# BEFORE THE PUBLIC UTILITY COMMISSION

# OF OREGON

# UM 1121

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| In the Matter of | ) |
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| OREGON ELECTRIC UTILITY | ) |
| COMPANY, LLC, et al., | ) |
| | ) |
| Application for Authorization to Acquire | ) |
| Portland General Electric Company | ) |
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OPENING BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

November 17, 2004

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## I. INTRODUCTION

Texas Pacific Group's (TPG) proposed acquisition of Portland General Electric is an unusual case both in process and in substance. Procedurally, this case is different because it is the first filing under ORS 757.511 in recent memory that has made it to the briefing stage without a critical mass of parties supporting a global settlement. The parties were not able to arrive at a set of conditions that minimized the risk and created net benefits. Despite the mantra in TPG's testimony that TPG's interests are aligned with customers and that the proposal is good for everybody concerned, TPG could not manage to respond to the needs of the various parties and convince them that the substance of the deal matched TPG's rhetoric.

It is here in the substance of the deal that we find the second and crucial deviation from the norm. For this acquisition and this would-be owner are inherently different from anything this Commission has seen.

TPG is a private equity investment firm that is no more interested in owning and operating an electric utility than it is in making hamburgers or yellow cardigan sweaters. They are interested in one thing: making a lot of money over a short period of time. From this single reality flow a number of risks that are unique to the traditional utility regulatory paradigm.

TPG is a short-term owner. TPG will not be around long enough, in an industry that plans 20 years ahead and invests 40 years ahead, to establish a relationship with the regulator or the customer, and will not respond to the traditional long-term incentives or disincentives. By definition, this business plan cannot create stability, rather it simply prolongs PGE's ride on the ownership merry-go-round.

The corporate structure is a tortured fantasy consisting of a conditional or temporary "local" Board that holds power subject to an extensive set of veto rights held by the real owner. All because TPG does not really want to own PGE, it just wants to avoid Public Utility Holding Company Act regulation while it sells PGE: an elaborate arbitrage scheme.

TPG views PGE itself as the commodity, not the electricity generated by PGE. TPG's money is not to be made while it owns PGE, but when it sells PGE. There is little or no evidence, other than mere assertion from the proposed owner, that TPG's interests are aligned with customer interests. There is no clear window into how a TPG-owned PGE will make decisions fundamental to utility operations.

TPG's incentives to cut costs or make investments are different from the incentives that other PUC-regulated utilities feel. There is testimony and documentary evidence that demonstrates that TPG's natural incentives and inclinations are to cut costs dramatically and stiff long-term investment. Coupled with TPG's short presence on the scene, TPG could be gone before the damage becomes obvious – even with conditions that promise greater regulatory scrutiny.

The double-leveraged financing of the proposed acquisition exposes an investor who does not want to put up too much of its own money, and who may want to get out before complexities with the onerous debt arise. TPG's plan to pay down OEUC's debt with dividends from PGE maximizes capital gains for the investor but does nothing for the customer when TPG sells PGE to an entity that itself relies heavily on debt to close the deal. In the meantime, customers bear some or most of the debt risk.

It is impossible to sequester the risks of this deal with the investor. Yet on the benefits side, we see benefits that are illusory, such as a local Board that may vaporize, or stability that isn't, or a rate credit that might not be. The benefits are so dwarfed by the risks as to be invisible.

TPG's offer to purchase PGE, with its set of conditions, in no way approaches the required net benefits standard. We are equally convinced that Staff's set of offered conditions also does not meet the standard. In our judgment, Staff does not recognize many of the unique aspects of this deal and seems to have a view of the public interest that is so narrow as to be unrecognizable by the public. We think that the situation and the evidence justify more. We have not seen the convincing case from either TPG or the Staff for why this application should be approved. Yet, if it is to be approved, it must be approved for a reason. Given the risks of this proposed ownership, many of which this regulatory body has little or no experience combating, the net benefits must be far clearer and better identified than anything produced so far by TPG or Staff.

What TPG is saying publicly and to the Commission is different from what TPG is thinking privately. This is true for issue after issue. In contrast to the genuine risks and uncertainties this transaction creates and the uncertainty around what TPG is thinking versus saying, the uncertainties of the bankruptcy process with its preferable probable outcome look pretty good to us.

We support denial of the application. We will explain the risks and uncertainties, point out some of the conflicts between TPG's public words and private internal discussions, and indicate where TPG's and in some cases Staff's conditions are insufficient to meet the net benefit standard. Because we have to, we will identify conditions that, in the aggregate, move this application closer to the net benefits standard.

## II. PROCEDURAL BACKGROUND

On March 8, 2004 TPG filed an application under ORS 757.511 for authorization to acquire PGE. CUB filed its Notice of Intervention on March 15, 2004. TPG filed a supplemental application on May 27, 2004, and again supplemented the application to replace a local applicant on July 13, 2004.

CUB and other parties filed opening testimony on July 21, 2004. TPG, Enron and PGE filed rebuttal testimony on August 16, 2004. Parties' September 22, 2004, surrebuttal testimony was followed by TPG, Enron and PGE's sursurrebuttal testimony on October 11, 2004. Cross-examination hearing was held October 21 and 22 before Judges Logan and Smith.

Settlement conferences between the parties began June 8, 2004 and were held from time to time until October 14, 2004.

## III. THE STANDARDS TO BE APPLIED IN THIS CASE

**A. Net Benefits**

The Commission set the standard to be applied in applications to exercise influence under ORS 757.511 in its September 4, 2001, Order 01-778. There, the Commission determined that "the net benefit standard is the appropriate standard." Order 01-778, p. 11. While that Commission opined that it did not prefer this result, it was compelled to do so by its reading of the statute. The Commission may only approve an ORS 757.511 application if it finds a net benefit for customers and no harm to the public at large.

In the 1988 order approving the Pacific Power and Utah Power merger, decided under ORS 757.485, not ORS 757.511, the Commission stated that a finding that a transaction is "consistent with the public interest necessarily encompasses a determination that the public will be protected" and "ORS 756.040 does not require that every transaction authorized by the Commission must improve the position of utility customers and the public." Order 88-767. The net benefits represents a higher standard and does require a discernable improvement for customers of the utility. Thus while the condition of the public generally need not necessarily improve as a result of the transaction, the Commission may only approve the transaction if it improves the position of utility customers.

Even though the Commission protested the standard that it was compelled to find in Order 01-778, the Legislature was crystal clear why it legislated the net benefits standard in ORS 757.511.

(1) The Legislative Assembly finds and declares that:
   (a) The protection of customers of public utilities which provide heat, light or power is a matter of fundamental statewide concern;
   (b) Existing legislation requires the Public Utility Commission's approval of one public utility's acquisition of another public utility's stocks, bonds and certain property used for utility purposes, but does not require the commission's approval of such acquisitions by persons not engaged in the public utility business in Oregon; and
   (c) An attempt by a person not engaged in the public utility business in Oregon to acquire the power to exercise any substantial influence over the policies and actions of an Oregon public utility which provides heat, light or power could result in harm to such utility's customers, including but not limited to the degradation of utility service, higher rates, weakened financial structure and diminution of utility assets.

(2) It is, therefore, the policy of the State of Oregon to regulate acquisitions by persons not engaged in the public utility business in Oregon of the power to exercise any substantial influence over the policies and actions of an Oregon public utility which provides heat, light or power in the manner set forth in this section and ORS 757.511 in order to prevent unnecessary and unwarranted harm to such utilities' customers.

ORS 757.506

The Legislature identified a potential problem when persons not engaged in the public utility business in Oregon attempt to take over a local utility, and the Legislature created a review process so that the Commission could approve or deny such attempts based on their merit. The Commission had, and has, no choice but to find net benefits in order to approve a 757.511 application.

The Commission found that the net benefits standard is neither rigid nor arbitrary and need not come in the form of economic consideration. The Commission "will consider the total set of concerns presented by each merger application in determining how to assess a net benefit." Order 01-778, p 11. The determination is on a case-by-case basis.

