BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1121

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

REPLY BRIEF OF THE CITY OF PORTLAND, OREGON

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I. Uncertainty is the only certain aspect of this Application.

There is a clear point of demarcation between those advocating in favor of the proposed acquisition and against it.[1] The Applicants describe the range of harms and risks identified by Staff and intervenors as speculative or irrelevant because they are merely possible, rather than absolutely certain to occur.[2] However, the intervenors have had to evaluate the Application based upon information provided by the Applicants that is, at best, incomplete.

The Applicants describe a range of benefits based on expectations about the future—for example, insisting that TPG's management expertise will benefit PGE and its ratepayers—that are accompanied by anecdotes of past efforts but no assurances of achieving specific future outcomes.

After weighing the harms and the benefits, the Applicants and Staff suggest that the Commission has limited authority to impose conditions in order to make certain that the public interest is served by the proposed acquisition.[3] The conditions sought by the intervenors do not constitute a "wish list."[4] Nor are the intervenors asking that the Commission "give out favors and make everybody happy."[5] Rather, the intervenors are struggling to come to grips with a proposed acquisition that presents "unique complexity, opacity, uncertainty and risks."[6] The conditions proposed by the various intervenors have rough proportionality to the risks posed by the proposed acquisition, and fundamentally relate to the substantial harms that may occur to PGE customers and Oregonians in general as a result of the proposed transaction.

II. Oregon law requires the Applicants to prove that the acquisition will provide actual

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[11] AOI Opening Brief (*AOI Opening)*, p. 29 ("[O]nly the Applicants are in support of the transaction as proposed.")
[2] Enron Opening Brief (*Enron Opening*), pp. 10-13.
[3] *Enron Opening*, pp. 15-26; Staff Opening Brief (*Staff Opening*), p. 38 fn. 10.
[4] *Enron Opening*, p. 26.
[5] *Id.*
[6] *AOI Opening*, p. 8.

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benefits to PGE's customers, outweighing any risks and potential harms.

The Commission may only approve the proposed acquisition if it can determine that "the application will serve the public utility's customers in the public interest." ORS 757.5111(3). "[T]o find net benefits, the expected overall benefits of the proposed acquisition must outweigh its expected risks and harms."[7] The proposed acquisition must leave PGE's customers better off than if the transaction did not occur. Absence of harm to PGE's customers is not sufficient.

In reaching this determination, the Commission must consider whether the utility will potentially suffer degradation of services, higher rates, weakened financial structure or diminution of utility assets. ORS 757.506. The Commission must determine that the proposed acquisition will measurably improve the utility's strength and services – better services, stronger financial structure and an increase in utility assets.[8] The Commission is under an affirmative duty to approve only proposed acquisitions that are "more than neutral with respect to utility customers."[9] The multiple risks and potential harms of the proposed transaction must be mitigated or offset to restore PGE customers to their current position, and benefits must be provided to improve that position.[10] The lesson that the Commission must draw from recent history is that "the best of intentions do not guarantee results and the unthinkable may indeed become the reality."[11]

Enron suggests that the intervenors have the burden of "prov[ing] a demonstrably increased risk of harm to customers."[12] But this inappropriately shifts the burden of proof. The burden of proving that the application is in the public interest is upon the Applicants at all

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[7] *Staff Opening*, p. 3.
[8] *BOMA Opening Brief (BOMA Opening)*, p. 2; *CUB Opening Brief (CUB Opening)*, p. 5 (Transaction must provide "discernable improvement" for the position of utility customers).
[9] Order No. 01-778 at 10; *ICNU Opening*, p. 7.
[10] *ICNU Opening*, p. 6.
[11] *AOI Opening*, p. 8.

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times.[13]

Because the Applicants have failed to meet the required standard for approval, the City of Portland has concluded with other intervenors and Staff that the Commission should deny the Application.[14]

III. The Commission should compare the Application to PGE's current status and its foreseeable future.

The City agrees with other intervenors that the appropriate baseline for evaluation the proposed acquisition is PGE's current situation.[15] Any comparison must be to PGE's status quo – operational, financial, legal and structural.[16]

PGE is currently in "good shape . . .operating as a locally managed, financially healthy, stand alone utility."[17] PGE does not currently operate under "financial pressures for debt service or dividends for its parent company."[18]

> If PGE is not sold, under the Chapter 11 Plan the shares of PGE's common stock will be distributed over time to the Debtors' creditors. Until shares are distributed to creditors, Enron will retain the right to sell PGE if it is determined that a sale would be in the best interests of the creditors.[19]

> [If] the sale to Oregon Electric does not close and Enron does not enter into any alternative transaction for the sale of PGE, the distribution of **Enron's entire interest in PGE will occur in a single transaction**.[20]

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[12] *Enron Opening*, p. 13.
[13] *Staff Opening*, p. 4; City of Portland Opening Brief (*COP Opening*), p. 4.
[14] *See ICNU Opening*, p. 6, p. 11; *BOMA Opening*, p. 10; *CUB Opening*, p. 4 ("We support denial of the application."); *Staff Opening*, p. 2 ("Staff recommends the Commission deny the Applicants' Application as presented")
[15] *ICNU Opening*, p. 17.
[16] *AOI Opening*, p. 19.
[17] *AOI Opening*, pp. 20-23. *But see, CUB Opening*, p. 9, "The status quo of PGE currently is one of uncertainty and change."
[18] *ICNU Opening*, p. 11.
[19] *ICNU Opening*, p. 10; *BOMA Opening*, pp. 9-10; *Staff Opening*, p. 35.*Enron Opening*, p. 11 fn. 5.
[20] Enron 1/Bingham 6 (emphasis added).

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Until PGE emerges as "a publicly traded, stand-alone company" the conditions imposed in the Enron merger will continue to apply.[21]

While PGE does need to have its ultimate ownership status resolved to reduce outside distractions and achieve long-term ownership stability, this status will be resolved with or without the proposed acquisition. Enron's ownership will end either way.

IV. The proposed acquisition poses unprecedented risks and potential harms to PGE's customers.

The Applicants argue that the "alleged" harms identified by the intervenors and Staff are speculative, are not related to the merger, or will not occur "unless approved by the Commission."[22] The Applicants' arguments suggest that they are exclusively positioned to evaluate potential risks or to identify potential harms associated with the proposed acquisition, and thus they are uniquely qualified to identify appropriate conditions – all else is supposition and conjecture.[23] