide a return to common shareholders. From 1991 until the merger with Enron, for example, Portland General Corporation paid approximately \$51 million per year in dividends to its shareholders.¹⁰² In addition, the payment of dividends to a holding or parent company is not unique to a leveraged private acquisition. After the merger with Enron and until 2001, PGE paid dividends to Enron in the amount of approximately \$80 million per year.¹⁰³ Thus, the intervenors' implication that the Proposed Transaction presents unique pressures on PGE to pay dividends is incorrect.

Moreover, while several parties voice concern that Oregon Electric will place undue pressure on PGE to engage in imprudent cost cutting to fund dividends, they provide no factual basis or evidentiary support for their assertions.¹⁰⁴ Staff witness Morgan acknowledges that the risk of default is "small" and that it is "likely" that sufficient funds will be available for Oregon Electric to meet its debt service obligations.¹⁰⁵ As discussed above, TPG took great care to analyze the amount of dividends PGE could be expected to pay Oregon Electric (as well as historical dividend levels prior to the Enron bankruptcy¹⁰⁶) while maintaining at least a 48%

¹⁰¹ CUB/200, Dittmer/25-30; Staff/900, Morgan/16; City of Portland/101, Anderson/9.

¹⁰² See PGE/400, Piro/14.

¹⁰³ See *id.*

¹⁰⁴ See, e.g., CUB/200, Dittmer/27 (engaging in double speculation about what Oregon Electric *might* do in response to events that *might* happen, without even attempting to quantify the probability that any imagined scenario would occur); in contrast, see PGE/100, Piro/8 ("[L]ittle about this [cost-cutting] scenario makes sense to me. . . . It is also unrealistic to think that Oregon Electric could cause PGE to engage in extreme cost cutting without Commission intervention.").

¹⁰⁵ Staff/900, Morgan/9.

¹⁰⁶ See PGE/400, Piro/14 ("From 1991 until the merger with Enron, Portland General Corporation paid approximately \$51 million per year in dividends.").

equity ratio. This analysis was critical to TPG's determination of the amount of debt that prudently could be placed at Oregon Electric.¹⁰⁷

As discussed more generally above, TPG ran a number of different model scenarios that varied key assumptions to understand their impact on the overall financial forecast and the strength of Oregon Electric's capital structure.¹⁰⁸ Four basic scenarios were developed, each with and without the assumption that substantial additional capital expenditures would be invested to build new generation resources (*i.e.*, Port Westward): (1) a scenario assuming 2% load growth over the projection period; (2) a scenario assuming 2.5% load growth; (3) a scenario assuming a faster than anticipated economic recovery and slightly higher load growth over the projection period than in the first two scenarios; and (4) a scenario assuming a slower than anticipated economic recovery and slightly lower load growth than in the first two scenarios. Additional sensitivities were performed to evaluate the effect of potential operating and capital efficiencies.¹⁰⁹ Notably, this modeling demonstrated that under all scenarios, including those where no operating or capital efficiencies were assumed, PGE would have the liquidity necessary to fund its budgeted expenditures while funding sufficient dividends to allow Oregon Electric to service and pay down its debt.¹¹⁰

In addition, at Staff's request, and in order to further "stress test" the capital structure, TPG used its model to run additional downside sensitivities that assumed 10%, 20%, and 30% sustained declines in "EBIT" from baseline scenarios for the entire five-year projection period. EBIT means "earnings before interest and taxes." It is an important measure of the core

¹⁰⁷ See Oregon Electric/200, Wheeler/5-6 ("[T]he extensive financial modeling we performed gives us a high degree of confidence that PGE's dividends will be more than sufficient to service Oregon Electric's debt. This determination was made only after assessing various sensitivities that illustrated the financial implication of highly unlikely, persistent financial underperformance by the company.").

¹⁰⁸ See Oregon Electric/200, Wheeler/4 (describing financial modeling process); see Section II(C)(2), *supra*.

¹⁰⁹ See Oregon Electric/200, Wheeler/7. A "sensitivity" represents a scenario run through the model where one or more assumptions are modified (such as load growth or the potential for operating efficiencies) to determine their potential impact on projected financial performance. TPG ran 48 different scenarios to capture a wide range of potential outcomes and associated returns. See Oregon Electric/203, Wheeler/26.

¹¹⁰ See Oregon Electric/200, Wheeler/10 ("Significantly, model runs that do not contemplate any savings still demonstrate that there is sufficient liquidity to meet all debt service obligations.").

profitability of a company, prior to the payment of interest and taxes, both of which are impacted by the capital structure of a company. For reference, PGE has generated average EBIT of \$244 million over the last ten years. This compares to projected EBIT levels of \$235 million in the 10% decline scenario, \$209 million of EBIT in the 20% decline scenario, and \$183 million of EBIT in the 30% decline scenario.¹¹¹

The sustained periods of meaningful declines implied by these stress-testing analyses produced earnings that are much lower than PGE's long-term, historical average performance and, in particular, are unprecedented in terms of the five-year duration of the downturn in earnings.¹¹² EBIT has been lower than the 30% decline projections only once in the past 15 years, and there has been no instance of a persistent downturn at the earnings level implied by the 10%, 20%, or 30% decline projections at any time in PGE's past 15-year history.¹¹³

Furthermore, the downturn in earnings posited by these analyses is so severe and persistent that it could occur only if PGE were unable to recover its costs in rates over sustained periods of time.¹¹⁴ Such an occurrence would imply a complete departure from the regulatory compact under which PGE currently exists and is extremely difficult to imagine.¹¹⁵ That said, the results of these "stress-testing" analyses demonstrated that even during a period of unprecedented difficulty, the capital structure would allow for ample liquidity, and debt service requirements at both Oregon Electric and PGE would be met.¹¹⁶

While these particular analyses tested extremely remote scenarios, they are helpful in demonstrating that the proposed capital structure for Oregon Electric and PGE would be

¹¹¹ See Oregon Electric/200, Wheeler/7-8; Confidential Exhibit Staff/202, Morgan/169-178 (Applicants' Response to Request Staff/OEUC 37 and Supplements thereto).

¹¹² See PGE/100, Piro/5 ("[T]he circumstances that would produce the results modeled in [Staff's worst-case scenario] are highly improbable.").

¹¹³ See *id.*; PGE/100, Piro/5; Oregon Electric/200, Wheeler/8.

¹¹⁴ See Oregon Electric/200, Wheeler/8.

¹¹⁵ See PGE/100, Piro/4-5 ("It is doubtful that a utility, under any form of ownership, could allow wide negative variations to persist long without asking the regulators to revisit what is 'normal.'").

¹¹⁶ See Oregon Electric/200, Wheeler 8. See also Confidential Exhibit Staff/202, Morgan/169-178 (Applicants' Response to Request Staff/OEUC 37 and Supplements thereto); Oregon Electric/203, Wheeler/7-8 (Applicants' Response to Staff/OEUC 42).

resilient, even in the event of a downturn in financial performance of unprecedented severity and duration. Moreover, the Oregon Electric Revolver will provide an additional source of liquidity to allow Oregon Electric to service its debt obligations even in the highly unlikely event that PGE's dividends are less than anticipated.¹¹⁷ As a result, the Oregon Electric Revolver will provide additional protection that PGE will not be unduly pressured to fund dividends if it ever becomes imprudent to do so.¹¹⁸ Thus, the fear that pressure to fund dividends to service Oregon Electric's debt will result in imprudent cost cutting is unsubstantiated.

b. PGE's Cost of Capital Will Not Materially Increase as a Result of a Downgrade in Credit Rating and will Not Harm Customers

Staff and several intervenors argue that the leveraged nature of the Proposed Transaction will have an immediate, overall negative impact on PGE's financial standing and credit rating.¹¹⁹ They argue that a downgrade in PGE's credit rating will increase PGE's cost of capital and could limit PGE's access to financing sources.¹²⁰ The evidence is to the contrary.¹²¹

Standard & Poor's Rating Evaluation Service ("Standard & Poor's") has advised that PGE will maintain its investment grade rating in all categories.¹²² PGE's senior secured debt rating is expected to remain at its current rating of BBB+.¹²³ Only PGE's unsecured debt may be downgraded one notch to BBB-.

Secured Debt. PGE's secured debt represents 80% of long-term debt. All of PGE's secured debt is at fixed interest rates.¹²⁴ As a result, PGE's interest obligation for this debt will not be impacted by any credit rating change. In addition, because PGE's secured debt rating is not expected to be adversely affected by the transaction, the planned refinancing of

¹¹⁷ See Section II(C)(2), *supra*.

¹¹⁸ See Oregon Electric/200, Wheeler/6 (discussing additional protection provided by Oregon Electric Revolver).

¹¹⁹ See ICNU/200, Antonuk-Vickroy/16, 18; COP/100, Anderson/5; Staff/200, Morgan/28-32; Staff/900, Morgan/9; CUB/200, Dittmer/12-13; COP/101, Anderson/9.

¹²⁰ See, e.g., Staff/100, Conway/24; Staff/200, Morgan/29, 50-51; Staff/900, Morgan/12, 14.

¹²¹ See PGE/100, Piro/13 ("Oregon Electric's ownership, by itself, will not weaken PGE's capital structure.").

¹²² See Staff/202, Morgan/593-596.

¹²³ See Oregon Electric/200, Wheeler/15; Confidential Oregon Electric/203, Wheeler/11; PGE/100, Piro/19-20.