While "potential harm from merger transactions is often difficult to verify," common sense dictates that when the Commission applies the net benefits standard, the Commission must first assess the potential harms, and then find that the benefits of the transaction more than compensate for and outweigh the risks. If the risks cannot be fully mitigated, then the benefits ought to substantially outweigh the remaining risks.

There is a legitimate question as to whether the Commission wants to get into the business of cobbling conditions together from one or more parties to present a "counter offer" to the Applicant. There is an argument that says the Commission either must or, for public policy reasons, should either accept or deny the application as presented by the Applicant.

If the Commission is inclined to construct a conditioned acceptance, the acceptance must itself satisfy the net benefits standard. The Commission has broad powers to define and determine the benefits that go to make up the net benefits standard. The regulation of public utilities constitutes a legislative function and this Commission appears "to have been granted the broadest authority – commensurate with that of the legislature itself –for the exercise of [its] regulatory function." Pacific Northwest Bell v. Sabin, 21 Or. App. 200, 213-214 ((1975). The Commission's authority is bounded by the state and federal constitutions and can be further limited by the legislature itself. Id at 213. The utility statutes in general reflect a legislative scheme in which the PUC exercises "broad powers to protect consumer interests". Pacific Northwest Bell v. Katz, 121 Or. App.48, 53 (1993).

So, the award of the state legislature's broadest authority means the Commission can do anything the legislature could do with regard to the regulation of public utilities except those functions specifically proscribed by the legislature. An example of an express legislative limitation of the Commission's authority was identified in a 1976 Commission investigation of reduced rates for low-income customers. Order 76-039, 14 PUR 4th 87 (1976). The Commissioner found that the Commission's power to set rates was limited by ORS 757.310, which generally forbids discriminatory ratemaking, and therefore at that time the Commission could not allow reduced rates for low-income customers. Id at 90. However, in 1999, the legislature removed the prohibition on reduced low-income rates, saying that notwithstanding 757.310, the Commission can allow reduced rates to low-income households. ORS 757.612(7)(f).

The Commission can consider low-income issues and ways to address those issues as part of the net benefits test. Environmental concerns that are cost-effective or go toward filling out a diverse, lower-risk resource investment policy can be considered. The Commission considered both of these sets of issues when it made its net benefits determination in the ScottishPower 757.511 case. Order 99-616, p. 14-15, 21, October 6, 1999. The Commission has broad latitude when determining general customer benefits and can consider both economic and non-economic benefits.

ORS 757.511(3) states that "[t]he commission may condition an order authorizing the acquisition upon the applicant's satisfactory performance or adherence to specific requirements." If the Commission does not find that the approval of the application will result in net benefits for customers, then the Commission must deny it: "The commission otherwise shall issue an order denying the application."

## B. Burden of Proof

ORS 757.511(3) states "[t]he applicant shall bear the burden of showing that granting the application is in the public interest." The Commission has interpreted the functionally equivalent burden in ORS 757.210 to mean that the applicant must make its showing by a preponderance of the evidence in order to satisfy the statutory standard. The Commission has stated that if an applicant "fails to meet that burden, either because the opposing party presented compelling evidence in opposition to the proposal, or because [the applicant] failed to present compelling information in the first place, then [the applicant] does not prevail." Order 01-777, page 6, August 31, 2001 (UE 115).

## C. Comparison to the Status Quo

In order to determine whether or not an application improves the condition of utility customers, the obvious question to ask is "as compared to what." While it would be simple to say that the point of comparison is the status quo of PGE and its customers as of today, such a position would also be overly simplistic. The status quo of PGE currently is one of uncertainty and change. There will be little precedent for comparing a past 757.511 application to such a situation as we have before us now.

Without this transaction, it is likely that PGE's future will once again be subject to circumstances involving the Enron bankruptcy proceeding. However, there is an existing plan in bankruptcy to redistribute PGE shares to creditors. There is also the realistic possibility that PGE, if it were again part of the Enron bankruptcy, could be sold to another private party or even a public entity. While it is speculation to assume an alternative outcome as a result of the bankruptcy proceeding, there also remains a degree of uncertainty as to how the Applicant will operate PGE and how it will dispose of PGE.

We merely point out that there are uncertainties in the status quo case and uncertainties should this application be approved. The Commission must weigh those uncertainties when it compares risks and benefits to the status quo.

## IV. ARGUMENT

### A. The Transaction

According to TPG's Application, this transaction is "simple and straightforward." The transaction would bring stability, local focus, a first-class board, long-term planning, capital reinvestment and efforts to achieve best-in-class performance. Application, p. 3. The evidence TPG supplies to support this vision relies mostly on witnesses with little or no utility regulation experience making self-serving statements, one former regulator who, objectively, has lost his objectivity, and a meager amount of documentary evidence, some of which seriously undermines TPG's own assertions. In contrast, parties who oppose the application rely on witnesses who are both students of and veteran participants in the Oregon Public Utility Commission process who present documentary evidence and analysis that belies TPG's position.

In one sense, the structure of the transaction is simple and straightforward. TPG establishes a parent company, Oregon Electric Utility Company, appoints its board members, who in turn oversee PGE. While there is debt held at both the PGE and OEUC level, OEUC would have no other subsidiaries other than PGE.

Yet, in another sense, this transaction is complicated as it is unlike all other ownership structures overseen by this Commission and it is based on several fundamental contingencies, conditions and uncertainties. Whether TPG's veto rights render the OEUC Board impotent, whether the local Board will have *any* voting authority under the

OEUC Operating Agreement, whether the incentives to maximize profit from resale of PGE are consistent with the customers' long-term interests, whether existing regulatory tools are sufficient to manage this unusual animal: these are conditions or unknowns that make relying on TPG's assertions as difficult as trying to hold electricity in your hand.

These contingencies, conditions and uncertainties all come from the core problem in this case. TPG only wants to own PGE to sell it and TPG's return comes not from ownership, but from salesmanship. It is this unique problem that makes it impossible for the Commission to rely on merger conditions from previous 757.511 cases. This transaction raises questions about whether the regulatory tools that work for all the other utilities who have committed owners will work for this owner. Can the Commission regulate this owner sufficiently to protect the customer and, in fact, put customers in a better position than they otherwise would be?

These contingencies, conditions and uncertainties are a direct result of TPG's business model. That model assumes that TPG is a temporary owner, assumes profiteering outside of the normal regulatory construct, and envisions a relatively quick get away. So, before we address the risks inherent in this transaction, or why many of the conditions presented by TPG or the Staff are insufficient to mitigate some of those risks, or why ultimately the risks outweigh the benefits, we examine a few aspects of TPG's short-term ownership structure that belie the assertion that a local Board would be in control of or influential to OEUC and PGE decision-making.

1. The Local OEUC Board and Voting Rights

OEUC, ostensibly run by the Local Applicants ("Managing Members"), is not designed to be a mechanism to incorporate local input and control, it is simply a trick to keep TPG from being regulated as a holding company under the Public Utility Holding Company Act. How do we know this? The draft OEUC Operating Agreement tells us so.

The Local Applicants initially have 95% of the Class A interests and TPG Funds have a 5% share in Class A interests. Operating Agreement, Schedule C, OE/106/Davis/29. TPG owns 100% of the Class B interests. Ibid. Initially, Class A interests vote on all matters that are submitted to the members for a vote and Class B interests have no right to vote. Schedule B, OE/106/Davis/25. So, Local Applicants have 95% voting rights in OEUC matters: unless there is a Conversion Event.

A "Conversion Event" is defined in the Operating Agreement as:

> a reasonable determination by Members holding a majority of the Class B Interests [TPG] that repeal of, amendment to, or administration of, the Public Utility Holding Company Act of 1935, as amended, has eliminated the risk that the holders of the Class B Interests in the Company will be regulated as a holding company thereunder . . .

OE/106/Davis/2

If such a conversion event occurs, if PUHCA is repealed or otherwise neutered, then there is a dramatic shift in the voting rights at OEUC and hence in local influence. Section 3.02(d) says upon a Conversion Event "Class B Interests shall become full voting interests in the Company, and thereafter, the Class A Interests and the Class B Interests shall have 100% of the voting power of the Company in the aggregate, allocated among the two issues pro rata based on the economic interests represented thereby."

