

**MARY ANN HUTTON**

**Canon and Hutton, Attorneys at Law**

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■ Southern Oregon Office: 1141 NW Kring St., Roseburg, OR 97470 Phone: (541) 440 9717 ■  
Email: mah@canonandhutton.com

December 2, 2004

VIA OVERNIGHT DELIVERY

Ms. Annette M. Taylor  
Administrative Hearings Division  
Oregon Public Utility Commission  
550 Capitol Street N.E., Suite 215  
Salem, OR 97308-2148

RE: **Docket No. UM 1121**  
Reply Brief of Associated Oregon Industries

Dear Ms. Taylor:

Enclosed for filing in the above-referenced docket are the original and five copies of the Reply Brief of Associated Oregon Industries. A certificate of service is also attached.

Please call me with any questions. Thank you for your assistance.

Sincerely,

*/s/ Mary Ann Hutton*

Mary Ann Hutton

Enclosures

cc: UM 1121 Service List

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the Reply Brief of Associated Oregon Industries upon the parties, shown below, on the official service list for Docket No. UM 1121, by causing the same to be electronically served on December 3, 2004, upon all parties who have an email address on the official service list, and by U.S. Mail, postage-prepaid, deposited on December 2, 2004, to those parties who do not have an email address on the official service list.

Dated at Roseburg, Oregon, this 2<sup>nd</sup> day of December, 2004.

/s/ Mary Ann Hutton  
Mary Ann Hutton

JIM ABRAHAMSON -- <b>CONFIDENTIAL</b> COMMUNITY ACTION DIRECTORS OF OREGON 4035 12TH ST CUTOFF SE STE 110 SALEM OR 97302 jim@cado-oregon.org	SUSAN K ACKERMAN NIPPC PO BOX 10207 PORTLAND OR 97296-0207 susan.k.ackerman@comcast.net
GRIEG ANDERSON 5919 W MILES ST. PORTLAND OR 97219	JEANNE L ARANA OREGON HOUSING AND COMMUNITY SERVICES DEPT PO BOX 14508 SALEM OR 97301 jeanne.arana@hcs.state.or.us
KEN BEESON -- <b>CONFIDENTIAL</b> EUGENE WATER & ELECTRIC BOARD 500 EAST FOURTH AVENUE EUGENE OR 97440-2148 ken.beeson@eweb.eugene.or.us	JULIE BRANDIS -- <b>CONFIDENTIAL</b> ASSOCIATED OREGON INDUSTRIES 1149 COURT ST NE SALEM OR 97301-4030 jbrandis@aoi.org
KIM BURT WEST LINN PAPER COMPANY 4800 MILL ST WEST LINN OR 97068 kburt@wlinpco.com	J LAURENCE CABLE -- <b>CONFIDENTIAL</b> CABLE HUSTON BENEDICT ET AL 1001 SW 5TH AVE STE 2000 PORTLAND OR 97204-1136 lcable@chbh.com
D. KEVIN CARLSON DEPT OF JUSTICE - GENERAL COUNSEL DIVISION 1162 COURT ST NE SALEM OR 97301-4096 d.carlson@doj.state.or.us	MICHAEL CARUSO 176 SW HEMLOCK DUNDEE OR 97115 carusodad@hotmail.com