¹²⁴ See PGE/100, Piro/21.

approximately \$405 million of this pre-transaction debt by 2010 also will not be affected by the Proposed Transaction.¹²⁵ Oregon Electric expects that it will meaningfully improve its credit rating due to the accelerated pay down of debt during the intervening period. Consequently, there is no reasonable expectation that PGE's borrowing costs for senior secured debt should be impacted by the transaction.¹²⁶

Unsecured Debt. Standard & Poor's does expect PGE's senior unsecured rating to fall by one notch from BBB to BBB- following the closing of the transaction. This rating applies to PGE's short-term debt and will remain investment grade. However, even if PGE's cost of short-term debt increases, because the interest rate on short term debt is not considered in setting rates, there is no impact on customers. This is because the Commission uses the working capital concept as part of PGE's revenue requirement, and this concept does not include the cost of short-term debt.¹²⁷

The cost of short-term debt may, however, become part of the interest rate used to calculate Allowance for Funds Used during Construction ("AFUDC").¹²⁸ But, depending on the financing alternatives used during the construction process, it may not add any cost.¹²⁹ Even if PGE needed to issue unsecured notes at the BBB- rating, rather than the current BBB rating, the maximum basis point spread (or the difference in interest rate) between the level at which it would be able to raise unsecured debt is estimated to be only 25 points.¹³⁰ To frame the potential magnitude of this difference, if PGE theoretically raised \$100 million of new unsecured debt, this would have a maximum incremental cost of only \$250,000 per year.¹³¹ Significantly, even if the Proposed Transaction results in an increase in PGE's financing costs, Oregon Electric has

¹²⁵ See PGE/400, Piro/10.

¹²⁶ See PGE/100, Piro/21.

¹²⁷ See PGE/100, Piro/21, footnote 1.

¹²⁸ See Hearing Tr. at 28. The dollar amount of AFUDC is added to Construction Work in Progress ("CWIP") at the time a capital project is placed in service. The total rate base for a capital project that will be recovered in rates will include the sum of AFUDC and CWIP.

¹²⁹ See PGE's Opening Brief at *; Hearing Tr. at 28.

¹³⁰ See Oregon Electric/200, Wheeler/16.

¹³¹ See Oregon Electric/200, Wheeler/16.

agreed that PGE's customers will be held harmless and any such increase would not be included in PGE's revenue requirement. Thus, this concern has been adequately addressed and the potential risk mitigated.¹³²

Finally, Applicants' model runs showed that even if EBIT were to decline 10% and 20% from the baseline projections throughout the five-year forecast period (ending in 2009), PGE's and Oregon Electric's core credit statistics (such as funds from operations to total debt, interest coverage, and total debt to capitalization) would remain strong and indicative of Standard & Poor's senior secured credit ratings of BBB+ for PGE and ratings of BB for Oregon Electric. Even if EBIT were to decline by 30% from the baseline projections for the entire forecast period upon which the analysis was based, Oregon Electric would have sufficient liquidity to cover its financial obligations. These characteristics speak volumes regarding the resilience of Oregon Electric's proposed capital structure.¹³³

c. There is No Material Risk of Oregon Electric Declaring Bankruptcy

Staff and ICNU argue that the amount of debt service required at Oregon Electric is "not normal" and will increase the risk of default by Oregon Electric.¹³⁴ These parties also argue that the Enron ring-fencing provisions were inadequate to protect PGE from the effects of Enron's bankruptcy.¹³⁵

Again, the parties provide no evidentiary support for these assertions, instead relying upon unsubstantiated fears and unsupported statements. As discussed in detail above, the risk of default is extremely remote. As TPG's rigorous and highly analytical modeling showed, the capital structure that will be in place at Oregon Electric would be supported, even in the event of a significant and sustained downturn in PGE's earnings. Staff witness Thomas Morgan has stated that such a downturn is "highly unlikely."¹³⁶ There is no reason to anticipate bankruptcy.

¹³² See Condition Nos. 17 and 18, Oregon Electric/501, Davis/5.

¹³³ See Oregon Electric/200, Wheeler/8-9.

¹³⁴ See Staff/200, Morgan/29; Staff/900, Morgan/12.

¹³⁵ See ICNU/200, Antonuk-Vickroy/6, 12; Staff/200, Morgan/31; Staff/100, Conway/24.

¹³⁶ See Staff/900, Morgan/13.

Moreover, it is important to note that, even in the highly unlikely event that Oregon Electric declared bankruptcy, there is no material risk that PGE would be pulled into the bankruptcy. As explained by Oregon Electric's bankruptcy expert, Daniel Bussel, the intervenors' fears to the contrary are unfounded.¹³⁷ The "worst-case scenario" is that PGE would continue to operate as it operates now, as an asset in a parent's bankruptcy, well-protected by ring-fencing and other financial conditions that are even broader and stronger than those that have protected PGE during the Enron bankruptcy.¹³⁸

d. Oregon Electric's Proposed Financial Conditions Entirely Mitigate Any Remaining Risks Allegedly Posed by the Capital Structure

As demonstrated above, Oregon Electric has proposed a prudent capital structure that does not expose PGE to undue pressure to fund dividends, increased borrowing costs due to a credit rating downgrade, or an increased risk of bankruptcy at Oregon Electric. Nevertheless, Oregon Electric has agreed to a set of ring-fencing and other financial conditions that provide further protections to PGE customers.¹³⁹ These conditions are far more stringent than those conditions adopted in the Enron merger and give the Commission an unprecedented ability to monitor and restrict PGE's and Oregon Electric's financial affairs. These conditions are as follows:

(1) Minimum Equity. Oregon Electric has proposed a "minimum equity" condition—the prototypical ring-fencing condition that protects the integrity of PGE's capital structure from any adverse effect caused by Oregon Electric's ownership. Generally, the minimum equity condition prohibits PGE from making any distributions to Oregon Electric if such distribution would cause PGE's equity to fall below 48%. Oregon Electric's proposal is as follows:

¹³⁷ See Oregon Electric/800, Bussel/4 ("There is no material risk of 'substantive consolidation' in the event that: (1) the Oregon Electric-PGE transaction is consummated on the proposed terms; and (2) at some time subsequent thereto Chapter 11 proceedings are commenced in respect of Oregon Electric.").

¹³⁸ See PGE/100, Piro/13 (noting that PGE has operated normally during Enron's bankruptcy).

¹³⁹ Under Oregon Electric's proposal, the cash flow sweep and re-leverage conditions cease to be in effect in the event of any initial public offering ("IPO"). See Oregon Electric/600, Wheeler/20.

16. PGE will not make any distributions to Oregon Electric that would, as determined in accordance with Generally Accepted Accounting Principles (“GAAP”), cause the common equity portion of PGE’s total capital structure to fall below 48 percent without Commission approval.
- a. “Total capital structure” is defined as PGE’s common equity, preferred equity, and long-term debt.
 - b. “Long-term debt” is defined as PGE’s outstanding debt with a term of more than one year, excluding revolving lines of credit except to the extent the amount of the rolling 12-month average of committed and drawn balances under PGE’s unsecured revolving lines of credit (Unsecured Revolvers) less any balances related to collateral or security provided to counterparties for power supply and related agreements, is greater than \$250 million.
 - c. A “committed balance” is the sum of the commitments used to support any borrowing capacity or other purposes, such as a commercial paper program or letters of credit.
 - d. A “drawn balance” is sum of amounts drawn against the Unsecured Revolvers.
 - e. Hybrid securities (e.g., convertible debt) will be assigned to equity and long-term debt based on the characteristics of the hybrid security. The Commission, prior to their issuance, will determine the assignment of the equity and debt characteristics.

Oregon Electric’s minimum equity condition is similar to the minimum equity condition adopted in the Enron merger, but provides additional protections for PGE’s financial health by including certain revolver debt in the definition of long-term debt. However, despite this fact, as well as the fact that the Enron minimum equity condition was extremely effective in protecting PGE, Staff is recommending a significantly more onerous minimum equity condition.¹⁴⁰

¹⁴⁰ Specifically, Staff’s proposed condition states:

16. PGE will not make any distributions to OEUC that would, or could reasonably be expected to, cause the common equity portion of PGE’s total capital structure to fall below 48 percent.
- a. “Total capital structure” is defined as common equity, preferred equity, and long-term debt.
 - b. “Long-term debt” is defined as (1) outstanding debt with an initial term of more than one year plus the sum of committed and drawn balances greater than \$150 million on any of PGE’s unsecured revolving lines of credit (Unsecured Revolvers); and (2) the sum of committed and drawn balances on PGE’s secured revolving lines of credit (Secured Revolvers).
 - c. A “committed balance” is the sum of the commitments used to support any borrowing capacity or other purposes, such as a commercial paper program.
 - d. A “drawn balance” is sum of amounts drawn against the Revolvers.
 - e. Hybrid securities (e.g., convertible debt) will be assigned to equity and long-term debt based on the characteristics of the hybrid security. For these hybrid securities, The Commission, prior to their issuance, will determine the assignment of the equity and/or debt characteristics.

Oregon Electric's and Staff's proposals differ in two significant respects. First, under Oregon Electric's proposal, PGE could not make any distributions to Oregon Electric that would, *as determined in accordance with Generally Accepted Accounting Principles ("GAAP")*, cause the common equity portion of PGE's total capital structure to fall below 48% without Commission approval. By contrast, Staff's proposed condition would prohibit distributions that would, *or could reasonably be expected to*, cause the common equity portion of PGE's total capital structure to fall below 48% without Commission approval. Second, Staff's proposed condition would include unsecured revolver balances in excess of \$150 million and *any* balance on a secured revolver in the definition of long-term debt, whereas Oregon Electric's proposal would include average unsecured revolver balances in excess of \$250 million and would not include balances on secured revolvers.