OE/106/Davis/6.

If PUHCA is repealed, then the Local Applicants' voting rights in OEUC go from 95% to eight tenths of 1%.

In addition, if such a Conversion Event occurs, the right of the Local Applicants to designate 80% of the PGE Board also disappears and TPG, with nearly 100% voting rights in PGE's parent, will name the Board. 4.04(h), OE/106/Davis/8.

In essence, as discussed by one of the Local Applicants at hearing, in case of PUHCA repeal the Local Applicants must then rely on TPG's good will as to whether the local input is considered at all.

> Q -- if this PUHCA event occurs and essentially you lose 95 percent of the voting interest, are you suggesting now that we must rely on the intent of Texas Pacific as stated here to fulfill the various benefits and aligning the interests that you've spoken of?
>
> A Well, I realize there's uncertainty in terms of how this would play out. And again if PUHCA is in fact reversed I can only go by the discussions that I've had about the intentions with regard to PGE being served best by having the strong local representation that's already been identified under the current PUHCA guidelines.
>
> Q Dr. Kohler, do you know of any recent attempt in Congress to repeal PUHCA through legislation?
>
> A I do know that it's been recommended at some point. I don't know where that stands right now.

Cross Examination of Dr. Kohler by Jason Eisdorfer,
Tr. Vol. 2, p. 133-134, Oct 21, 2004

In reality, given the results of the national election on November 2, 2004, it is not a question of if, but when PUHCA is repealed. This is the reality the Commission must confront. As we discuss later, neither TPG nor the Staff have suggested adequate transaction conditions with regard to access to information at TPG given that TPG will unquestionably be the driving force behind PGE operations and policies.

2. Negative Consent Rights

A primary example of TPG driving decision-making at OEUC and PGE is the fact that even while the Local Applicants still have 95% voting rights, these rights and the rights of the PGE Board are substantially controlled by veto powers held by TPG. Draft

OEUC Operating Agreement, Schedule B.II.B., OE/106/Davis/25-28. The Consent Rights first appeared as Exhibit 7 of OEUC's application. These Consent Rights were superceded by a new version in OE/901 which was attached to the sursurrebuttal testimony of Richard Schifter. This new version was submitted late enough in the process so that intervenor parties had no opportunity to offer written testimony in response. Nevertheless, many parties did offer testimony on the significance of the Consent Rights and their effect on Board activity and dynamics. Don Schoenbeck, witness for the Industrial Customers of Northwest Utilities, offered this analysis:

> These rights give TPG control of virtually all of PGE's fundamental business decisions, including the investment of capital (number 8), accounting practices (number 12), the hiring and firing of senior management positions within the company (number 15), the approval and any amendments to operating and capital budgets (number 17), and the submission or amendment of any jurisdictional filing, including permitting applications (number 21). . . . These negative consent rights present a risk that is not present in a typical utility board of directors because a single entity, TPG, would have veto power over such a wide range of management decisions.

ICNU/100/Schoenbeck/5-6

The extent of the negative consent rights is an important indicator of TPG's ability to exercise a controlling influence over OEUC and thus whether or not TPG should be regulated under PUHCA. The testimony of Richard Shifter indicates that the staff of the Securities and Exchange Commission advised TPG that they would prefer that TPG submit an application under Section 2(a)(7) of the act for a determination of whether TPC is a holding company, rather than seek a no-action letter from staff. OE/900/Schifter/3. Coincidentally, or perhaps not so coincidentally, TPG made this filing with the SEC two days after the national election.

3. TPG Decides How to Sell PGE

The Draft OEUC Operating Agreement makes it clear who has the right to decide when and how to sell PGE and to whom. Section 6.04(a) says, "[a]fter consultation with the Company Board and the PGE Board, Members holding a majority of the Class B Interests [TPG] shall have the right to effect a Transfer of all outstanding equity interests in PGE or an initial public offering of the equity securities of the Company or PGE . . ." OE/106/Davis/11. In other words, after TPG talks to the Board, it can do whatever it wants with PGE.

It was disconcerting to discover that one of the Local Applicants did not understand that TPG retains the right to decide how to dispose of PGE.

> Q (BY MR. EISDORFER.) If Texas Pacific Group decides to sell PGE, can the managing members of Oregon Electric stop them?
>
> A As I think of the structure -- I think the answer's yes . . .
>
> At least, as I've thought about it and read all those Rights, including the revised ones, I don't find -- I can't recall within those -- any place where they get an absolute right to initiate actions.
>
> So if I understand your question, do they get as investors the right to initiate an action that doesn't find favor with the board, my assumption is no, they cannot do that.

Cross examination of Tom Walsh by Jason Eisdorfer,
Tr. Vol. 2, p. 162-163, Oct 21, 2004.

Upon cross examination by Melinda Davison of ICNU, Richard Schifter had to correct Mr. Walsh's testimony.

> Q And you recall that he was asked a series of questions from Mr. Eisdorfer regarding the sale -- ultimate sale of PGE.
>
> A Yes.
>
> Q Did you agree with his testimony?
>
> A . . . I would say, though, that his testimony would require correction as a technical legal matter. The current draft of the LLC Agreement does provide that

> in essence TPG, subject to consultation with other board members of OEUC and PGE, can in fact cause either an IPO or another sale of PGE.

Cross examination of Richard Schifter by Melinda Davison,
Tr. Vol. 2, p. 176-177, Oct 21, 2004

Once again, the corporate structure is not really as TPG advertises or even, unfortunately, as some of the Local Applicants believe it to be. Local Applicants state that through TPG's ownership there will be a "strong, focused, local, and expert Board." OE/2/Local Applicants/8. We certainly agree that the Board may well exert some muscle, but based on the proposed corporate construct there is every reason to believe that there will be, practically speaking, nothing at all local about it. And exactly what the TPG members, the de facto board, focus on and what they are experts in lead us to a discussion of the risks inherent in this application.

**B. The Risks Inherent in TPG's Ownership of PGE**

We set out the risks and harms from TPG's ownership of PGE below.

1. Corporate Governance

As we have seen above, the corporate structure as set out in the Draft OEUC Operating Agreement is not really local and therefore it is not a benefit. In fact, the envisioned corporate governance is a tangible harm. Even before PUHCA repeal and the complete takeover of the OEUC board by TPG, the negative consent rights give TPG a level of authority over the operations of the holding company and PGE that is quite extraordinary. The proposed corporate governance cedes authority to TPG. This is not our opinion, it is thinking of TPG. See CUB/100/Jenks-Brown/24. TPG says publicly "[t]he consent rights simply require that if certain actions are approved by the Board, TPG Applicants must consent before the action may be taken." OE/22/Davis/15. It seems so simple and fair when they state it publicly, but this is what they are thinking privately:

CONFIDENTIAL MATERIAL FOLLOWS

END OF CONFIDENTIAL MATERIAL

TPG's Investment Review Committee memo, CUB/112/Jenks-Brown/2

The kinds of investment and operating decisions that TPG will control by virtue of its veto power, or directly after PUHCA repeal, go to the core of utility operations. TPG has no experience running an electric utility, yet they will have virtual or actual control of OEUC and PGE. They lack experience in all aspects of regulated utility service: cost controls, appropriate generating resource decisions, appropriate infrastructure investments, input into state, regional and global energy policy, relationships with regulators and stakeholders. It is ironic that not only does TPG not have experience running an electric utility, they do not necessarily want to gain experience, because the business model has TPG disposing of PGE in the blink of an eye in utility industry terms.

The corporate governance does not improve PGE customers' position; it sets us back.

2. Corporate Structure and Transparency

We must not harbor delusions about where the decision-making clout resides in this proposed transaction. As we have seen, TPG is clear about their governance role. Ibid. Yet our ability and the Commission's ability to access relevant information from the relevant sources is severely restricted in this model. Any inability to obtain potentially relevant documents interferes with the Commission's oversight role and that harms customers. If the Commission cannot access information from the true decision-maker, TPG, or cannot even get substantive information about use of negative consent rights, then its ability to understand and regulate PGE's activities is seriously undermined. We discuss this further in the section below that addresses acquisition conditions and their adequacy to mitigate harms. The Applicants have proposed conditions relating to transparency, but they only go as far as the Applicant wants them to go. OE/500/Davis/25-27. They do not give the Commission or case parties access to TPG's internal analyses. In other words, in future proceedings the Commission would not have access to the kind of documents that, in this docket, have revealed the real thinking of the real decision-makers. The Commission will not in the future be able to contrast the decision-makers' public statements from the real thinking. Needless to say, neither TPG nor Staff provides conditions that come close to mitigating this substantial harm.