JENNIFER CHAMBERLIN -- <b>CONFIDENTIAL</b> STRATEGIC ENERGY LLC 2633 WELLINGTON COURT CLYDE CA 94520 jchamberlin@sel.com	WILLIAM H CHEN CONSTELLATION NEWENERGY INC 2175 N CALIFORNIA BLVD STE 300 WALNUT CREEK CA 94596 bill.chen@constellation.com
JOAN COTE -- <b>CONFIDENTIAL</b> OREGON ENERGY COORDINATORS ASSOCIATION 2585 STATE ST NE SALEM OR 97301 cotej@mwvcaa.org	CHRIS CREAN -- <b>CONFIDENTIAL</b> MULTNOMAH COUNTY 501 SE HAWTHORNE, SUITE 500 PORTLAND OR 97214 christopher.d.crean@co.multnomah.or.us
MELINDA J DAVISON -- <b>CONFIDENTIAL</b> DAVISON VAN CLEVE PC 1000 SW BROADWAY STE 2460 PORTLAND OR 97205 mail@dvclaw.com	JIM DEASON CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW FIFTH AVE STE 2000 PORTLAND OR 97204-1136 jdeason@chbh.com
JAMES DITTMER -- <b>CONFIDENTIAL</b> UTILITECH INC 740 NW BLUE PKWY STE 204 LEE'S SUMMIT MO 64086 jdittmer@utilitech.net	J JEFFREY DUDLEY -- <b>CONFIDENTIAL</b> PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC1300 PORTLAND OR 97204 jay.dudley@pgn.com
GARY DUELL -- <b>CONFIDENTIAL</b> 11301 SE CHARVIEW COURT CLACKAMAS, OR OR 97015 gduell@bigplanet.com	JASON EISDORFER -- <b>CONFIDENTIAL</b> CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
JAMES F FELL -- <b>CONFIDENTIAL</b> STOEL RIVES LLP 900 SW 5TH AVE STE 2600 PORTLAND OR 97204-1268 jffell@stoel.com	ANN L FISHER -- <b>CONFIDENTIAL</b> AF LEGAL & CONSULTING SERVICES 1425 SW 20TH STE 202 PORTLAND OR 97201 energylaw@aol.com
ANDREA FOGUE LEAGUE OF OREGON CITIES PO BOX 928 1201 COURT ST NE STE 200 SALEM OR 97308 afogue@orcities.org	SCOTT FORRESTER FRIENDS OF THE CLACKAMAS RIVER 2030 NW 7TH PL GRESHAM OR 97030 clackamas9@aol.com
KATHERINE FUTORNICK 14800 NE BLUEBIRD HILL LANE DAYTON OR 97114 futork@onlinemac.com	LORA GARLAND L-7 BONNEVILLE POWER ADMINISTRATION P.O. BOX 3621 PORTLAND OR 97208-3621 lmgarland@bpa.gov
LEONARD GIRARD 2169 SW KINGS COURT PORTLAND OR 97205 lgirard@teleport.com	ANN ENGLISH GRAVATT -- <b>CONFIDENTIAL</b> RENEWABLE NORTHWEST PROJECT 917 SW OAK - STE 303 PORTLAND OR 97205 ann@rnp.org

PATRICK G HAGER -- <b>CONFIDENTIAL</b> PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC0702 PORTLAND OR 97204 patrick.hager@pgn.com	ROY HENDERSON PENSION ENHANCEMENT COMMITTEE 895 NW DALE AVENUE PORTLAND OR 97229 royhensn@msn.com
MARY ANN HUTTON -- <b>CONFIDENTIAL</b> CANON AND HUTTON SOUTHERN OREGON OFFICE 1141 NW KRING ST ROSEBURG OR 97470 mah@canonandhutton.com	JOE JANSSENS PGE PENSION ENHANCEMENT COMMITTEE 24495 BUTTEVILLE RD NE AURORA OR 97002 osprey64@juno.com
VALARIE KOSS COLUMBIA RIVER PUD PO BOX 1193 SAINT HELENS OR 97051 vkoss@crpud.org	GEOFFREY M KRONICK LC7 -- <b>CONFIDENTIAL</b> BONNEVILLE POWER ADMINISTRATION PO BOX 3621 PORTLAND OR 97208-3621 gmkronick@bpa.gov
MICHAEL L KURTZ BOEHM, KURTZ & LOWRY 36 E 7TH ST STE 1510 CINCINNATI OH 45202-4454 mkurtzlaw@aol.com	ROCHELLE LESSNER -- <b>CONFIDENTIAL</b> LANE, POWELL, SPEARS, LUBERSKY LLP 601 SW 2ND AVE. STE. 2100 PORTLAND OR 97204 lessnerr@lanepowell.com
KEN LEWIS -- <b>CONFIDENTIAL</b> 2880 NW ARIEL TERRACE PORTLAND OR 97210 kl04@mailstation.com	STEVEN G LINS GLENDALE, CITY OF 613 E BROADWAY STE 220 GLENDALE CA 91206-4394 slins@ci.glendale.ca.us
JAMES MANION -- <b>CONFIDENTIAL</b> WARM SPRINGS POWER ENTERPRISES PO BOX 960 WARM SPRINGS OR 97761 j_manion@wspower.com	LLOYD K MARBET DON'T WASTE OREGON 19142 S BAKERS FERRY RD BORING OR 97009 marbet@mail.com
GORDON MCDONALD PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232 gordon.mcdonald@pacificcorp.com	DANIEL W MEEK -- <b>CONFIDENTIAL</b> DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net
THAD MILLER -- <b>CONFIDENTIAL</b> OREGON ELECTRIC UTILITY COMPANY 222 SW COLUMBIA STREET, SUITE 1850 PORTLAND OR 97201-6618 tmiller6@optonline.com	WILLIAM MILLER IBEW 17200 NE SACRAMENTO PORTLAND OR 97230 bill@ibew125.com
CHRISTY MONSON LEAGUE OF OREGON CITIES 1201 COURT ST. NE STE. 200 SALEM OR 97301 cmonson@orcities.org	MICHAEL MORGAN -- <b>CONFIDENTIAL</b> TONKON TORP LLP 888 SW 5TH AVE STE 1600 PORTLAND OR 97204-2099 mike@tonkon.com
FRANK NELSON 543 WILLAMETTE CT MCMINNVILLE OR 97128 fnelson@viclink.com	NANCY NEWELL 3917 NE SKIDMORE PORTLAND OR 97211 ogec2@hotmail.com