Staff's proposal is unacceptable in both respects. First, the phrase "could reasonably be expected to" is vague and unavoidably subjective. In effect, Staff proposes to create a new, untested, and highly subjective standard to govern PGE's distributions to Oregon Electric, while Oregon Electric proposes using a known and predictable set of independent accounting principles. Reasonable business people evaluating a proposed dividend under Staff's condition would very likely differ in their application of this "reasonable expectation" standard and PGE would have no precedent to apply to determine its meaning.¹⁴¹ GAAP, on the other hand, is used throughout the business world. PGE uses these principles in its accounting, as do almost all other large businesses in the United States. Accountants can be called upon to interpret and apply these principles, and their recommendations can be checked against a large, public body of precedent.¹⁴²

Second, the inclusion of revolver balances in Staff's proposed condition effectively raises the minimum equity requirement to a level above 48%. The basic purpose of the minimum

ICNU proposes a similar condition. *See* ICNU/301, Schoenbeck/2 (Condition 10).

¹⁴¹ *See* Oregon Electric/600, Wheeler/11.

¹⁴² *See* Oregon Electric/600, Wheeler/11; PGE/400, Piro/7-8.

equity condition is to protect PGE's financial health by limiting the distributions PGE can send to Oregon Electric. In the Enron merger, the parties agreed to prohibit a distribution that would cause the common equity portion of PGE's total capital structure to fall below 48%.¹⁴³ There is no evidence that PGE is financially unhealthy with this capital structure. In fact, when ScottishPower applied to exercise influence over PacifiCorp in 1999, the Commission approved a merger condition allowing PacifiCorp to send dividends to ScottishPower so long as PacifiCorp's equity remained at or above 35%.¹⁴⁴ The threshold today is 39%.¹⁴⁵ Despite the absence of any need to change the capital structure portion of the Enron ring-fencing conditions to protect the financial health of PGE, and despite Staff's own recommendation that the common equity floor be set at 48%,¹⁴⁶ Staff's proposed conditions would effectively raise the threshold for dividends to a number *above* 48%.¹⁴⁷

As described by PGE's Chief Financial Officer, Jim Piro, PGE regularly uses revolvers to fund short-term working capital needs.¹⁴⁸ The balances on these revolvers can vary significantly over short periods of time, are not treated as long-term debt under GAAP, and have not previously been treated by the Commission as long-term debt for any purpose, including calculation of the equity rates. For these reasons, revolver balances appropriately were *not* included in the definition of debt in the Enron ring-fencing conditions. Staff is proposing to artificially alter PGE's actual capital structure requirements by including such balances in the definition of long-term debt and thereby further limiting the amount of dividends PGE can send

¹⁴³ See UM 814, Order No. 97-196 at 7 (Jun. 4, 1997).

¹⁴⁴ See Condition 6 of the Stipulation in the ScottishPower/PacifiCorp merger, which required PacifiCorp to maintain increasing minimum equity levels from 1999 (35%) to 2004 (39%). On January 1, 2005, the level will increase to 40%. *In the Matter of the Application of ScottishPower plc and PacifiCorp for an Order Authorizing ScottishPower plc to Exercise Substantial Influence Over the Policies and Actions of PacifiCorp*, UM 918, Order No. 99-616 (Oct. 6, 1999) (Appendix – Stipulation 5, pg. 6).

¹⁴⁵ See *id.*

¹⁴⁶ Staff/900, Morgan/14.

¹⁴⁷ See Oregon Electric/600, Wheeler/9. See also PGE/400, Piro/5-6 (“In essence, Staff's proposal to include short-term debt simply increases the minimum equity level that PGE must have in its capital structure before we can make a dividend to our equity owners.”).

¹⁴⁸ See PGE/400, Piro/3-4.

to Oregon Electric.¹⁴⁹ It is difficult to overstate the importance of this point. The inclusion of revolver balances in the calculation of long-term debt will unduly limit the company's flexibility to respond to market conditions and may deter PGE from utilizing its most cost-effective financing options.¹⁵⁰ Staff proposes this change despite the fact that there has been no evidence to suggest that the existing ring-fencing provision has not been sufficient to protect PGE's financial health.

Though Staff's testimony does not provide an explicit reason or any evidentiary support for its proposal regarding unsecured revolver debt, it may have been intended to restrict PGE's ability to incur unsecured revolver debt in an amount in excess of its present unsecured revolver of \$150 million. However, as explained by Mr. Piro, even absent this transaction, PGE plans to increase its revolver to \$250 million, which is more in line with the capacity it has had in the past.¹⁵¹ To that end, Oregon Electric is willing to agree to include average balances in excess of \$250 million on its unsecured revolvers in the calculation of long-term debt. While Oregon Electric disagrees with the fundamental principle of including *any* revolver balance in the definition of long-term debt, Oregon Electric is nonetheless willing to set a "ceiling" on the level of revolver balances. However, this condition must stand the test of time, and it is difficult to predict what working capital needs PGE may have in the future. Considering the volatile nature of power markets and the potential need to build additional generation resources, it is important that this condition provide sufficient flexibility to PGE and Oregon Electric over the long term.¹⁵²

Staff's attempt to further restrict PGE's flexibility also clearly interferes with the utility's power to regulate its own affairs and manage its own business.¹⁵³ Indeed, the U.S. Supreme

¹⁴⁹ See PGE/400, Piro/5-6.

¹⁵⁰ See Oregon Electric/600, Wheeler/10.

¹⁵¹ See Enron/2, Bingham/3.

¹⁵² See Oregon Electric/600, Wheeler/10.

¹⁵³ See, e.g., *Pacific Telephone & Telegraph Co. v. Flagg*, 189 Or. 370, 391 (1950) (restricting method by which utility contracts for services "would be an interference with the powers of management incident to ownership, which

Court stated: “[i]t must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership.”¹⁵⁴ More to the point, “[t]he Commission is not the financial manager of the corporation, and it is not empowered to substitute its judgment for that of the directors of the corporation[.]”¹⁵⁵ PGE’s use of revolvers and management of its capital structure properly are matters for decision by the company, and the Commission should not interfere.¹⁵⁶

With respect to secured revolvers, Oregon Electric has not proposed to include them in the definition of long-term debt. As Mr. Piro testified, PGE does not currently have a secured revolver.¹⁵⁷ Because a secured revolver is backed by first mortgage bonds, PGE must seek Commission approval before one may be issued. Given that the reasons PGE might seek a secured revolver are unknown at this time, the question as to whether balances should be included in long-term debt should be reserved until all the relevant information is known (*i.e.*, at the time the Commission’s approval is sought).¹⁵⁸

(2) **Hold Harmless Conditions.** Even if Oregon Electric’s ownership of PGE was to result in an increase in PGE’s cost of capital or revenue requirement, PGE’s customers would be protected because Oregon Electric has agreed to hold customers harmless for any such increase. Oregon Electric has agreed to the following conditions of approval:

. . . we are not at liberty to hold was authorized by the legislature in the absence of a clear expression of that intent.”).

¹⁵⁴ *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 289 (1923). See also *Mountain States Tel. & Tel. Co. v. Public Utilities Commission*, 763 P.2d 1020, 1027 (Colo. 1988) (“Every aspect of a public utility’s operations has never been deemed subject to the approval of the PUC. The PUC regulates public utilities, it does not operate them.”).

¹⁵⁵ *Southwestern Bell*, 262 U.S. at 289 (citing *States Public Utilities Commission ex rel. Springfield v. Springfield Gas & Electric Co.*, 125 N.E. 891, 901 (Ill. 1920)). See also *Metropolitan Edison Co. v. Pennsylvania Public Utility Comm.*, 437 A.2d 76, 81 (Pa. Cmwlth. 1981) (“The Commission is not empowered to act as a super board of directors for the public utility companies of this state.”).

¹⁵⁶ See, e.g., *Elyria Tel. Co. v. Public Utilities Comm.*, 110 N.E.2d 59 (Ohio 1953) (holding that Public Utility Commission lacked authority to impose restrictions on utility’s decision-making regarding payment of dividends to shareholders).

¹⁵⁷ See PGE/400, Piro/7.

¹⁵⁸ See *id.*

17. *Oregon Electric agrees that the customers of PGE shall be held harmless if PGE's return on common equity and other costs of capital, viewed on a stand-alone basis, rise as a result of Oregon Electric's ownership of PGE. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.*
18. *Oregon Electric agrees that the customers of PGE shall be held harmless if PGE's revenue requirement, viewed on a stand-alone basis, is higher due to Oregon Electric's ownership of PGE.*

These ring-fencing conditions ensure that any increases in PGE's cost of capital and revenue requirement due to Oregon Electric's ownership will be borne by PGE's shareholders and not its customers. Significantly, at Staff's request, these hold harmless conditions are stronger than those to which the parties agreed in the Enron merger. The Enron conditions provided that customers would be held harmless if the merger itself resulted in higher costs to PGE. However, Staff has stated that after the merger was complete, disagreements arose as to whether customers were protected from only those higher costs that may have resulted immediately from the merger, or whether they were protected from higher costs that may have resulted from Enron's ownership. To eliminate any confusion and provide additional protection to PGE's customers, Oregon Electric has agreed to hold harmless conditions that make it clear that if Oregon Electric's ownership results in a higher cost of capital or revenue requirement at any time during the period of its ownership, then PGE's customers will be held harmless.¹⁵⁹

(3) ***Separate Debt Ratings.*** In addition to the hold harmless provisions, PGE's customers are protected by the following condition:

6. *PGE and Oregon Electric shall maintain separate debt ratings and, if more than \$5 million of preferred stock is outstanding, then PGE and Oregon Electric shall maintain separate preferred stock ratings.*

This is similar to one of the Enron ring-fencing conditions and ensures that the rating agencies will continue to review PGE's finances and issue PGE's credit ratings on a stand-alone