3. Short-Term Ownership Creates Instability

The TPG business model is simple: a private equity firm with no experience in operating an electric utility nor any real desire to own an electric utility buys a utility during an economic downturn, spruces it up and resells it. This model does not create any real local presence during TPG's ownership (see corporate structure issues above), and because the ownership model assumes TPG will sell PGE to the highest bidder from amongst a long list of potential bidders, the chances the highest bidder will necessarily have its own "local presence" is minute. See CUB/110/Jenks-Brown/1-4. There is nothing local during TPG ownership, and little likelihood upon resale as well.

Contrary to TPG's amazing claims of stability during its ownership period, there is the far greater potential that a quick flip of PGE will cause still more uncertainty and management malaise. TPG makes some weak claims that it might hold on to PGE longer than some of its other assets, but there is no real evidence for this. In fact, TPG holds its investments for an average of five to seven years. Staff/202/Morgan/19. One thing is clear, TPG will do whatever it can to maximize its capital gain upon resale and that could well mean a quick turn around; as soon as PUHCA is repealed, for example. Or, TPG may discover it does not like full economic regulation and decide to cut its losses.

It is supercilious in the extreme for TPG to claim that this transaction creates stability when the transaction itself is based on churning the asset again in a few short years. What is an asset to TPG is an essential service provider to its customers and what is a long investment for a quick turnaround private equity investment firm is a short-term whipsawing of the utility to the employees and customers.

4. Short-Term Ownership Creates All The Wrong Incentives

For twenty years CUB has studied what motivates monopoly utilities to do the right thing and what motivates them to do wrong. The business model inherent in this transaction taps into a set of incentives for the owner that is rather unique and, as CUB has analyzed them, are harmful to customers. There is no guaranteeing that TPG would necessarily pay attention to those incentives and TPG could operate PGE with a blind eye toward TPG's immediate financial benefit. But TPG would be foolish to do that and TPG are no fools. Therefore, the set of incentives implicated by this short-term ownership are an absolute harm.

CUB summarized the incentives for a short term owner this way:

> In brief, a short-term owner who has plans to resell the utility in five to ten years has every incentive to cut short-term costs and reduce capital expenditures well below the levels needed for the sake of efficient operation in order to boost company earnings in the short run. This makes the utility more attractive to the next buyer. Concurrent with the incentive to cut costs to the bone, however, the short-term owner has a disincentive to invest in the utility infrastructure for the long-term. Overzealous cost-cutting in the near term and no investment for the long-term spells disaster for those customers and employees who are still here years after OEUC has left.

CUB/100/Jenks-Brown/8-9

CUB witness Mr. Dittmer found the same incentive:

> As a potentially short term owner of PGE, Oregon Electric arguably has an even greater incentive to cut costs in the short run. Any short term reduction of costs serves potentially two purposes. First, as noted, in periods of financial stress, with its highly leveraged capital structure, Oregon Electric may be motivated if not required to preserve cash to meet its debt interest and repayment schedules. Second, and importantly, the exit valuation or sales price for the PGE business enterprise will likely be dependent in large part upon recently achieved earnings, interest coverage, as well as other cash flow coverage ratios.

CUB/200/Dittmer/29

Let there be no mistake: TPG's internal documents filed in this case show that in contemplating this deal, TPG thought as deeply about how to resell PGE as it thought about how to operate PGE. See CUB/107,108,109 and 110; ICNU/104/7,8,9,10,11,12, 13,14,17-20, and ICNU/10. TPG is buying PGE to sell it.

So does TPG understand the short-term owner incentives and do they act accordingly? You betcha. Despite TPG's protests that there are no natural synergy savings inherent in this transaction, cost-cutting and reduction of capital investment in

PGE are at the forefront of their thinking. CUB documents TPG's real cost-cutting thinking in CUB/100/Jenks-Brown/8-11, CUB/200/Dittmer/28-30, and CUB/300/Jenks-Brown/2-4 (and associated exhibits). These analyses are not undefined risks or speculation; they are based on TPG's own documented thinking.

ICNU witnesses Mr. Schoenbeck undertook a comprehensive look at TPG's thinking about cost-cutting and capital investment at PGE. While Mr. Schoenbeck did not specifically comment on the incentives of a short-term owner, the results he found from his examination of TPG's thinking are consistent with those incentives. "While ICNU believes PGE should be an efficiently run utility, concerns arise over the apparent premise of TPG that the cost savings must be achieved to realize the substantial rates of return targeted by TPG for this investment." ICNU/100/Schoenbeck/12. He then proceeded to examine TPG's internal thinking on cost-cutting at PGE. ICNU/100/Schoenbeck/12-19, with supporting exhibits. His findings with regard to TPG's thinking about capital expenditure levels were also consistent with the short-term owner incentives. He shows that TPG's analysis of the transaction presented to the rating agencies suggests the possibility of reducing annual capital investment by a significant amount. ICNU/100/ Schoenbeck/19-20.

TPG's response to all this is 'don't pay attention to what we are thinking, listen to what we are saying'. TPG tells us to ignore most of TPG's internal analytical documents because they were just due diligence and, as everybody knows, due diligence is a limited tool and thus cannot be relied on as "an indication of what ultimately will be achieved." OE/100/Davis/16. But as CUB points out, while TPG dismisses the cost-cutting analyses of TPG's documents because of the "inherent limitations" of due diligence, it is the due diligence of a potential buyer of PGE that is largely supposed to protect us from the threat that TPG will reduce longer-term capital investment. CUB/300/Jenks-Brown/5-6. TPG can't have it both ways. TPG's internal cost-cutting and investment reduction analysis was reasonably well done, and we think they meant what they thought then, not what they say now.

TPG's other defense is that their incentives to resell PGE and maximize their capitals gains are perfectly aligned with the interests of customers who want a well-run appropriately capitalized utility. OE/100/Davis/20. TPG does not provide documentary evidence on this point, but only the sad, self-interested testimony of a former regulator from another state. CUB spent considerable time documenting why this witness' experience was actually a good example of the problem and why his testimony should be roundly ignored, which we will summarize briefly in the next section.

TPG points to its decision to build Port Westward as support for its position that it will invest capital appropriately. OE/100/Davis/23. The problem is that TPG had no choice but to decide the way it did. If it had not, this transaction would have died six months ago. TPG knew that its capital investment inclinations were an issue in the case and a veto of Port Westward would have been ample proof of TPG's attitude. In addition, since the Commission acknowledged the basics underlying Port Westward in LC 33, killing Port Westward meant risking an imprudent action. In fact, the defense of its Port Westward decision in rebuttal testimony was an attempt to explain away a few internal documents which seem to contradict TPG's current position.

In addition, the rather awkward dialogue in testimony between CUB and TPG with regard to its cost-cutting and capital improvement history with other assets made it clear that TPG's history is at best a mixed bag for those us who will continue to be PGE customers well after TPG has gone. The dialogue was awkward because neither side seemed very well informed about TPG's past investment history. It's just not something that CUB has had to think about over the last 10 years. But despite TPG's attempt to recast the success of its investments, there are a number of examples of TPG laying off huge chunks of employees and making significant operational changes. And these examples are the ones TPG selected as examples of their work. One example stands out. TPG did not dispute CUB's finding that under TPG's ownership, J. Crew's full-time employee levels dropped 38%. CUB/300/Jenks-Brown/4. In defense, Mr. Davis replied, "[a]s a result of this prudent implementation of efficiency enhancements and productivity improvements, J.Crew was able to fund increased levels of capital expenditures . . ." OE/500/Davis/15. This begs a couple of questions. Are we going to have to rely on TPG to find huge "efficiency" enhancements in order to see them make capital investments? Which utility services or which customer groups or which employees will have to suffer these efficiencies to fund capital improvements?