<p>JAMES NOTEBOOM -- <b>CONFIDENTIAL</b>  KARNOPP PETERSEN NOTEBOOM ET AL  1201 NW WALL ST STE 300  BEND OR 97701  jdn@karnopp.com</p>	<p>LISA F RACKNER -- <b>CONFIDENTIAL</b>  ATER WYNNE LLP  222 SW COLUMBIA ST STE 1800  PORTLAND OR 97201-6618  lfr@aterwynne.com</p>
<p>DONALD W SCHOENBECK -- <b>CONFIDENTIAL</b>  REGULATORY &amp; COGENERATION SERVICES INC  900 WASHINGTON ST STE 780  VANCOUVER WA 98660-3455  dws@r-c-s-inc.com</p>	<p>REBECCA SHERMAN -- <b>CONFIDENTIAL</b>  HYDROPOWER REFORM COALITION  320 SW STARK STREET, SUITE 429  PORTLAND OR 97204  northwest@hydroreform.org</p>
<p>JOHN W STEPHENS -- <b>CONFIDENTIAL</b>  ESLER STEPHENS &amp; BUCKLEY  888 SW FIFTH AVE STE 700  PORTLAND OR 97204-2021  stephens@eslerstephens.com</p>	<p>BRETT SWIFT -- <b>CONFIDENTIAL</b>  AMERICAN RIVERS  320 SW STARK ST, SUITE 418  PORTLAND OR 97204  bswift@amrivers.org</p>
<p>MITCHELL TAYLOR -- <b>CONFIDENTIAL</b>  ENRON CORPORATION  PO BOX 1188  1221 LAMAR - STE 1600  HOUSTON TX 77251-1188  mitchell.taylor@enron.com</p>	<p>LAURENCE TUTTLE  CENTER FOR ENVIRONMENTAL EQUITY  610 SW ALDER #1021  PORTLAND OR 97205  nevermined@earthlink.net</p>
<p>S BRADLEY VAN CLEVE -- <b>CONFIDENTIAL</b>  DAVISON VAN CLEVE PC  1000 SW BROADWAY STE 2460  PORTLAND OR 97205  mail@dvclaw.com</p>	<p>BENJAMIN WALTERS -- <b>CONFIDENTIAL</b>  CITY OF PORTAND - OFFICE OF CITY ATTORNEY  1221 SW 4TH AVE - RM 430  PORTLAND OR 97204  bwalters@ci.portland.or.us</p>
<p>MICHAEL T WEIRICH -- <b>CONFIDENTIAL</b>  DEPARTMENT OF JUSTICE  1162 COURT ST NE  SALEM OR 97301-4096  michael.weirich@state.or.us</p>	<p>STEVEN WEISS  NORTHWEST ENERGY COALITION  4422 OREGON TRAIL CT NE  SALEM OR 97305  steve@nwenergy.org</p>
<p>ROBIN WHITE  PORTLAND BOMA  1211 SW 5TH AVE STE 2722-MEZZANINE  PORTLAND OR 97201  rwhite@bigplanet.com</p>	<p>LORNE WHITTLES  EPCOR MERCHANT &amp; CAPITAL (US) INC  1161 W RIVER ST STE 250  BOISE ID 83702  lwhittles@epcor.ca</p>
<p>LINDA K WILLIAMS -- <b>CONFIDENTIAL</b>  KAFOURY &amp; MCDUGAL  10266 SW LANCASTER RD  PORTLAND OR 97219-6305  linda@lindawilliams.net</p>	

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

In the Matter of	)	
	)	
OREGON ELECTRIC UTILITY	)	<b>REPLY BRIEF OF</b>
COMPANY, LLC, <i>et al.</i> ,	)	<b>ASSOCIATED OREGON INDUSTRIES</b>
	)	
Application for Authorization to Acquire	)	
Portland General Electric Company	)	
_____	)	

Associated Oregon Industries (“AOI”) submits this Reply Brief in UM 1121 to highlight several concerns arising from the Opening Briefs for the Public Utility Commission of Oregon (“OPUC” or “Commission”) to consider in determining whether granting this application would protect PGE customers from harm, result in a net benefit for those customers, and be in the public interest.<sup>1</sup>

The applicants say they understand that they “must earn the trust and confidence of the Commission and its Staff every day to best serve its customers and investors.”<sup>2</sup> The applicants have obviously failed that task, at least with regard to Staff and customers, in the nine months since this application was filed. Despite reams of testimony and exhibits and settlement negotiations spanning months, the applicants have failed to persuade the Staff or major customer groups that its application -- with the package of conditions the applicants are willing to accept -- sufficiently protects

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<sup>1</sup> Re Legal Standard For Approval of Mergers, OPUC Docket No. UM 1011, Order No. 01-778 (Sept. 4, 2001) at 11.