¹⁵⁹ See Oregon Electric/600, Wheeler/5. Staff has agreed in principle to these conditions, though they have not been included in a stipulation. See Staff/900, Morgan/20-21.

basis. Staff, Oregon Electric, and several intervenors have agreed to this condition in a Partial Stipulation signed on July 16, 2004.¹⁶⁰

(4) **Cash Flow Sweep.** Oregon Electric intends to use the dividends received from PGE to meet its fixed obligations and to use any excess cash flow to pay down debt on an accelerated basis. In recognition of this fact, Oregon Electric has proposed the following “cash sweep” provision:

25. *After closing, each PGE distribution to Oregon Electric will be used by Oregon Electric exclusively to pay operating expenses and debt service until all of the following conditions are met:*
 - a. *The rolling 12-month average of the committed and drawn balances of all PGE’s Unsecured Revolvers is less than \$250 million; and*
 - b. *Oregon Electric has paid down at least \$250 million of its outstanding debt as compared to the level of outstanding debt at closing (no portion of the proposed “catch-up dividend” that will be paid at closing will be considered to have paid down debt).¹⁶¹*

This condition ensures that PGE’s and Oregon Electric’s overall financial structure will be strengthened over time. This condition is not one of the original ring-fencing conditions to which Enron agreed. Rather, it is another example of Oregon Electric’s commitment to more stringent financial restrictions, ensuring greater protection for PGE and its customers. Despite this fact, Staff seeks to impose an even more restrictive condition, again for no stated reason and without any evidentiary support or analysis.¹⁶²

¹⁶⁰ See Staff/102, Conway/49-53.

¹⁶¹ This condition would be lifted in the event of an IPO. See Oregon Electric/600, Wheeler/20.

¹⁶² Staff’s proposed condition states:

25. *Each PGE distribution to OEUC will be used by OEUC exclusively to pay direct operating expenses and debt service for at least five years and until all of the following conditions are met:*
 - a. *The sum of the drawn balances of all PGE’s Secured Revolvers is zero and there has not been a balance for three months; and*
 - b. *OEUC has paid down at least \$250 million of its outstanding debt as compared to the level of outstanding debt at closing including the catch-up dividend from PGE.*

Direct operating expenses are expenses that were incurred from services, supplies or assets provided by OEUC personnel directly and are not based on any type of allocation from an affiliate (parent or subsidiary).

There are four primary problems with Staff's proposed condition. First, like Oregon Electric's proposal, Staff's proposed condition requires Oregon Electric to use PGE distributions only to pay operating expenses until the requirements of the provision are met. However, Staff's definition of "direct operating expenses" includes only those services and supplies that are provided by Oregon Electric personnel. Thus, Staff's proposal would not allow Oregon Electric to contract for services its own personnel could not efficiently provide. Oregon Electric has every incentive to devote cash flow to pay down debt at Oregon Electric rather than to incur excess operating expenses. To that end, Oregon Electric will be a very "lean" company with few employees. To the extent that it requires legal, financial, accounting, and other general business advice, it will need to acquire those services from outside of the company.¹⁶³

Second, Staff's proposal would prevent dividends from Oregon Electric to its shareholders unless and until there are no balances under any secured revolvers at PGE. This provision appears to be based on Staff witness Morgan's assertion that PGE would seek a secured revolver only in the face of "weak financial performance."¹⁶⁴ However, there are circumstances under which PGE might seek permission to open a secured revolver that would *not* indicate financial difficulties at PGE.¹⁶⁵ In addition, the Commission has the full authority and discretion to approve any secured revolver and can condition its approval as it deems necessary at that time.¹⁶⁶ Thus, it is appropriate for the Commission to defer a decision on the treatment of secured revolver debt under this cash sweep condition until all of the facts and circumstances can be considered.

Third, Oregon Electric's proposed condition is effective "after close" of the transaction to allow for payment of the purchase price and transaction and financing fees, all of which will be

¹⁶³ See Oregon Electric/600, Wheeler/15.

¹⁶⁴ Staff/900, Morgan/22.

¹⁶⁵ See Oregon Electric/600, Wheeler/15-16; PGE/400, Piro/7.

¹⁶⁶ See ORS § 757.415. For an example of the Commission exercising this authority, see *In the Matter of Portland General Electric Application for Authority to Issue and Sell Not More than \$300 Million of First Mortgage Bonds*, UF 4188, Order No. 02-384 (Jun. 10, 2002).

paid at the close of the transaction.¹⁶⁷ For the same reason, the “after close” language is included in Oregon Electric’s proposed condition regarding allocation of costs, discussed below.

Fourth, Oregon Electric proposes that the cash sweep requirement be satisfied after it has paid down \$250 million in debt, regardless of when that event occurs. Staff proposes that the cash sweep requirement cannot be satisfied until five years after close—even if \$250 million in debt has been paid down at an earlier date. The purpose of the cash sweep provision is to ensure that Oregon Electric debt is reduced to a level that allows for an improved credit rating that will benefit Oregon Electric and PGE. An arbitrary five-year requirement is unsupportable because it bears no relation to the financial objective.

Oregon Electric’s proposed condition will achieve Staff’s intended result: it will make concrete Oregon Electric’s promise to use distributions from PGE to pay down debt, while not unduly limiting PGE’s ability to take advantage of least-cost financing opportunities and to use its revolvers to fund working capital and pay for other necessary services.

(5) ***Restriction on Re-leveraging.*** Oregon Electric has agreed to the following condition of approval:

27. *Oregon Electric shall not re-leverage, i.e., increase the amount of its outstanding long-term debt once such debt has been liquidated, if the increased debt would, as determined in accordance with GAAP, bring the consolidated capital structure (excluding short-term debt) below 30 percent equity.*¹⁶⁸

This is another proposed condition that goes above and beyond the financial conditions to which Enron or any other Oregon utility has agreed. Staff has proposed a different condition that, among other things, proposes a 40% equity floor.¹⁶⁹

¹⁶⁷ See Oregon Electric/600, Wheeler/16. Oregon Electric has agreed to a condition of approval that provides that Oregon Electric and PGE shall exclude all costs and fees of the acquisition from PGE’s utility accounts (Condition No. 3, Oregon Electric/501, Davis/1).

¹⁶⁸ This condition would be lifted in the event of an IPO. See Oregon Electric/600, Wheeler/20.

¹⁶⁹ Staff’s proposed condition states:

27. *OEUC shall not re-leverage, i.e., increase the amount of its outstanding long-term debt once it has been liquidated, if the increased debt would, or could reasonably be expected to, bring the consolidated capital structure below 40% common equity. The capital structure calculations refer to the OPUC policy that does not include short-term debt capital.*

Staff's proposed condition would have several detrimental effects. First, the market could evolve such that it would be financially advantageous to re-leverage below 40% equity. With the proposed financial conditions in place, Oregon Electric could do so without adversely affecting PGE, yet Staff's proposal would prevent this. Denying Oregon Electric the ability to re-leverage could result in unnecessary financial harm to Oregon Electric.¹⁷⁰

In sum, the potential effects of the leverage at Oregon Electric have been adequately mitigated by Oregon Electric's proposed financial conditions. Because the financial conditions to which Oregon Electric has already agreed would protect PGE and its customers from any deleterious effects of the proposed leverage, it stands to reason that PGE and its customers will remain protected by those same provisions should Oregon Electric choose to re-leverage. For this reason, Oregon Electric does not believe that a restriction on re-leveraging is necessary. Nonetheless, Oregon Electric is willing to agree to such a condition provided the limit on re-leveraging does not have an unnecessarily negative effect on Oregon Electric.¹⁷¹

(6) Allocation of Costs/Direct Billing. Oregon Electric has also agreed to the following condition which caps annual payments from Oregon Electric to TPG:

28. After closing, the TPG entities will not allocate or direct bill Oregon Electric for any goods, services, supplies or assets in excess of \$5 million per year.

Staff has proposed a different condition, which states that the TPG entities will not allocate or direct bill Oregon Electric for any goods, services, supplies or assets until the cash flow sweep provision has been satisfied.¹⁷² However, Staff's condition would unduly limit TPG's ability to charge Oregon Electric for ongoing services that TPG may provide. For instance, TPG may charge Oregon Electric for ongoing monitoring and advice, just as it does for many of its portfolio company investments. It is a common and accepted practice for investors

¹⁷⁰ See Oregon Electric/600, Wheeler/17-18.

¹⁷¹ See Oregon Electric/600, Wheeler/17.

¹⁷² Staff's proposed condition states:

28. TPG Applicants will not allocate or direct bill OEUC for any goods, services, supplies or assets until condition number 25 (cash sweep provision) has been satisfied.

to charge their portfolio companies for the expense of monitoring the investment and providing advice. These charges will not unduly burden Oregon Electric, and Oregon Electric is willing to cap the amount that TPG would charge to Oregon Electric to no more than \$5 million per year.¹⁷³

All of the above conditions adequately mitigate any risks posed by Oregon Electric's proposed capital structure. Any remaining concerns are without merit.

2. Alleged Risks of "Short-Term" Ownership are Without Merit

Some intervenors have argued that, because TPG Applicants intend to sell their interest in PGE within 12 years,¹⁷⁴ it is a "short-term owner" that will lack the incentive to make substantial expenditures as part of a long-term strategy for PGE.¹⁷⁵ In support of their position, they assert that: (1) TPG's due diligence of PGE reveals that Oregon Electric intends to make aggressive cost cuts;¹⁷⁶ and (2) the regulatory system cannot protect PGE from a short-term owner who imprudently cuts costs or underinvests, because any harm would not be revealed until after PGE is sold to a new buyer.¹⁷⁷

There is no justification for intervenors' fears. Promoting short-term savings at the expense of prudent long-term investment in PGE is inconsistent with TPG's investment philosophy, as described in Section II(D) above and as evidenced by the substantial capital investment TPG historically has made in other companies in which it has owned a controlling stake.¹⁷⁸ It is also contrary to Oregon Electric's stated goal of building PGE's value for its

¹⁷³ See Oregon Electric/600, Wheeler/18-19.