The truth is that the incentives for a short-term owner and those for a long-term customer base are different. Customer satisfaction is one way of making money, especially in the free market, but in a regulated system, there are other ways to make money. See CUB's discussion of USWest, CUB/300/Jenks-Brown/8-9. Any objective and rational treatment of the issue would discover that a car owner who intends to sell the car in six months will make decisions differently than if she intends to own it for the remainder of its operating life. Same holds true for a home owner looking to fix the roof: am I going to be here for another year or another ten years? We have no window into how TPG will influence decision-making when cost-cutting opportunities arise or when capital investment needs occur. Ultimately this is another example of the documentary evidence conflicting with the statements of the Applicant. Yet again, we must trust them to do something different from what they are thinking.

5. Short-Term Ownership Regulatory Paradigm

This ownership structure and the short-term incentives have severe implications for the adequacy of existing utility regulation and whether that regulation provides the Commission sufficient tools to protect customers from TPG's ownership. CUB offered a considerable amount of testimony describing why, based on our experience and professional judgment, this transaction and the incentives it creates will pose a substantial challenge for this Commission and to the regulatory paradigm.

One simply cannot ignore that TPG and its business plan are unlike any that this Commission or most utility commissions have seen. TPG wants to own PGE for the sole purpose of selling it. It is not here to earn a regulated return over the long term, or to make long-term relationships with the regulators or customers, or to concern itself with the long-term policies of the region. It is here to maximize its capital gain when it sells PGE. We have addressed issues related to this fact, such as how inexperienced decision-making will be to our detriment and why the owner's incentives do not align with the customers. But there is the larger issue of how does this business model fit into the existing regulatory framework.

In opening testimony, CUB described the basic tenets of utility regulation and the tools built around those tenets do not work well with a short-term, speculator like TPG. Utility regulation is based on the premise that a utility owner is around for a long time. A number of points flow from this. See CUB/100/Jenks-Brown/4-13. One, the regulated returns are established with the assumption that over time the ups and downs will even out and that over the long term the utility will earn its allowed rate of return. Two, that the utility will be satisfied with this arrangement. Three, that there is an expectation that the utility owner will want to make major capital investments in the utility, and since customers need this expensive investment over the long term and investors benefit from making the investment over the long term, the interests are reasonably well aligned. Four, there is an expectation that the utility investor will want to over-invest in the utility for the same reason as three, above, and that regulators will need to balance customer and investor needs, perhaps disallowing some costs when necessary. Five, since the utility owner is around for the long-term, it makes sense to create relationships with regulators and customers, and since most of the regulator's tools are long-term, the utility owner will tend not to under invest or ignore the needs of the system, since the utility owner would still be around when the system deteriorates. Six, the utility owner will have an interest in long-term energy policies that will affect the long-term health of the utility, the customer, and the environment. Seven, the regulator need not worry about management drifting aimlessly or frequent upheaval, because the utility ownership is stable. Eight, the utility owner will be accustomed to working with regulators and providing them with the information they need.

Throw all this out the window when TPG comes to town.

TPG will not be around for a long time; only five to seven years if this is to be an average TPG investment. Internal documents show that TPG will not settle for the traditional regulated rate of return. As we have seen, the incentives for a short term owner are to skimp on major capital investments and cut costs aggressively, and TPG's internal documents support a finding that TPG understands this. There is no need to establish a good relationship with regulators and customers, because they will be gone before the trouble hits. There is no need to establish long-term policies, because TPG is not about long-term. This transaction doesn't run the risk of management aimlessness and upheaval, it guarantees it, because ownership will turn over yet again upon TPG's exit. And of course, TPG is shy private equity firm. The only thing TPG wants to avoid more than appearing on the front page of the newspaper is being told it has to produce documents associated with its investment.

The regulatory system simply is not well-designed for this short-term speculator-owner. There is a good reason for this: it is a good idea to have long-term owners involved in an industry that requires long-term planning and long-term investment and it's a bad thing to let your utilities be traded by investment firms like baseball cards.

Is this all hyperbole and baseless fear-mongering? Well, the only arguments that have any documentary support are those that oppose the transaction. The only arguments made in support of the transaction and in support of the idea that regulation works perfectly with this new construct come from witnesses with little or no utility regulation history. Except for one.

TPG's answer to what we thought were well-reasoned concerns and questions was to sic Karl McDermott, a former utility commissioner, on us. Dr. McDermott's unqualified praise of this transaction and regulation in general was either inspiring or depressing. CUB set out some of his generous statements in CUB/300/Jenks-Brown/7-8. In rejecting CUB's concerns outright, Dr. McDermott said, "[a]ll of the risks that do exist are mitigated by regulatory protections." OE/400/McDermott/12. Wow. No Commissioner in America truly believes that utility regulation mitigates all risk. That's why regulation is in a slow but constant state of flux. (And if regulation were perfect, the concept of retail access would never have come to fore.) Our experience shows that even when administered fairly, regulation is not perfect. We were not so much interested in what state commission this guy was on, but what planet he was on.

When we did look into Mr. McDermott's regulatory experience we discovered that he was not only not part of the perfect, he contributed to the problem. CUB set out a fairly detailed description of insufficient infrastructure investment by Commonwealth Edison in Illinois over 10 years, the regulator's insufficient real-time response, the resulting outages and service problems, and the utility's escape from a retroactive regulatory response. CUB/300/Jenks-Brown/9-16. We will not rehash our findings here. Needless to say, based on Commonwealth Edison's lack of investment while Dr. McDermott was on the Illinois Commerce Commission and his later testimony as a Commonwealth Edison witness to avoid the impact of reactive regulation, his testimony in this case rings hollow. And we're being nice here. If anything, he helped us make our point.

6. The Double Leveraged Structure of the Deal

The double leveraged structure of the deal indicates to us that the financing is a financing of convenience for a short term, not a long-term commitment with a healthy equity investment. But, regardless of the philosophical driver, the double leveraged structure presents significant risks where investor and customer interests are not aligned.

Staff witness Mr. Morgan presents a full discussion of what double leveraged means. Staff/200/Morgan/22-32. He describes how the shareholders benefit from it because they borrow money at lower cost than the allowed ROE they earn at the PGE level, and they keep the difference. Id. at 28. He outlines a number of the risks of a highly double leveraged deal, including access to fresh financing, a decrease in PGE credit quality because of the increased potential for default, and the overall interest rate environment. Id. at 28-30. He ends by saying the Enron conditions were inadequate to completely protect PGE's credit rating and there is no perfect ring-fencing. Id. at31-32. Mr. Morgan presents financial conditions that attempt to "protect PGE and its customers while not being overly onerous or prescriptive." Staff/900/Morgan/11, 17-27.

In addition, the double leveraged nature of the deal guarantees that customers will overpay on utility taxes. PGE customers pay taxes calculated on a PGE stand-alone basis, which ignores the considerable tax savings due to the additional layer of borrowing at the OEUC level. Again, TPG keeps the difference. This amounts to a $ 15 million per year windfall for TPG, funded by PGE customers. Staff/1200/Johnson/4.

Both CUB witness Dittmer and ICNU witnesses Antonuk and Vickroy discuss the double leveraged structure of the deal at length. CUB/200/Dittmer/25-33; ICNU/200/ Antonuk-Vickroy/13-27. Both sets of testimony pointed out that Standard and Poor's did not view favorably the change in PGE's financial circumstances as a result of the TPG purchase. Dittmer reports that S&P placed PGE rated debt instruments on CreditWatch "with negative implications" two days after TPG's March 8, 2004, 757.511 application. CUB/200/Dittmer/30-31. Mr. Antonuk and Mr. Vickroy then provided the confidential S&P evaluation of the TPG transaction which was the basis for the March 10 announcement. ICNU/202/Antonuk-Vickroy. Antonuk and Vickroy go on to say that the TPG transaction actually deteriorates PGE's financial condition as it stands during the Enron bankruptcy.