<sup>2</sup> Oregon Electric Utility Company (“OEUC”) Opening Brief at 12.

customers from risks and harms, let alone results in a net benefit. Neither the Staff nor any customer group in this docket has expressed its support for the application as filed.

The law requires the applicants to set forth detailed information regarding the applicants' experience operating public utilities, the applicants' plan for operating the utility, how the acquisition will serve the public utility's customers in the public interest, among other factors.<sup>3</sup> The applicants have provided some telling evidence in this regard through this docket. This proceeding is the applicants' only public utility experience the Commission can examine, and it certainly does not evoke "trust and confidence" for the future.

**Applicants Challenge OPUC Authority.** The applicants come before the Oregon Commission seeking approval and immediately challenge the Commission's authority. The applicants have "offered to abide by a package of conditions" but dispute the Commission's authority to impose more stringent conditions.<sup>4</sup> They do not merely disagree. In their brief, the applicants reject the Commission's authority to regulate PGE in a manner necessary to protect customers. On a critical condition through which Staff and customers seek to protect ratepayers (Condition No. 16), the applicants claim, "Staff's attempt to further restrict PGE's flexibility . . . clearly interferes with the utility's power to regulate its own affairs and manage its own business."<sup>5</sup> The applicants assert that "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."<sup>6</sup>

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<sup>3</sup> ORS 757.511(2).

<sup>4</sup> OEUC Opening Brief at 2 and 32-33.

<sup>5</sup> OEUC Opening Brief at 32.

<sup>6</sup> OEUC Opening Brief at 33.

Essentially, the applicants claim the Commission lacks the power to impose conditions with which the applicants disagree in managing the utility and its finances.

Yet later, when it suits their argument, the applicants claim that the Commission “should have complete confidence that it will have the ability to effectively regulate PGE upon approval of the Proposed Transaction.”<sup>7</sup>

Clearly, the Commission has the express authority to condition an order upon the applicants’ adherence to specific requirements.<sup>8</sup> Moreover, the Commission has broad general authority granted by the Legislature, and indeed an affirmative duty to protect customers from harm.<sup>9</sup> If the applicants begin their relationship with the OPUC by challenging its basic authority to regulate the utility they want to acquire, what does this portend for their plans in operating the utility?

**Applicants Dispute Commission Rulings.** The applicants dispute the Commission’s well-established ruling that ORS 757.511 requires a “net benefit” test.<sup>10</sup> They “do not believe that the statute requires a showing of ‘net benefits’”.<sup>11</sup> The applicants endorse Enron’s Opening Brief wherein Enron argues that requiring a net benefit even exceeds the powers of the Oregon Legislature.<sup>12</sup>

In the UM 1011 docket, the Commission exhaustively examined the statutory construction and history of ORS 757.511 and considered extensive arguments of the OPUC Staff, Oregon utilities, and customer groups. The Commission concluded the

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<sup>7</sup> OEUC Opening Brief at 45.

<sup>8</sup> ORS 757.511(3).

<sup>9</sup> See Citizens’ Utility Board (“CUB”) Opening Brief at 7; ORS 756.040; ORS 757.506; ORS 757.511.

<sup>10</sup> OEUC Opening Brief at 1, footnote 4; and relying on Enron Opening Brief.

<sup>11</sup> Id.

<sup>12</sup> Enron Opening Brief at 9.



legal standard under ORS 757.511 requires a net benefit test.<sup>13</sup> Even before it definitively set that legal standard, the Commission only approved recent mergers after finding that the transactions would result in net benefits to customers.<sup>14</sup> The Commission stressed that the question addressed in UM 1011 was purely one of law.<sup>15</sup> Even though the Commissioners at the time were not enamored with the test as a matter of policy, they were nonetheless “compelled by the statutory language” to conclude that the net benefit test was required under ORS 757.511(3) as a matter of law.<sup>16</sup> If this is an indication of the applicants’ utility experience and plans to operate PGE, what other established Commission rulings will we be rearguing in the future?