¹⁷⁴ Oregon Electric/3, Davis/12.

¹⁷⁵ See, e.g., CUB/100, Jenks-Brown/11-12 (CUB suggests that, as a "short-term investor," Oregon Electric will "let maintenance slip," "reap the saved dollars for a few years," and let a subsequent owner deal with the result while the owners of Oregon Electric are "sipping martinis elsewhere.").

¹⁷⁶ See, e.g., ICNU/200, Antonuk-Vickroy/36; CUB/200, Dittmer/29-30.

¹⁷⁷ See, e.g., ICNU/400, Antonuk-Vickroy/13-14

¹⁷⁸ Some examples of TPG's philosophy of building value in its portfolio companies through capital investment include Continental Airlines (\$5.5 billion in new aircraft over six years), Seagate Technology (approximately \$1.9 billion in capital expenditures since 2000), and MEMC Electronic Materials (capital expenditures increased by 70 percent since 2001 and are projected to double in 2004). See Oregon Electric/100, Davis/12-13 (describing capital investments in these companies, PETCO Animal Supplies, and J. Crew).

investors.¹⁷⁹ Indeed, irresponsible stewardship would *decrease* rather than increase the value of PGE for Oregon Electric’s investors, because it would degrade service and cause PGE’s relationship with regulators to suffer. As a result, future buyers would be willing to pay far less for the utility.¹⁸⁰

According to Staff, Oregon Electric’s response to intervenors’ “short-term ownership” concerns is “well reasoned.”¹⁸¹ Certain intervenors, on the other hand, continue to question Oregon Electric’s commitment to invest in PGE’s future, without providing any reasonable basis for doing so. These parties ignore the example of Enron, whose tenure as PGE’s owner directly contradicts their position. Enron has been actively trying to sell PGE for the last five years and is therefore the quintessential “short-term owner.”¹⁸² Yet there has been no suggestion that, during these five years, Enron has attempted to cut costs imprudently or underinvest in PGE’s future. To the contrary, TPG’s due diligence revealed that Enron has supported necessary investments in PGE, presumably to maintain its value and attractiveness as an investment.¹⁸³ Jim Piro further testified:

Enron, at least since 1999 when PGE was first put up for sale, has not been a “long-term investor.” Yet, PGE has continued to invest in our distribution system and generating plants, performed several major plant upgrades and run an acclaimed hydro re-licensing program.¹⁸⁴

¹⁷⁹ See Oregon Electric/108, Davis/18 (“TPG’s primary focus is not on the duration of its investments, but on the responsible stewardship of the companies in which it invests TPG’s investment goals for PGE, which include stabilizing the company and its earnings, building a more efficient and effective utility, addressing the company’s energy short position, and realizing profitable, long-term growth, will take significant time and attention. While careful investment in the utility industry may result in steady, long-term growth, it is unlikely to result in a quick return or profit. TPG knows this, and would not have chosen to invest in the industry if they were interested in a quick turnaround. Ultimately, TPG does not intend to sell its investment in PGE until it realizes its investment goals.”).

¹⁸⁰ See Oregon Electric/100, Davis/9 (Intervenors’ concerns are “predicated on the belief that the market is populated by naïve investors who are willing to spend vast sums of money to purchase a company without determining the condition of the company’s assets.”). See also Oregon Electric/108, Davis/31 (“Applicants and investors would not benefit from allowing PGE to become resource deficient, or by delaying necessary capital improvements. Instead, such actions would undermine PGE’s ability to serve its customers, and at the same time, its value to investors.”).

¹⁸¹ See Staff/1000, Durrenberger/4.

¹⁸² See CUB/300, Jenks-Brown/27 (calling the last five years of Enron ownership a “merry-go-round of uncertainty”).

¹⁸³ See Confidential Staff/300, Durrenberger/5 (commenting on results of TPG due diligence).

¹⁸⁴ PGE/100, Piro/24.

In this respect, Oregon Electric would have exactly the same incentives as Enron or any other utility owner, regardless of length of ownership. It is illogical to claim otherwise.¹⁸⁵

As further evidence that intervenors' fears are misplaced, Oregon Electric already has demonstrated a substantial, irrefutable commitment to PGE's short-term and long-term future. First, with respect to PGE's short-term future, Oregon Electric has agreed to extend and improve current Service Quality Measures ("SQMs") for 10 years. Staff considers this agreement a "tangible benefit" that will "ensure PGE maintains the current high level of customer service."¹⁸⁶ By necessity, it will require substantial ongoing capital investment to maintain PGE's infrastructure and customer service programs at the level required to satisfy expectations.

Second, with respect to PGE's long-term future, Oregon Electric approved the construction of a new generation facility at Port Westward.¹⁸⁷ This is a substantial commitment by any measure. Investment in Port Westward, however, is just one aspect of Oregon Electric's goal to help PGE address its energy short position and enable it to better serve its customers well into the future.¹⁸⁸ Oregon Electric knows that even after Port Westward is completed, PGE will continue to have an energy short position.¹⁸⁹ During the next year, PGE's Board of Directors will consider major long-term resource planning decisions that will be the subject of the 2005 Least Cost Plan. Oregon Electric is committed to supporting the Board as it looks for additional investments in PGE's future, such as opportunities to cost-effectively obtain or build more long-term generation resources, or to enter into long-term contracts.¹⁹⁰

¹⁸⁵ See Oregon Electric/700, McDermott/14 ("All investor-owned utilities seek to operate the utility for financial gain. It would be naïve in the extreme to believe that public stockholders or long-term investors have a different motive.").

¹⁸⁶ See Staff/100, Conway/26.

¹⁸⁷ See Oregon Electric/500, Davis/10.

¹⁸⁸ See Oregon Electric/100, Davis/23.

¹⁸⁹ See Oregon Electric/100, Davis 11-12.

¹⁹⁰ See *Id.*

Oregon Electric's commitments to SQMs and Port Westward are direct evidence of a commitment to prudent investment in PGE's future. Intervenors' claims to the contrary lack merit.

a. *Due Diligence Reports Regarding Potential Cost Savings at PGE Are Not Evidence of Harmful Cost-Cutting Plans*

During negotiations with Enron, TPG's consultants performed due diligence on PGE and produced reports of preliminary findings that suggested certain cost savings might be achieved in PGE's operations and capital expenditure budgets. Certain intervenors have hypothesized that these due diligence reports are evidence of cost-cutting proposals or plans to "excessively constrain[] near term expenditures" that will harm PGE over the long term.¹⁹¹ That is simply wrong. Certain intervenors fundamentally misunderstand the purpose of such due diligence reports.

In the context of a corporate acquisition, the term "due diligence" generally refers to the investigation of a business undertaken by a potential buyer. The purpose of due diligence in this context is to provide the potential buyer with sufficient information to determine whether to pursue the transaction and, if so, the appropriate terms and purchase price to inform the negotiating and documentation process. As part of financial due diligence, prospective buyers will perform financial modeling to predict a broad range of possible scenarios with respect to future financial performance. These scenarios are informed by the buyer's due diligence findings, which are typically limited by the level and quality of information to which the buyer has access. While due diligence work can provide important information about the status of a company and the value of its assets, it has inherent limitations and is *not* intended to result in operational plans for the company.¹⁹²

Specifically, the due diligence analyses performed by TPG's consultants included comparing or "benchmarking" PGE's performance against other utilities that have significant

¹⁹¹ CUB/200, Dittmer/29-30; *see also* ICNU/200, Antonuk-Vickroy/36.

¹⁹² *See* Oregon Electric/100, Davis/14-16.

differences with respect to many factors, including inherent characteristics of service territory, weather patterns and generation resources. In addition, the due diligence analyses were necessarily limited by the fact that they were conducted from an external vantage point and with only the limited information provided to TPG and its consultants. The findings were not vetted by PGE to test their validity. Most importantly, the due diligence analyses on which the findings were based did not consider the impact of any cost-cutting measures or productivity enhancements on customer service and reliability. Accordingly, it is improper for intervenors to view these preliminary due diligence investigations as evidence of what Oregon Electric plans for PGE. They represent only possible areas where Oregon Electric may look for improvements.¹⁹³

TPG itself acknowledged the limited usefulness of due diligence reports when it evaluated the transaction. In all of TPG's financial modeling, TPG assumed that PGE would continue to expend maintenance-oriented capital on a basis consistent with historic levels. In some scenarios, the level of expected capital expenditures was varied modestly to reflect the possibility of achieving capital efficiencies, but *never* to the full extent discussed in the consultants' due diligence analyses.¹⁹⁴

PGE's Board of Directors will identify actual cost-saving opportunities, if any, after the Commission grants approval of the transaction and the Board is able to undertake a top-down review of PGE's operations.¹⁹⁵ Although Oregon Electric is confident that it can help PGE operate more efficiently, significant savings may not materialize. Either way, cost reductions are *not* required for PGE to prove successful as an investment and Oregon Electric will not feel

¹⁹³ See Oregon Electric/100, Davis/16.

¹⁹⁴ See Oregon Electric/100, Davis/17.