> In fact, the financial standing and credit ratings of PGE would not be improved, but would worsen, due to the added leverage that the acquisition would produce. As we have previously noted, the high levels of leverage proposed to finance the purchase of PGE from Enron will cause increased financial risk to PGE. . .The increased financial risk due to the double leverage overrides the benefits from PGE's removal from Enron.

ICNU/200/Antonuk-Vickroy/18-19

The other credit ratings agencies withheld judgment on PGE's financial condition, with Moody's saying there could be an "adverse effect on credit quality in the event of a highly leveraged transaction" and Fitch saying an upgrade in PGE's rating could be "constrained if a highly leveraged capital structure is adopted. . ." CUB/200/Dittmer/32.

PGE witness Mr. Piro acknowledged at the hearing that a ratings downgrade could impact the cost of certain financial tools.

> Q (BY MS. DAVISON.) So if I understand this correctly, the downgrade of unsecured debt could impact the cost of your revolver; is that direct (sic)?
>
> A Based on the pricing matrix that we have, you get -- you can draw against your revolver based on various credit-scoring matrix.
>
> And so to the extent you're down a grade and you're drawing against that revolver, then that could -- that could increase your cost, if you draw on your revolver. Typically the company doesn't draw against the revolver, we use the Commercial Paper Program, which doesn't really look at your overall ratings.
>
> So, you know, it really depends on where we are; whether we have access to commercial paper, and whether, in fact, we have to draw against the revolver. . . So it's not a black-and-white question, it really depends on what happens over the next period of time and how we finance our construction program.
>
> Q Did you say earlier this morning that PGE may be required to rely on its revolver if Oregon Electric removes the 220 million dollars from the company?
>
> A Yes, PGE may be required -- again, depending on how we issue long-term debt into the future. If we issue long-term debt ahead of our needs, then we would have cash to draw on to fund our construction program.

> If we don't think markets are favorable, we may delay the financing and use our revolver for a period of time.

Cross Examination of Jim Piro by Melinda Davison,
Tr. Vol. 1, p. 29-31, Oct 21, 2004

The double leveraged structure of the proposed transaction does implicate a number of risks that are new to PGE. S&P and the other ratings services responded accordingly. ICNU's witnesses have analyzed the rating services' responses and came to the conclusion that the TPG transaction was a net deterioration from the status quo. Numerous acquisition conditions have been bandied about relating to the financial conditions of PGE and OUEC, sometimes to the exclusion of all else. We address the acquisition conditions separately below.

7. The Endgame Creates New Risks

By design, this transaction assumes a resale of PGE within a relatively short period. CUB believes that it is irresponsible for the Commission to ignore the obvious, and that the endgame must be considered part of the approval assessment. If TPG is buying PGE to resell it, the Commission ought to recognize that the resale of PGE is part of this transaction. Staff did not address the various endgame issues. Apparently they believe, as TPG has argued, that the Commission's approval process allows these issues to be postponed under the next 757.511 application. We believe that harms are created prior to that point.

CUB has addressed the endgame extensively. CUB/100/Jenks-Brown/16-20 and CUB/300/Jenks-Brown/24-32. ICNU has also testified that it is appropriate to adopt conditions addressing the scenarios under which PGE will be transferred at the end of TPG's limited ownership. ICNU/300/Schoenbeck/7. The City of Portland also addressed the "exit strategy" issue. COP/101/Anderson/11-14. While these parties may have different ways of addressing the issue, at least we address the issue. We have not heard a credible argument for why addressing the endgame, which is clearly implicated by this application, is somehow legally beyond the reach of this Commission. On the contrary, we think that ignoring this issue fails the public and the public interest.

First, as we have said above, because TPG's business model assumes a short time frame for TPG ownership, there will be yet another owner and there will be management upheaval after TPG is finished with PGE. This proposed transaction does not end the merry-go-round of PGE suitors and owners.

Second, despite TPG's public assertions that as a result of TPG's ownership, PGE could again return to the pre-Enron days as a locally headquartered, publicly-traded company, the reality is that there is neither a guarantee of this, nor even a likelihood. CUB uncovered TPG's real thinking on the matter. CUB/100/Jenks-Brown/18-20. And at hearing, we were able to enlighten one of the Local Applicants who had his own vision of the endgame.

> Q Why is an initial public offering your preferred choice?
>
> A Succinctly, I think it's the best long term both option and assurance that would bring PGE back to what it historically was, which is a locally-controlled, investor-owned utility. . .
>
> And it's my personal hope, and I've discussed this with some other board members, that it will be an IPO. And at that point the whole saga of the historically great PGE that went through the mud bath of Enron will be over and we'll be back to where we all wished we'd stayed in the first place.
>
> Q Your preferred choice is an IPO. Do you have any inkling what the, what Texas Pacific Group's preferred exit choice would be?
>
> A I do not.
>
> Q Have you had an opportunity to look through the Investment Review Committee notes of Texas Pacific on this concerning this deal?
>
> A I have not. . . .

Q (BY MR. EISDORFER.) Mr. Walsh, if you could look at CUB Exhibit 107, page two -- well, page one. It's identified as a Memo from a number of Texas Pacific employees relating to this particular project, --

A Mm-hm.

Q -- the purchase of Portland General Electric. . .

CONFIDENTIAL MATERIAL FOLLOWS

END OF CONFIDENTIAL MATERIAL

[Q] So Mr. Walsh, your pre- -- while your preferred exit is an initial public offering, do you have any reason to believe that that is the preferred exit of the major investor, Texas Pacific, in this case?

A No, I have no reason to -- other than these documents that you've given me today, we've had these discussions generally, TPG has been pretty clear that as one prospective board member, I'm fully free and entitled to hold my opinion, and it may not be widely shared.

Q Is it your understanding that -- who will make the decision how PGE ultimately is disposed of?

Cross examination of Tom Walsh by Jason Eisdorfer,
Tr. Vol. 2, p. 153-160, Oct 21, 2004

Of course we then learned that in fact TPG has the right to sell PGE when and how it wants to, even in the face of the Local Applicant's contrary opinion. See, above, pages 15-16.

TPG will not be tied down on the endgame because it might reduce its opportunity to maximize its capital gains from the sale. OE/500/Davis/30. And TPG will not come clean with its intentions with regard to PGE because those intentions are not necessarily aligned with the best interests of customers or employees, or consistent with the aspirations of the Local Applicants. Complete flexibility for the endgame necessarily benefits TPG, not the customers.

While some may ignore the endgame now and rely on the Commission's future 757.511 process, we are greatly concerned about the future of that process given the intersection of two dynamics: one, the repeal of PUHCA and two, the precedent that this case may set.

If the Commission says yes to this, the Commission is setting a precedent that future owners need only plunk down a wad of money in front of the existing shareholders for the sole purpose of arbitraging the short-term value of a utility and the customers it serves. This case has the potential to create a precedent that it is OK to buy and sell our utilities in relatively rapid succession. After PUHCA is repealed, the number of potential buyers goes up, the number of buyers with no utility experience goes up, and the number of buyers who want to buy PGE to sell it goes up. Ignoring the endgame in this case may make it harder to protect the public's and the customers' interests in future cases. And ignoring the endgame in this case would be a dereliction of the Commission's duty to protect and enhance the interests of current and future PGE customers.

**C. TPG's and Staff's Conditions Are Inadequate to Address the Major Problems**

CUB has determined that many of the conditions TPG offered to mitigate risks or to provide benefits do neither. In addition, a number of Staff conditions that they assert are prerequisite to a net benefit finding are themselves inadequate to provide the Commission the necessary tools to regulate TPG and to provide customers a net benefit. We attempt to identify some of the inadequate conditions below.

1. Transparency of Decision-Making & Control

TPG and Staff both offer Condition 12 to provide the Commission access to information relating to PGE. This condition is insufficient and results in a net harm.

> 12. *Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all book 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.*

OE/501/Davis/4 and Staff/801/Conway/8

This condition is inadequate because it stops at the OEUC level. The Commission must be able to go up the chain of command and examine records that "are reasonably calculated to lead to information relating to PGE." As we have seen in the discussion of the corporate structure, TPG is largely in control before PUHCA repeal, and after PUHCA repeal, they are completely in control. The PUC must be able to go up the chain of command, to TPG, to determine the basis for decisions: are the decisions made based on an analysis that shows they are least cost to customers or are they being done in order to create the most profit for TPG. We are unsure why Staff did not push for access to relevant information at the TPG level when in all likelihood, both before and after PUHCA repeal, many of the critical decisions relating to PGE investment and operations will be made by TPG prior to an OEUC or PGE board meeting.