**Applicants Withhold Information.** The applicants have not been forthcoming with information concerning this transaction to the Staff, intervenors, and the public. Staff was unable to fully assess the risks to customers of the transaction in its first round of testimony due to the many unanswered questions surrounding the application.<sup>17</sup> The applicants did not provide timely responses to Staff’s data requests. (Of 155 Staff requests by mid-July, only 14 were answered on time.)<sup>18</sup> The applicants filed numerous motions to keep information confidential.<sup>19</sup> They objected to routine data requests.<sup>20</sup> They fought the release of information to intervenors that ultimately proved extremely

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<sup>13</sup> Re Legal Standard for Approval of Mergers, OPUC Docket No. UM 1011, Order No. 01-778 (Sept. 4, 2001).

<sup>14</sup> Id., at 1, citing Re Sierra Pacific Resources, OPUC Docket No. UM 967, Order No. 00-702 at 6 (Oct. 30, 2000); Re Scottish Power, OPUC Docket No. UM 918, Order No. 99-616 at 13 (Oct. 6, 1999); Re Enron Corp. OPUC Docket No. UM 814, Order No. 97-196 at 6 (June 4, 1997).

<sup>15</sup> Id., at 1 and 11.

<sup>16</sup> Id., at 11.

<sup>17</sup> Staff/100, Conway/5.

<sup>18</sup> Staff/100, Conway/10-11.

<sup>19</sup> Id.

<sup>20</sup> Id.

relevant.<sup>21</sup> They redacted material even from already confidential documents, limiting parties' analysis.<sup>22</sup> They kept key information from the public, such as their assumptions, plans and projected profits.<sup>23</sup> Even to the end, the Staff noted in its surrebuttal testimony that due to the applicants' failure to provide data, Staff's analysis of the critical indemnification issue was limited.<sup>24</sup> In its Opening Brief, the Staff complained there were still no final financing contracts or operating agreements for the staff to review.<sup>25</sup>

As Staff observed early on, this proceeding was the applicants' first opportunity to make a good impression on the Commission. As such, Staff would "expect the applicants would do all they could to cooperate" with the investigation.<sup>26</sup> Staff wondered whether the applicants' actions were "perhaps an indicator" that the Commission would have even more difficulty obtaining the applicants' cooperation if the Commission approved the transaction, removing the applicants' incentive to be on their "best behavior".<sup>27</sup> Nothing in the applicants' actions since that initial round of testimony have assuaged those concerns.

Given that this proceeding is the sum total of the applicants' experience related to public utilities, this experience raises serious concerns as to whether the applicants appreciate the level of transparency expected of regulated monopoly utilities, their owners and affiliates. If this application is approved, the need for very explicit and extensive reporting requirements becomes ever more clear.

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<sup>21</sup> Industrial Customers of Northwest Utilities ("ICNU") Opening Brief at 4.

<sup>22</sup> See, e.g., ICNU/200, Antonuk-Vickroy/30 (Confidential); ICNU/203, Antonuk-Vickroy/4 (Confidential).

<sup>23</sup> See, e.g., Staff/800, Conway/12 (Confidential); Staff/200, Morgan/7, 14-16, 21-22 (Confidential); ICNU/100, Schoenbeck/7, 12-20 (Confidential); ICNU/200, Antonuk-Vickroy/27, 29-30 (Confidential).

<sup>24</sup> Staff/900, Morgan/6.

<sup>25</sup> Staff Opening Brief at 20.

<sup>26</sup> Staff/100, Conway/11.

<sup>27</sup> Id.

**Applicants Reject Conditions Needed to Protect Customers.** The applicants deign to abide by their own package of conditions and no others.<sup>28</sup> In essence, it seems the applicants' conditions are the only right conditions because they are the conditions to which the applicants consent. Furthermore, according to the applicants and Enron, they are the only legally permissible conditions. Others are outside the Commission's authority, the Legislature's authority, and are unconstitutional, they say.<sup>29</sup>

Moreover, in their testimony and Opening Brief, the applicants caution us not to rely on the explanation they provide on the meaning of their conditions.<sup>30</sup> To the extent the explanation in their testimony or brief "differs from the language in the condition itself, the language in the condition is controlling."<sup>31</sup> If we cannot rely on the applicants' explanations in their testimony and brief, then those explanations have no value. Under these circumstances, we can only imagine the arguments in future proceedings to enforce such conditions.

The applicants call the Staff and customers' concerns speculative, unsubstantiated, unjustified and misguided.<sup>32</sup> The applicants seem to overlook that they bear the burden of proof.<sup>33</sup> To a great extent, Staff and intervenors have attempted to assist the applicants in meeting their burden by suggesting the specific language of conditions that would at least help meet statutory standards.

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<sup>28</sup> OEUC Opening Brief at 2; OEUC/500, Davis/34, 14-18.