¹⁹⁵ See Oregon Electric/22, Davis/4-8 (discussing Oregon Electric's "Initial Review Process Plan" for PGE); *see also* Section II(D), *supra*.

pressure to make imprudent cost cuts at the expense of service quality or the long-term financial health of the company.¹⁹⁶

b. The Regulatory System Is Capable of Protecting PGE's Customers from Imprudent Cost Cutting

Some intervenors have argued that the Commission lacks the ability to protect customers from a “short-term owner” of PGE because any harm caused by imprudent cost cutting or underinvestment might not become apparent until after PGE is sold to a new owner.¹⁹⁷ As with intervenors’ other concerns relating to “short-term ownership,” there is no evidence to support intervenor fears. Both Oregon Electric’s expert witness, Dr. Karl McDermott, and Jim Piro testified at length regarding the wide variety of regulatory tools that collectively provide a comprehensive system that effectively protects customers.¹⁹⁸ Specifically, these witnesses discussed the Commission’s:

- Broad supervisory authority, including the power to investigate the operations and management of the utility, to control and approve PGE financing decisions, to impose service quality standards, and to review and restrict affiliate transactions;¹⁹⁹
- Ratemaking authority, including the authority to investigate and set rates;²⁰⁰
- Authority to impose conditions on mergers and acquisitions;²⁰¹
- Ability to order PGE to rectify any deficiencies in practice or investment,²⁰² and
- Continuous involvement in the utilities’ long-term planning for power acquisition through the Least Cost Planning Process.²⁰³

¹⁹⁶ See Oregon Electric/100, Davis/17. See also Oregon Electric/200, Wheeler/10 (“[TPG] model runs that do not contemplate any savings still demonstrate that there is sufficient liquidity [for Oregon Electric] to meet all debt service obligations. Therefore, there would be no undue pressure to reduce costs at PGE.”).

¹⁹⁷ See ICNU/400, Antonuk-Vickroy/12,13 (describing service quality measures as “lagging indicators”); CUB/300, Jenks-Brown/6 (“cost cutting could have negative implications for customers, and . . . those implications may not show up during TPG’s control of PGE”).

¹⁹⁸ See Oregon Electric/400, McDermott/5-7, 16-19; Oregon Electric/700, McDermott/3-13. See also PGE/100, Piro 8-9 (“It is . . . unrealistic to think that Oregon Electric could cause PGE to engage in extreme cost cutting without Commission intervention.”)

¹⁹⁹ See *id.*

²⁰⁰ See Oregon Electric/400, McDermott/18.

²⁰¹ See Oregon Electric/400, McDermott/6.

²⁰² ORS § 756.070, 075.

²⁰³ See Oregon Electric/400, McDermott/10.

Taken together, this regulatory authority gives the Commission the power it requires to protect PGE's customers and the public interest.

Enron – again, the quintessential “short-term owner” – is the best evidence that intervenors' concerns about the limitations of the regulatory system and the Commission's power are misplaced. The Commission effectively regulated PGE throughout the Enron bankruptcy. Most notably, the Commission has actively supervised PGE's Least Cost Planning Process. As a result of this process, PGE identified and is now implementing plans for a new power generation facility at Port Westward, which will require a substantial long-term investment. The Commission has the authority to review and acknowledge the final form of PGE's Least Cost Plan and will continue to do so under Oregon Electric's ownership.²⁰⁴

The Commission's power applies to PGE *regardless of ownership structure*. The rules and regulations in place in Oregon are more than sufficient to prevent negative impacts from any alleged “short-timer's” incentive.²⁰⁵ Thus, the Commission should have complete confidence that it will have the ability to effectively regulate PGE upon approval of the Proposed Transaction.

c. Applicants Have Agreed to Conditions that Enhance the Commission's Ability to Oversee Investment in PGE

As demonstrated above, Oregon Electric has every incentive to make all prudent investments in PGE within the existing regulatory regime. Nevertheless, Oregon Electric has agreed to significant approval conditions to alleviate any residual concerns and further enhance the Commission's ability to monitor PGE's ongoing investment in its infrastructure and operations and maintenance (“O&M”).

²⁰⁴ See, e.g., OPUC Order No. 04-375 (July 20, 2004).

²⁰⁵ CUB points to service quality and reliability problems experienced by Commonwealth Edison (“ComEd”) (an Illinois electric utility) and U.S. West (a western-region telecommunications utility) as evidence that regulation could not deter Oregon Electric from irresponsibly cutting costs or underinvesting in PGE. However, in his testimony, Dr. McDermott explains at length that these examples are distinguishable and do not justify CUB's concerns that the Commission lacks the power it needs to oversee Oregon Electric's investment in PGE. See Oregon Electric/700, McDermott/5-10.

First, Oregon Electric has proposed the following condition:

22. *Oregon Electric and PGE agree to submit a final “transition plan” to the Commission within one year of closing.*

This condition is very similar to a condition requested by Staff.²⁰⁶ Oregon Electric is committed to engaging in a thorough review of PGE’s operations after the closing of the Proposed Transaction pursuant to an Initial Review Process Plan that Applicants have developed for PGE.²⁰⁷ This process will result in the creation of a Transition Plan that will set out Oregon Electric’s goals for PGE and will include an initial set of priorities to guide Oregon Electric’s and PGE’s implementation of these goals.²⁰⁸

Oregon Electric also has agreed to a condition, similar to the one proposed by Staff, that provides the Commission with the ability to closely monitor Oregon Electric’s ongoing capital investment:

23. *PGE agrees to the following with respect to its non-fuel operation and maintenance (O&M) expenses and capital expenditures:*
 - a. *PGE shall file with its Results of Operations report an O&M expense and capital expenditure update report (OMCE Update). Using individual FERC accounts for O&M (i.e., FERC Accounts 500 through 598 and 901 through 923), and Construction Work-in-Progress (CWIP) costs by functional area, the OMCE Update will compare the actual O&M and capital expenditures for the most recent past year with (a) the current year’s budgeted O&M and capital expenditures, and (b) the average of the preceding three calendar years’ actual O&M and capital expenditures. The OMCE Update will also compare actual O&M costs by functional area for the most recent past year to the last approved test year revenue requirement. The OMCE Update will include a written narrative description of the reasons for major variances between the compared accounts, including accounting changes and the most recent organization chart for PGE. If requested, PGE shall present the major findings of the OMCE Update at a Commission meeting.*
 - b. *After completing and presenting its third OMCE Update, PGE may petition the Commission to terminate this condition. The Commission*

²⁰⁶ Staff’s proposed condition states:

23. *Oregon Electric and PGE agree to submit a final “transition plan” to the Commission within one year of closing. The plan shall detail the areas where efficiencies and/or cost-cutting efforts could occur and will provide annual estimates of the expected savings.*

²⁰⁷ See Oregon Electric/22, Davis/3-8.

²⁰⁸ See Oregon Electric/22, Davis/5-6.

shall provide PGE and other interested parties an opportunity to be heard with respect to the termination. In accordance with this condition, PGE will present an annual report that will provide detailed information regarding the level of O&M and capital expenditures at PGE. This condition will allow the Commission and other interested parties to monitor the level of investment in PGE and any variation between budgeted and actual expenditures.

Staff indicated that this condition is acceptable. In accordance with this condition, PGE will file and present an annual report that will provide detailed information regarding the level of O&M and capital expenditures at PGE. This information will allow the Commission and other interested parties to monitor the level of investment in PGE and any variations between budgeted and actual expenditures. This condition renders moot any concern that Oregon Electric could “get away with” underinvestment or imprudent cost cuts.

Finally, Oregon Electric has agreed to an audit provision:

24. *Within the first seven years after closing, but no sooner than 2007, PGE agrees, if directed by the Commission, to conduct an audit, using an independent auditor approved by the Commission, to review the company's O&M and/or capital construction plans and expenditures. The shareholders will bear the expense of the audit up to \$400,000.*

This condition contains minor changes to a similar condition that Staff proposed.²⁰⁹ Unlike Staff's proposal, under Oregon Electric's condition, an audit could not be conducted before 2007. There are two reasons for the timing of this audit: (1) Oregon Electric and PGE will be developing and submitting the Transition Plan during the first year of Oregon Electric's ownership; and (2) PGE anticipates filing a rate case at the end of 2005 or early 2006. Because these two processes will provide a significant level of information regarding PGE's current and planned O&M and capital expenditures, an audit should not be necessary until after 2007, after the rate case has been considered. Applicants also capped Oregon Electric's obligation to pay for the audit at \$400,000, because Applicants believe that this is an amount sufficient to allow

²⁰⁹ Staff's proposed condition states:

24. *Within the first seven years after closing, PGE agrees, if directed by the Commission, to conduct an audit, at its shareholders' expense, using an independent auditor approved by the Commission, to review the company's O&M and/or Capital construction plans and expenditures.*

the Commission to conduct a thorough and complete audit on the subject areas of PGE.

These conditions exceed those that the Commission imposed on Enron's acquisition of PGE in 1997 and conform to requests that intervenors testified would alleviate their concerns.²¹⁰ Any alleged risk posed by Oregon Electric's intended length of ownership is sufficiently mitigated.

3. *Concerns Regarding Lack of Transparency are Without Merit*

Staff and other intervenors have expressed concerns that some Applicants are not prepared for the level of transparency that the Commission will require of PGE's owners.²¹¹ Among other things, intervenors proposed that Oregon Electric file with the Commission (and make available to interested parties) quarterly and annual financial disclosure reports equivalent to that of SEC Form 10-K and Form 10-Q. Oregon Electric agreed to this condition of approval, in addition to an unprecedented number of conditions related to transparency that include: (1) the separation of books and records for ease of review; (2) the Commission's unrestricted access to those books and records; (3) the requirement of mandatory notices and periodic reports, especially with regard to affiliate transactions; (4) the requirement of audits at the Commission's discretion; and (5) the provision of special enforcement mechanisms to ensure quick resolution of disputes regarding compliance with transparency conditions.²¹² As a result, to the extent any concerns regarding transparency still linger, they are unsupported by any evidence.²¹³ Indeed, Staff's and Oregon Electric's proposed conditions substantially overlap.²¹⁴

²¹⁰ See, e.g., CUB/300, Jenks-Brown/34-35 (calling for annual informational filings regarding PGE's projected construction expenditures and O&M expenses and an independent audit); ICNU/400, Antonuk-Vickroy/13 (calling for an outside management and operations audit of PGE at the Commission's discretion).