> 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.*

OE/501/Davis/4 and Staff/Conway/801/9

> 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.*

OE/501/Davis/8

Condition 28 is an example of why TPG and Staff Condition 14 is insufficient. Condition 28 makes clear that TPG expects affiliate transactions between it and OEUC, however, Condition 14 says that only records and documents of affiliate transactions between PGE and TPG come under Commission review.

What are the affiliate transactions between TPG and OEUC? TPG has its own professionals that will provide their "unique talents and diverse experience" to PGE. OE/100/Davis/57. This is consistent with how TPG describes their involvement with companies they own. TPG is an active owner. TPG chooses the management team, leads the development of business plans, and works with the company to find efficiencies and determine capital expenditures. OE/100/Davis/13, 17; OE/500/Davis/10-17. It is uncertain whether PGE has the liberty to decline this "advice."

This advice is the affiliate relationship that is the subject to the TPG Conditions 14 and 28. TPG should not be able to hide this "advice", i.e. control, by hiding the affiliate relationship at Oregon Electric. All affiliate transactions between OEUC and TPG companies have the potential to impact PGE and must therefore be subject to PUC review in the same manner as an affiliate transaction between PGE and TPG.

Staff's Condition 14 is identical to TPG's Condition 14 and suffers the same problem. Staff's Condition 28 does not assuage the problem.

2. Rate Credit

> 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…*
>
> *…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.*

OE/501/Davis/5-6

Condition 20 is TPG's rate credit proposal. Obviously we believe that the size of the rate credit does not approach adequate compensation for the size of the risks involved in this transaction. TPG expects to gain about $15 million annually in tax savings alone due to the interest deduction caused by the debt. Staff/1200/Johnson/4. As the record shows, this debt can impact PGE negatively. If one assumes that customers are taking some risk associated with this debt, and TPG profits from that risk beyond the regulated utility profits, then neither TPG's nor Staff's rate credit clears the no harm hurdle. These rate credit conditions are supposed to represent the most identifiable benefit to be weighed against the other harms, but we do not even see these rate credits as being sufficient in and of themselves to be considered a benefit.

TPG's proposed rate credit has additional flaws. First, it doesn't begin until 2007, even though the risks of this transaction begin immediately upon the deal closing. Secondly, TPG's proposed offset makes the actual benefit of the rate credit to customers significantly lower than the advertised $43 million. TPG is proposing that the rate credit be offset by any savings. Compare this to the language in TPG's Condition 18, which protects customers if the revenue requirement is higher due to TPG ownership. The revenue requirement is the overall level of costs that rates are based on. Condition 18 says that this overall number cannot rise due to TPG's ownership. Condition 20 allows any savings included in revenue requirement to be used to offset the rate credit up to $8.6

million annually. The net result of these two conditions together is that, if there are both new savings and new costs included in revenue requirement at the same amount (under $8.6 million), then the rate credit essentially pays for the new costs due to TPG ownership. Depending on how one looks at it, either customers do end up paying for TPG costs, or customers get less from the rate credit.

Staff's rate credit is larger and cannot be offset, but because Staff testimony gives the full benefit of the $15 million annual tax savings to OEUC, customers essentially take on additional risk *and* overpay on taxes to fund a rate credit of equal size over the same period of time.

3. Cost-Cutting and 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 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 an expenditures. The shareholders will bear the expense of the audit up to $400,000.*

OE/501/Davis/6-7

Conditions 23 and 24 are supposed to protect customers from aggressive cost-cutting and to assure appropriate capital investment during TPG's short stint as PGE's owner. TPG's Condition 23 requires PGE to provide, with its annual results of operations, the current budget for O&M and capital expenditures along with a comparison of what the actual cost has been in the three previous years. While this may provide the Commission with important information, the information is provided too late for any action. PGE's results of operations aren't due until May 1, four months into the year, and the Commission must take the time to analyze the proposed budget, deliberate, decide, and act before an adjustment in the budget can be made. By this time, PGE is well into it current year and its current budget. If the Commission has concerns about the cost-cutting contained in that budget, it is simply too late.

TPG's Condition 24 is the audit condition. It is not adequate given the risks involved and it contains too many limitations. There can be no audit after 7 years. The shareholders' expense is limited to $400,000. After an audit is conducted there is no ability to conduct another if the situation deteriorates. The purpose of the audit is to protect customers from aggressive cost-cutting and to ensure adequate investment. The Commission's authority to require an audit should not be limited to one time, or a specific set of years, but should exist during the period of time that PGE is owned by a short-term owner with an incentive and business plan that includes cost-cutting. Finally, if there is aggressive cost-cutting and it impact customers, it would be unfair to customers to require that the audit costs above $400,000 be paid for by customers.

Staff's Condition 23 is similar to TPG's and has similar problems. The Commission is receiving budgets too late to act on them. Staff's Condition 24 is slightly better than TPG's, but still inadequate as it still suffers many of the same problems. Staff's condition also places too many limits on such an audit. The audit can only happen once. It can only happen within the first 7 years and it is limited to the company's O&M and capital construction plans and expenditures.

4. Financial Conditions

TPG's proposed conditions relating to the financial structure of the deal allows TPG to reap significant financial benefits from the highly leveraged structure at customer expense. Between the tax advantages of the structure and the benefits of borrowing money at less cost that the authorized ROE, the double-leveraged nature of the deal allows TPG to earn an ROE that is significantly higher than the 10.5% that is currently authorized for PGE. CUB/200/Dittmer/12. Customers are paying the company taxes that don't actually make it to the government and customers are paying the company a 10.5% return on equity for an investment that is actually made with money borrowed at a much lower rate.

While Staff has done a pretty good job of creating conditions to combat the risks of the double leverage construct, we think the Commission should go farther. We think about Staff witness Morgan's attempt to create conditions that "protect PGE and its customers while not being overly onerous or prescriptive." Sometimes in order to establish the right protections a regulator has to get a little onerous, especially when the regulator is in dangerous or uncharted waters as we are now.

Staff's Condition 16 says that "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%." Staff/801/Conway/9

PGE's common equity can fall below 48% by sending too much of its earnings to OEUC. It can also fall because PGE does not retain enough working capital and has to borrow money to finance new capital projects. A stronger provision would say that in the event that PGE's common equity falls below 48%, OEUC would be required to add new equity in order to return PGE's common equity to 48%.

**D. Because We Have To: Proposed Conditions to Meet the Net Benefits Standard**

As part of CUB's surrebuttal testimony, we included a list of conditions that would go toward moving TPG's application closer to the net benefits standard. We recommend them all to the Commission and will highlight some of those conditions here. We did not include a specific rate credit proposal, because we were still trying to gauge how far TPG would move on other issues. We did say in testimony that the starting place is the rate credit agreed to by Sierra Pacific in their 757.511 proceeding, $ 97 million. CUB/300/Jenks-Brown/36. TPG's proposed ownership presents more and new risks than did the Sierra Pacific deal.

<u>Rate Credit</u>. For lack of our own proposal, we recommend ICNU's $ 97 million rate credit proposal. ICNU Condition 1, ICNU/301/Schoenbeck/1.

<u>Endgame</u>. We believe that it would be irresponsible for the Commission to ignore the endgame in the course of its deliberations. CUB discussed our proposed endgame condition at length. The intent was to use TPG's admittedly brief ownership to transition to something stable and positive for customers, employees, and the community. The

condition we offered did not limit TPG's options absolutely, it said that if TPG did not dispose of PGE through a public offering then an option to buy would arise for the City of Portland or otherwise qualified consortium of local governments. If that process did not materialize into a bona fide offer, then TPG could sell PGE to whomever it wants. We have heard rumblings from some parties that the Commission might not have the authority to establish such a condition. To date, however, we have not seen or heard a mature legal argument put forward and therefore we cannot address it here. If another party raises this theory in opening briefs, we will address it in reply. Not addressing the endgame only assists TPG in maximizing its capital gains upon resale, and buys into TPG's whole business model. CUB Condition 1, CUB/325/Jenks-Brown/1.