<sup>29</sup> OEUC Opening Brief at 32-33; Enron Opening Brief at 18-19.

<sup>30</sup> OEUC Opening Brief at 13, footnote 60; OEUC/500, Davis/34, footnote 66.

<sup>31</sup> Id.

<sup>32</sup> OEUC Opening Brief at 27, 39, 49.

<sup>33</sup> ORS 757.511(3).

Also, it cannot be said that the Staff and intervenor groups are never satisfied and always want something more than what is offered. The last three acquisition cases went before the Commission with stipulations on extensive conditions agreed to by Staff and many intervenors.<sup>34</sup>

The disagreements over necessary conditions are not a matter of semantics or tactics. They indicate grave concerns over whether this application meets the basic statutory standards for approval. Even with enhanced conditions, there are serious reservations as to whether customers will be protected and the transaction will result in a net benefit.<sup>35</sup> As explained in the testimony and Opening Briefs of Staff, AOI, ICNU, CUB and others, the differences in conditions proposed in this docket are extremely significant. For example:<sup>36</sup>

Conditions 11 and 30. AOI's Condition No. 11 is superior to Staff's Conditions 11 and 30 or applicants' Condition 11.<sup>37</sup> They all require Oregon Electric to maintain a record of each instance in which TPG Applicants withhold their consent to a decision of the PGE Board of Directors. Staff's Condition 30 additionally requires OEUC to provide a report to the Commission on a semi-annual basis, with the date of the instance and the name of the Consent Right that was triggered. AOI's Condition 11 requires OEUC to provide the report quarterly and include the basis for the decision. It also extends the requirement to cover the potentiality of Consent Rights being exercised over the OEUC

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<sup>34</sup> Re Enron Corp. OPUC Docket No. Um 814, Order No. 97-196 at 2 (June 4, 1997); Re Scottish Power, OPUC Docket No. UM 918, Order No. 99-616 at 2 (Oct. 6, 1999); Re Sierra Pacific Resources, OPUC Docket No. UM 967, Order No. 00-702 at 1 (Oct. 30, 2000).

<sup>35</sup> Staff Opening Brief at 2; ICNU Opening Brief at 39; CUB Opening Brief at 40; AOI Opening Brief at 5; Building Owners and Managers - Portland ("BOMA") Opening Brief at 6.

<sup>36</sup> The discussion of some conditions here is not meant to diminish the importance of other conditions as cited in AOI's Opening Brief. The numbering of conditions here follows the numbering in the parties' Opening Briefs.

<sup>37</sup> ICNU's Condition 11, on which AOI's Condition 11 was based, was originally numbered 19 in ICNU/301, Schoenbeck/4.

Board. AOI's Condition 11 recognizes the right for the companies to seek protection of sensitive information, but also provides that the most basic information about the exercise of the Consent Right would not be subject to protection: The date of the action, the subject matter, and the specific Consent Right that was exercised. The affirmative requirement to provide the report to the Commission on a regular basis is important because otherwise the Commission and Staff would have no idea of when a Consent Right might have been exercised or know when to request the report. The provisions concerning disclosure of basic elements of the decision is essential to provide customers access to information about what decisions are being made, by whom, affecting critical PGE matters. Given customers' experience with applicants' disdain for public disclosure throughout this proceeding, we are rightfully concerned with the ability for customers to know or discover this most basic information in the future. We consider this simple condition to be an indicator for the basic regulatory transparency expected of the applicants.

Condition No. 12. Most parties embrace Condition 12 to give the Commission access to all books and records of OEUC and PGE that lead to information regarding PGE. CUB's corollary is also crucial: The Commission must also have unrestricted access to all books and records of TPG that lead to information relating to PGE.<sup>38</sup> TPG has the ultimate say over decisions affecting PGE, initially through Consent Rights and directly if the Public Utility Holding Company Act ("PUHCA") is repealed. The Commission must be assured that it has access to, and proper regulatory oversight

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<sup>38</sup> AOI Opening Brief at 37; CUB Condition No. 11 from CUB/325, Jenks-Brown/2; CUB Opening Brief at 34, 42.

over, the source of all decision-making affecting PGE.<sup>39</sup> This is but one area where conditions need to be rewritten to assure this oversight extends beyond OEUC, all the way up the chain of TPG ownership and control.