²¹¹ See Staff/100, Conway/10-11; CUB/100, Jenks-Brown/15-16.

²¹² See Oregon Electric/500, Davis 25-29.

²¹³ Staff did not raise any further concerns regarding transparency after Oregon Electric agreed to the conditions described above.

²¹⁴ Oregon Electric's proposed transparency conditions are identical or substantially similar to those proposed by Staff. Minor differences do exist with respect to Staff's proposed Condition 31, which are explained in the Surrebuttal Testimony of Kelvin Davis. See Oregon Electric/500, Davis/26-29. Staff also has proposed that Oregon Electric submit quarterly reports detailing certain financial information that will already be included as part of the SEC-type reports Oregon Electric has agreed to provide. See proposed Condition 32, Staff/801, Conway/13. This condition is redundant and unnecessary.

The transparency conditions give the Commission powers far beyond what the legislature deemed sufficient to carry out the agency's regulatory function. It will have, for example, unrestricted access to the books and records of both PGE and Oregon Electric that are reasonably calculated to lead to information relating to PGE, including but not limited to, Board of Directors' Minutes, Board Subcommittee Minutes, and other Board Documents. The Commission also will have unrestricted access to a record of any instance that TPG Applicants withhold their consent to a decision of the PGE Board of Directors. As explained earlier, Oregon Electric has also agreed to an audit using an outside auditor of the Commission's choice, and will pay for that audit out of shareholder funds up to \$400,000. The collective breadth of these transparency conditions and others is without precedent in Oregon and will ensure that the Proposed Transaction serves PGE's customers in the public interest.

V. CONCLUSION

Oregon Electric has presented a comprehensive package of clear benefits and protective conditions designed to greatly exceed the statutory requirement for approval of an acquisition transaction under ORS Section 757.511. Upon approval of the Proposed Transaction, PGE's customers will benefit from (1) a guaranteed \$43 million rate credit, (2) guaranteed local leadership and representation on PGE's Board of Directors, (3) indemnities that protect PGE against significant potential liabilities, (4) a 10-year extension of Service Quality Measures, and (5) an immediate end to the uncertainty of Enron's ownership.

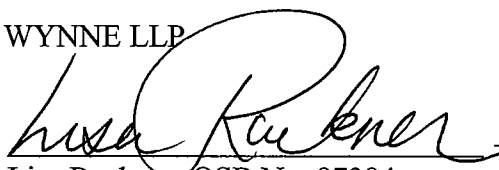
In addition, Oregon Electric has agreed to sweeping conditions that very specifically address the alleged risks of the Proposed Transaction, even when those concerns are demonstrably far-fetched, speculative, or even misguided. The result is a set of conditions broader than any this Commission has ever approved under ORS Section 757.511. Indeed, they are broader than those that protected PGE from the largest bankruptcy in U.S. history and broader than those deemed sufficient to protect PacifiCorp's customers from a foreign multinational corporation headquartered half-way around the world. No party has introduced

any evidence showing that the conditions Oregon Electric has proposed will be insufficient to protect PGE's customers or the public at large from any harm this transaction might cause.

The record presents compelling evidence that supports only one conclusion: Oregon Electric's acquisition of PGE will serve the utility's customers in the public interest. Applicants respectfully request the Commission find that the Proposed Transaction will serve PGE's customers in the public interest and that it meets the standard for approval set forth in ORS Section 757.511.

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ACQUISITION CONDITIONS

Stipulated Conditions

1. PGE and Oregon Electric shall maintain separate books and records. All PGE and Oregon Electric financial books and records shall be kept in Portland, Oregon.
2. Oregon Electric and PGE shall exclude from PGE's utility accounts all goodwill resulting from this acquisition.
3. Oregon Electric and PGE shall exclude all costs and fees of the acquisition, including, but not limited to, all costs and fees associated with gaining regulatory approval before the Oregon Public Utility Commission, Nuclear Regulatory Commission, Federal Energy Regulatory Commission, Federal Trade Commission, Securities Exchange Commission, costs and fees associated with forming Oregon Electric, and any banking or financial institution fees associated with the creation of Oregon Electric and the financing and closing of the Acquisition from PGE's utility accounts. Within 90 days following the completion of the transaction, Oregon Electric will provide a preliminary accounting of these costs. Oregon Electric and PGE agree to provide the Commission a final accounting of these costs within 30 days following the completion of the final accounting related to the transaction.
4. Unless such a disclosure is unlawful, Oregon Electric shall notify the Commission of:
 - a. Its intention to transfer more than 5% of PGE's retained earnings to Oregon Electric over a six-month period, at least 60 days before such a transfer begins.
 - b. Its intention to declare a special dividend from PGE, at least 30 days before declaring each such dividend.
 - c. Its most recent quarterly common stock cash dividend payment from PGE within 30 days after declaring each such dividend.
5. Subsequent to its purchase by Oregon Electric, PGE shall continue to perform under the Service Quality Measures ("SQM"), as set forth in Stipulations for PGE Service Quality Measures UM 814/UM 1121 dated July 13, 2004, for a period of ten full calendar years after the date the current SQM is scheduled to retire. Nothing in any provision of this Stipulation is intended to affect the Commission's authority to directly administer the stated terms of the SQM.

Notwithstanding the provisions described in this paragraph, the parties have agreed to replace the current R4 measurement with a CAIDI-related measurement, and further that PGE will maintain records of outages longer than three hours. In addition, PGE agrees to work with ICNU to evaluate and, if necessary, develop additional service quality standards related to service to industrial customers.

6. PGE and Oregon Electric shall maintain separate debt ratings and, if more than \$5 million of preferred stock is outstanding, then PGE and Oregon Electric shall maintain separate preferred stock ratings.

Conditions Not Yet Stipulated

7. The Commission or its agents may audit the accounts of Oregon Electric, its affiliates, and any subsidiaries that are the bases for charges to PGE to determine the reasonableness of allocation factors used by Oregon Electric to assign costs to PGE and amounts subject to allocation or direct charges. Oregon Electric agrees to cooperate fully with such Commission audits.
8. Oregon Electric and its affiliates shall not allocate to or directly charge to PGE expenses not authorized by the Commission to be so allocated or directly charged.
9. PGE shall maintain its own accounting system. PGE and Oregon Electric shall maintain separate books and records, both of which shall be kept in Portland, Oregon.
10. If the Commission believes that Oregon Electric and/or PGE have violated any of the conditions set forth herein, any conditions contained in other stipulations signed by Oregon Electric and PGE, or any conditions imposed by the Commission in its final order approving the Application (collectively, the "Conditions"), then the Commission shall give Oregon Electric and PGE written notice of the violation.
 - a. If the violation is for failure to file any notice or report required by the Conditions, and if Oregon Electric and/or PGE provide the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the ten-day period. For any other violation of the Conditions, the Commission must give Oregon Electric and PGE written notice of the violation. If such failure is

corrected within five business days of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the five-day period.

- b. If Oregon Electric and/or PGE fail to file a notice or written report within the time permitted in subparagraph (a) above, or if Oregon Electric and/or PGE fail to cure, within the time permitted above, a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation, with an opportunity for Oregon Electric and/or PGE to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that Oregon Electric and/or PGE violated one or more of the Conditions, then the Commission shall issue an Order stating the level of penalty it will seek. Oregon Electric and/or PGE, as appropriate, may appeal such an order under ORS 756.580. If the Commission's order is upheld on appeal, and the order imposes penalties under a statute that further requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalties specified in the order, and Oregon Electric and/or PGE shall file a responsive pleading agreeing to pay the penalties. The Commission shall seek a penalty on only one of Oregon Electric or PGE for the same violation.
 - c. The Commission shall not be bound by subsection (a) in the event the Commission determines PGE and/or Oregon Electric has violated any of the material conditions, contained herein, more than two times within a rolling 24-month period.
 - d. PGE and/or Oregon Electric shall have the opportunity to demonstrate to the Commission that subsection (c) should not apply on a case-by-case basis.
11. Oregon Electric shall maintain and provide the Commission unrestricted access to a record of each instance in which TPG Applicants withhold their consent to a decision of the PGE Board of Directors. The record shall detail the basis for the decision, including any governing report or document that memorializes the exercising of the consent rights and shall identify the persons involved in making the TPG Applicant Consent Rights decision. Oregon Electric shall provide the records to the Commission upon request. Nothing in this paragraph shall prevent the Commission from disclosing to the public the number of times the TPG Applicants exercised their consent rights within a certain period of time.

12. Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all books and records of Oregon Electric and PGE that are reasonably calculated to lead to information relating to PGE, including but not limited to, Board of Directors' Minutes, Board Subcommittee Minutes, and other Board Documents.
13. PGE and Oregon Electric shall notify the Commission within 30 days of the formation of any subsidiary. Such notice shall include a copy of the business plan and capitalization strategy, as well as any planned or anticipated transactions of the subsidiary with PGE or Oregon Electric as applicable.
14. Oregon Electric and PGE shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between PGE and all its affiliated interests, unless such transactions are exempt under applicable law or the Master Services Agreement.
15. In the event of a dispute between the Commission or Commission Staff and Oregon Electric or PGE regarding a request made pursuant to the Acquisition Conditions, the parties agree that an Administrative Law Judge (ALJ) shall resolve the dispute as follows: (i) within ten (10) business days Oregon Electric or PGE shall deliver to the ALJ the books and records responsive to the request and shall indicate the basis for the objection; (ii) Staff may respond in writing and Oregon Electric and/or PGE may reply to Staff's response; (iii) the ALJ shall review the documents in private; and (iv) the ALJ shall issue a ruling determining whether the documents (a) are reasonably calculated to lead to the discovery of relevant information, and, if so, (b) whether the documents should receive the protection requested. The ALJ shall use this standard whether or not the Commission or Commission Staff is making the request in connection with an open docket.
16. PGE will not make any distributions to Oregon Electric that would, as determined in accordance with Generally Accepted Accounting Principles ("GAAP"), cause the common equity portion of PGE's total capital structure to fall below 48 percent without Commission approval.
 - a. "Total capital structure" is defined as PGE's common equity, preferred equity, and long-term debt.
 - b. "Long-term debt" is defined as PGE's outstanding debt with a term of more than one year, excluding revolving lines of credit except to the extent the amount of the rolling 12-month average of committed and

drawn balances under PGE's unsecured revolving lines of credit (Unsecured Revolvers) less any balances related to collateral or security provided to counterparties for power supply and related agreements, is greater than \$250 million.

- c. A "committed balance" is the sum of the commitments used to support any borrowing capacity or other purposes, such as a commercial paper program or letters of credit.
 - d. A "drawn balance" is sum of amounts drawn against the Unsecured Revolvers.
 - e. Hybrid securities (*e.g.*, convertible debt) will be assigned to equity and long-term debt based on the characteristics of the hybrid security. The Commission, prior to their issuance, will determine the assignment of the equity and debt characteristics.
17. Oregon Electric agrees that the customers of PGE shall be held harmless if PGE's return on common equity and other costs of capital, viewed on a stand-alone basis, rise as a result of Oregon Electric's ownership of PGE. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.
18. Oregon Electric agrees that the customers of PGE shall be held harmless if PGE's revenue requirement, viewed on a stand-alone basis, is higher due to Oregon Electric's ownership of PGE.
19. Oregon Electric and PGE shall maintain (for a rolling five-year period) and provide the Commission unrestricted access to all written information provided to stock or bond rating analysts, which directly or indirectly pertains to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided and presentations made to stock and bond rating analysts. For purposes of this condition, "written" information includes, but is not limited to, any written and printed material, audio and videotapes, computer disks and electronically-stored information.
20. Oregon Electric agrees that PGE will provide a guaranteed rate credit in the amount of \$43 million to PGE's customers. The rate credit will be applied to customer bills in the amount of \$8.6 million annually for five years beginning January 2007. PGE's tariffs will reflect this guaranteed savings in two ways:

First, PGE will design a supplemental tariff rider to go into effect January 1, 2007 through December 31, 2011 to credit customers with an annual guaranteed rate credit amount of \$8.6 million or, upon the effective date of the tariffs approved in the next PGE general rate case (currently anticipated for 2007), the “adjusted annual guaranteed rate credit amount,” as defined below. For purposes of the guaranteed rate credit that will flow through this rider, PGE will establish a balancing account and credit that account in the appropriate amount on January 1, 2007, and on each subsequent January 1 through 2011. The balancing account will accrue interest on the unamortized balance, consistent with Commission policy, which is currently at PGE’s authorized rate of return. PGE shall roll any balances (positive or negative) remaining on December 31 of each year the rider remains in effect into the balancing account for the following year. The bill credit shall be distributed pro rata based on distribution load (in kWh).

The rider shall provide that in the event of a change of control of PGE before January 1, 2011, the annual amounts not yet credited to the balancing account shall be accelerated and credited to customers in a manner determined by the Commission at the time of closing of the transaction involving the change of control.

Second, to the extent that Oregon Electric and PGE demonstrate to the Commission’s satisfaction that the test year revenue requirement for PGE’s next general rate case includes savings (including savings in the various categories of O&M and A&G expenses), PGE will pass that part of the guaranteed rate credit amount to customers through its standard, base tariffs. To the extent the savings passed through to customers through the standard, base tariffs are less than \$8.6 million, such difference shall be the “adjusted annual guaranteed rate credit amount.” If the savings are equal to or greater than \$8.6 million, the “adjusted annual guaranteed rate credit amount” shall be zero.

21. To the extent that PGE incurs or suffers a loss that is subject to indemnification under the Stock Purchase Agreement, Oregon Electric will direct Enron to pay the benefit of such indemnity directly to PGE.
22. Oregon Electric and PGE agree to submit a final “transition plan” to the Commission within one year of closing.
23. PGE agrees to the following with respect to its non-fuel operation and maintenance (O&M) expenses and capital expenditures:
 - a. PGE shall file with its Results of Operations report an O&M expense and capital expenditure update report (OMCE Update). Using individual

FERC accounts for O&M (*i.e.*, FERC Accounts 500 through 598 and 901 through 923), and Construction Work-in-Progress (CWIP) costs by functional area, the OMCE Update will compare the actual O&M and capital expenditures for the most recent past year with (a) the current year's budgeted O&M and capital expenditures, and (b) the average of the preceding three calendar years' actual O&M and capital expenditures. The OMCE Update will also compare actual O&M costs by functional area for the most recent past year to the last approved test year revenue requirement. The OMCE Update will include a written narrative description of the reasons for major variances between the compared accounts, including accounting changes and the most recent organization chart for PGE. If requested, PGE shall present the major findings of the OMCE Update at a Commission meeting.

- b. After completing and presenting its third OMCE Update, PGE may petition the Commission to terminate this condition. The Commission shall provide PGE and other interested parties an opportunity to be heard with respect to the termination.
24. Within the first seven years after closing, but no sooner than 2007, PGE agrees, if directed by the Commission, to conduct an audit, using an independent auditor approved by the Commission, to review the company's O&M and/or capital construction plans and expenditures. The shareholders will bear the expense of the audit up to \$400,000.
25. After closing, each PGE distribution to Oregon Electric will be used by Oregon Electric exclusively to pay operating expenses and debt service until all of the following conditions are met:
- a. The rolling 12-month average of the committed and drawn balances of all PGE's Unsecured Revolvers is less than \$250 million; and
 - b. Oregon Electric has paid down at least \$250 million of its outstanding debt as compared to the level of outstanding debt at closing (no portion of the proposed "catch-up dividend" that will be paid at closing will be considered to have paid down debt).
26. [Not used.]
27. Oregon Electric shall not re-leverage, *i.e.*, increase the amount of its outstanding long-term debt once such debt has been liquidated, if the increased debt would, as

- determined in accordance with GAAP, bring the consolidated capital structure (excluding short-term debt) below 30% equity.
28. After closing, the TPG entities will not allocate or direct bill Oregon Electric for any goods, services, supplies or assets in excess of \$5 million per year.
 29. PGE agrees to work in good faith with Staff and other interested parties to develop and present to the Commission, within 270 days of the closing of the transaction, a billing accuracy SQM consistent with Staff/702. At the time of the presentation to the Commission, parties, including PGE, may present their views to the Commission on the necessity for and content of the SQM.
 30. [Not used.]
 31. The following actions shall be reported to the Commission by TPG Applicants or Oregon Electric, as appropriate, within 30 business days after their occurrence:
 - a. Any change of control of the General Partner of either of the TPG Applicants.
 - b. Any change in the ownership interest in Oregon Electric or any of the TPG funds investing in Oregon Electric.
 - c. Any amendment to the terms and conditions of Oregon Electric's Operating Agreement.
 - d. Any amendment to the terms and conditions of the Limited Partnership Agreement of either of the TPG Applicants.
 - e. Any designation, appointment, election, removal or replacement of any Member or Manager at Oregon Electric by a vote, approval or consent of a majority of the Members.
 32. Beginning twelve months following closing, Oregon Electric will prepare and make available to the Commission and the public, on a quarterly and annual basis, financial and operating disclosure reports that are equivalent in scope to that of Form 10-Q and Form 10-K reports filed with the U.S. Securities and Exchange Commission.
 33. Until the total long-term debt at Oregon Electric is less than 70% of total capital, Oregon Electric, PGE, and any of their respective subsidiaries shall not, without the prior notice to the Commission, directly or indirectly acquire, incorporate, or

otherwise organize any subsidiary, or enter into substantially new lines of business, which were not in existence as of January 1, 2005.

34. The Applicants will file a Master Services Agreement, which includes agreed-upon terms and conditions, no later than 30 days after a final order in UM 1121 is issued approving the transaction.

General Provisions

- A. Nothing in the settlement affects any party's rights under law or Commission rules, unless expressly stated. For example, the right to seek protection of information or documents is subject to the usual Commission rules unless expressly waived herein.
- B. Conditions 25, 27, 31, 32 become inapplicable after an Initial Public Offering of Oregon Electric or PGE.
- C. Nothing in this settlement shall be construed to result in disallowance of costs from PGE's revenue requirement unless expressly stated.

**CERTIFICATE OF SERVICE
UM 1121**

I hereby certify that a true and correct copy of **OREGON ELECTRIC'S OPENING BRIEF** was served via U.S. Mail on the following parties on November 17, 2004:

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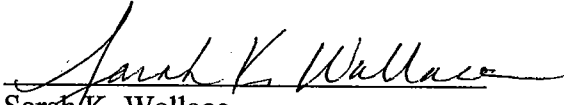
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