Tax Windfall. CUB Condition 5 would recognize that the double leveraged nature of the deal creates a tax windfall for TPG at ratepayer expense. The condition would cause PGE's retail rates to more closely approximate the taxes actually being paid by OEUC. Without this condition, for example, PGE customers are funding the rate credit that Staff has proposed and that credit therefore is no benefit to customers at all. CUB Condition 5, CUB/325/Jenks-Brown/2.

Audit. CUB Condition 9 would supplant TPG's and Staff's Condition 24, which, as we discussed above, are not adequate given the circumstances. CUB's condition gives the Commission the authority to order more than one audit, thereby not giving TPG free rein to do as it pleases after the first audit. CUB's condition allows for a broader scope, but limits the frequency of audits. CUB Condition 9, Ibid.

Response to Audit. In its rebuttal testimony, TPG argues that the Commission has the power to order it to remedy any deficiencies that are discovered in such an audit.

OE/400/McDermott/17. We do not believe that the Commission has such power unless it makes it a condition of approval of this application. So we provide one. CUB Condition 10, Ibid.

Transparency. CUB Condition 11 would allow the Commission access to records relating to PGE all the way up to TPG, which is the real source of control in the corporate structure. CUB Condition 11, Ibid .

Customer Contribution to PGE Board Expense. ICNU Condition 18 would prohibit including in PGE's revenue requirement more than 50% of the fees and costs of the PGE Board. Since the Board will be distracted from its operational responsibilities when it focuses on the resale of PGE, which benefits TPG, customers should not be asked to bear the entire burden. ICNU Condition 18, ICNU/301/ Schoenbeck/4.

Enforcement. Given some of the dynamics we have witnessed in the proceeding, we think it is necessary to grant or allow any party in this docket the right to enforce violations of the approved conditions. ICNU Condition 28, ICNU/301/Schoenbeck/7.

Other Public Interest Conditions. Before we list a few more necessary conditions, we feel compelled to address what we think is a hole in Staff's testimony. We acknowledge from the outset that it is not the job of the new owner of PGE to single-handedly close the gap in the low-income energy assistance program, or to empower the renewables industry, or to remedy the plight of wild fish runs. However, it is PGE's responsibility to run a utility in such a way as to address these public interest issues and to improve the various situations.

While some of Staff's conditions are strong and some are inadequate, as a set, they are disappointing. Staff's view of the public interest is simply too narrow. Perhaps

Staff feels pressure not to offend one group or another, but by not addressing any issue except some ring fencing provisions and a rate credit, Staff ignores most other relevant public interests. We do not agree with a legal interpretation of the Commission's powers to represent the utility customer and the public interest generally that excludes most of the issues that a utility necessarily touches. See ORS 756.040 ("the commission shall represent the customers of any public utility . . . in all controversies respecting rates, valuations, service and all matters of which the commission has jurisdiction.") . See discussion of the Commission's authority above at page 7. In SB 1149, the electricity restructuring bill, there was never any doubt that the Commission could establish rules and oversee issues relating to low-income customers, energy efficiency, renewable energy investments or retail choices, the behavior of marketers, and any number of relevant issues. Even TPG presented a broader understanding of the public interest, even if their attempts were woefully inadequate.

While the Commission should reserve general rate-making decisions to rate-making proceedings, unless a statute expressly forbids the Commission from considering an issue, the Commission's broadly delegated powers allow it to explore all aspects of the relevant public interest.

<u>Low-income assistance</u>. The law generally says that the Commission must not discriminate when it establishes rates. ORS 757.310. However, the law also says that notwithstanding 757.310, the Commission can allow reduced rates to low-income households. ORS 757.612(7)(f). Paying particular attention to low-income utility customers is consistent with the public interest and establishing enhanced low-income assistance can fully be part of the determination of net benefits. Low-income customers

have been disproportionately impacted by the increase in energy prices over the past few years.

CADO-OECA has included in its testimony a request for a commitment by TPG shareholders to provide $11 million per year, as long as they own PGE, to be used to provide energy assistance to PGE's low-income customers. CADO-OECA also requested that OEUC and PGE work collaboratively with them to develop new programs that would benefit this population. While we agree that TPG should not be required to shoulder the entirety of the gap in providing assistance to low-income customers, it is OK to ask the new owner of Oregon's largest electric utility to bear a fair share of the load. Any satisfaction of the net benefit standard should include more than lip service to the plight of the some 100,000 low-income households in PGE's territory. We do not know what the perfect condition is relating to low-income. It may not be CADO-OECA's $11 million dollars per year of shareholder contributions, but it surely isn't the meager amount offered by TPG.

Renewables. TPG seemed to recognize that doing something good for renewables might help the application move toward the net benefits standard, but the condition it offered approached the meaningless. TPG would "cause PGE to have about 400 MW of capacity from renewable resources by 2012 if economical." OE/100/Davis/48. We will not even discuss whether the "if economical" eviscerates the commitment, because the commitment itself is so weak. Since PGE does already have some renewables in its system and the latest IRP Action Plan calls for an additional 195 MW of capacity, then the commitment means that PGE will another have eight years to match the same amount of renewables that PGE's IRP says they will do in the next two years.

**E. This Deal Is Worse Than The Status Quo**

This application presents an ownership model that is fraught with uncertainties. We do not know how PGE will operate the utility, what input TPG will have, how vigorous the cost-cutting will be, how little capital investment will occur, or whether the owners understand or will respond to regulation or stakeholder input. Some of these uncertainties are similar to ones that would exist as PGE worked its way through the bankruptcy process.

However, the TPG deal creates additional harms and risks.

The double leveraged structure of the deal creates risks of sufficient proportion such that ICNU's expert witnesses believe that it creates a net harm compared to bankruptcy proceedings. The TPG deal is a less direct path toward a final disposition. In fact, as stock is redistributed through the bankruptcy proceeding over time, the incentives for the shareholders look a lot more like the incentives of the traditional utility owner while the incentives are always wrong as long as TPG owns PGE. The corporate structure in this deal creates a harm in that one entity, who will operate in secret and from whom the Commission potentially cannot seek information, will have enormous control over PGE operations and investments. And finally, while PGE may not be particularly focused during the bankruptcy period, arguably that is preferable to an owner who is focused on maximizing its private gain at the customers' expense.

When this proceeding began, we thought that TPG versus bankruptcy would be a difficult comparison. We discover that it is not. We can do without TPG and we are willing to take our chances in the bankruptcy proceeding. We think the outcome there is at least as certain, it may happen sooner, and the end state is preferable.

## V. CONCLUSION

The parties on record opposing the TPG application have identified a plethora of risks and harms caused by this transaction. Some of the evidence is in the form of expert witness testimony based on years of experience before this Commission and an objective analysis of the natural incentives that flow from the transaction. Some of the evidence is in the form of documentary evidence of what TPG is actually thinking, not saying, or analysis of the underlying financial structure. All this contradicts the Applicant's case which is primarily assurances and denials from witnesses who have neither experience before this Commission nor experience before any utility commission.

Both TPG and the Staff rely on the 757.511 process to protect customers from a bad deal when TPG sells PGE. If the Commission does not reject this deal, we have no confidence that a future Commission will reject the "next" bad deal. If ever there was a bad deal, this is it. If the Commission concludes, as we have done, that this application does not provide a net benefit for customers, then as a matter of law, the Commission must deny the application.

Dated this 17th day of November, 2004.
Respectfully submitted,

Jason Eisdorfer #92292
Attorney for Citizens' Utility Board of Oregon

# CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of November, 2004, I served the foregoing Brief of the Citizens' Utility Board of Oregon in docket UM 1121 upon each party listed below, by emailing a nonconfidential copy, and mailing through the U.S. mail, postage prepaid, two confidential pages to the appropriate parties as identified on the service list, and by sending 6 copies by overnight FedEx to the Commission in its Salem offices.

Respectfully submitted,

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