Condition Nos. 16 and 27. Staff makes a sound argument for why the language “or could reasonably be expected to” should be used in place of the applicants’ proposed language in Condition 16.<sup>40</sup> It is essential to allowing the Commission to review any distribution that caused or contributed to PGE’s equity ratio falling below 48%.<sup>41</sup> However, Staff admits that it proposes weakening the condition used in the Enron acquisition in another respect. The Enron condition prohibited PGE’s equity ratio from falling below 48% for any reason, while Staff’s language here only prohibits a distribution that would cause the equity ratio to fall below 48%.<sup>42</sup> The applicants would use the weakened version without the countervailing protections in the rest of Staff’s proposal. This renders the condition virtually meaningless, as OEUC could simply make sure that it is not the dividends sent from PGE to OEUC that cause the equity ratio to fall below permissible levels, but the cumulative effect of the dividends and other liabilities.<sup>43</sup> The issue is not the use of Generally Accepted Accounting Principles, but the ability of the Commission to not be constrained by a narrow definition of causation that is subject to manipulation.

The same arguments apply to Condition 27, wherein the Staff and ICNU stress the importance of the same “or could reasonably be expected to” provision.

Additionally, Staff and ICNU’s Condition 27 provides significantly more protection by

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<sup>39</sup> CUB Opening Brief at 34; BOMA Opening Brief at 4-7.

<sup>40</sup> ICNU’s Condition 16 also includes Staff’s phrase in its Opening Brief, Attachment A at 3

<sup>41</sup> Staff Opening Brief at 12-14.

<sup>42</sup> Id. at 12.

<sup>43</sup> See example in Staff Opening Brief at 13.

setting the standard for re-leveraging debt at 40% common equity instead of the applicants' proposed 30%. Applicants' desire to draw more dividends from PGE is not a justification to put the company and customers at greater risk from a higher debt load.

Condition Nos. 25 and 28. Here again, the interrelationship of TPG, OEUC, and PGE creates difficulty in crafting adequate protections. ICNU's condition provides that PGE distributions to OEUC will be used by OEUC exclusively to pay direct operating expenses and debt service, until certain conditions are met. In its Opening Brief, Staff inexplicably proposes modifications to its Condition 25, accepting OEUC's weakened version by deleting "direct" from the condition.<sup>44</sup> Staff also decides to adopt OEUC's version of Condition 28, which allows TPG entities to direct bill OEUC for goods, services, supplies or assets up to \$5 million per year. Resultantly, TPG could bill OEUC \$5 million per year and OEUC could draw cash from PGE for open-ended expenses.

Early in their brief the applicants assert, ". . . the resources of TPG's other principals and professionals will be available to advise and assist the PGE Board at no cost to PGE."<sup>45</sup> Later in the same brief, the applicants object that Staff's original Condition 28 "would unduly limit TPG's ability to charge Oregon Electric for ongoing services that TPG may provide."<sup>46</sup> The applicants want TPG to be able to charge OEUC \$5 million per year for "ongoing monitoring and advice".<sup>47</sup> This is the modification that Staff now proposes, but the Commission should reject.

If the Commission approves this application, it should at least adopt ICNU's versions of these conditions. ICNU's Condition 25 allows distributions to be used by

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<sup>44</sup> Staff Opening Brief at 26-27.

<sup>45</sup> OEUC Opening Brief at 3.

<sup>46</sup> OEUC Opening Brief at 38-39.

<sup>47</sup> Id.

OEUC only to pay direct operating expenses. ICNU's Condition 28 prohibits TPG Applicants from allocating or direct billing OEUC for any goods, services, supplies or assets. Given the applicants' reliance on the strength of local representation, and their advice and assistance being given "at no cost" to PGE, it is totally inappropriate to send \$5 million a year in fees to TPG for "monitoring and advice". This is true whether such amounts come from OEUC or through OEUC from PGE.

Intervenors' Conditions. In their Opening Briefs, AOI, ICNU, CUB, and Strategic Energy recommend several additional specific conditions that were not proposed by Staff.<sup>48</sup> These would strengthen or extend customer protections and help contribute toward achieving a net benefit. Staff now recommends some of these.<sup>49</sup> However, Staff explains that its recommended conditions do not provide complete protection from harms to customers and "time will tell" whether they are sufficient to protect PGE's customers and the public at large.<sup>50</sup> Staff explains its conditions only mitigate, not eliminate concerns and -- even with staff's proposed rate credit -- the conditions do not "ensure or guarantee that the acquisition would result in a net benefit for PGE's customers".<sup>51</sup> The staff sets out some of the "more worrisome concerns" that remain, despite the Staff's proposed conditions addressing those concerns.<sup>52</sup> If the Commission nonetheless decides to grant this application, it should do so only with the conditions that give customers the best chance of being protected from harm and realizing a net benefit from this transaction, including the additional conditions proposed by intervenors, as set out in AOI's Opening Brief.

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<sup>48</sup> See AOI Opening Brief at 42-44; ICNU Opening Brief at 39-41 and Appendix A at 5-7.

<sup>49</sup> Staff Opening Brief at 34.

<sup>50</sup> Staff Opening Brief at 2

<sup>51</sup> Staff Opening Brief at 19.

<sup>52</sup> Id.



**Application Leaves Questions Unanswered.** After all that has been said in this case, there are still fundamental questions that remain unanswered. If this application is approved, do the conditions and the Commission's jurisdiction sufficiently extend to TPG in all areas, since TPG will have de facto control immediately through Consent Rights and direct voting control if PUHCA is repealed?<sup>53</sup> What is the final purchase price and how much will Oregon Electric need to borrow to close this transaction?<sup>54</sup> What are the terms of the debt?<sup>55</sup> What is the extent and valuation of all liabilities?<sup>56</sup> If the TPG investors change over time, will the Commission be able to review the transaction under ORS 757.511?<sup>57</sup> Are the TPG Consent Rights (veto power) over the PGE Board, the OEUC Board, or both, and will the OEUC Board be making operational decisions affecting PGE?<sup>58</sup> Why have the applicants been unable to secure the actions they sought from the Securities and Exchange Commission ("SEC"), and what are the implications of now seeking an unprecedented action from the SEC?<sup>59</sup> How does the SEC action affect whether this transaction will close at all and, if so, when?<sup>60</sup> How would the Commission's investigation of this application have differed, or conditions differed, if the ownership structure were presented as TPG having complete voting control, since that will be the structure, with no further review by this Commission, if PUHCA is repealed?<sup>61</sup>

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<sup>53</sup> OEUC Opening Brief at 3, footnote 9.

<sup>54</sup> OEUC Opening Brief at 5-6.

<sup>55</sup> ICNU Opening Brief at 22.

<sup>56</sup> Staff/900, Morgan/7.

<sup>57</sup> OEUC Opening Brief at 21.

<sup>58</sup> Staff Opening Brief at 31.

<sup>59</sup> ICNU Opening Brief at 16.

<sup>60</sup> Transcript at 183, 186-187 (Schiffer).

<sup>61</sup> OEUC Opening Brief at 3, footnote 9.

**Different motivations lead to different conclusions.** The applicants look at the facts and say: Trust us. It will all work out so well. The Staff and major customer groups look at the same facts and say: Be very worried. This deal has very real harms and risks for customers. In examining these arguments and making its own judgment on the facts, the Commission should consider that these very different arguments come from very different perspectives.

What incentives do the Staff and customer groups have for recommending the Commission either deny the application or attach more stringent conditions necessary to help protect customers and result in a net benefit? What incentives do the applicants have to argue the contrary? Whose approach is more likely to result in an outcome that serves customers and is in the public interest?

**Staff & Customer Groups**

Oregon non-profit, public interest  
Decades of experience before OPUC  
Objective: what is good for customers  
Agrees with OPUC's legal standards  
Supports OPUC authority to regulate  
Attempts to get public disclosure  
Customers still here after 12 years

**Applicants**

Out-of-state private equity investors  
No experience before this or any PUC  
Objective: investor/management returns  
Disagrees with OPUC's legal standards  
Challenges OPUC authority to regulate  
Withholds information from PUC, public  
Applicants gone after 12 years

**Conclusion**

In sum, while the applicants are in the courtship phase of a relationship with the Commission, Staff, and customers, they dispute the Commission's regulatory authority to protect the public interest, withhold information, eschew public disclosure, and leave critical questions unanswered. What does this portend for the future if this application is

granted? Does this body of experience in the regulatory affairs of a public utility show that granting this application will serve customers and will be in the public interest?

The Staff and customer groups have spent over nine months analyzing this application. The deeper one drills into the details, the more questions and concerns emerge. The Staff and customer groups are not naïve about the status quo of PGE, its liabilities, and the paths to the ultimate resolution of its ownership status. It is telling that given a choice between the applicants' proposal and the status quo, the Staff and major customer groups conclude that customers will be better off under the status quo, with its trajectory toward permanent new ownership status. They reject the applicants' proposal as failing to provide adequate protections, failing to result in a net benefit and failing to be in the public interest. They urge the Commission to deny this application or, if it is granted, to impose upon it the rigorous conditions that are essential to better protect customers and help produce a net benefit.

Upon a close and thoughtful examination of the application, the Commission should reach the same conclusion.

Dated this 3<sup>rd</sup> day of December, 2004.

Respectfully submitted,

/s/ Mary Ann Hutton

Mary Ann Hutton

Canon and Hutton

Southern Oregon Office:

1141 NW Kring St.

Roseburg, OR 97470

Phone: (541) 440-9717

Fax: (541) 440-2320

Email: mah@canonandhutton.com

Attorney for Associated Oregon Industries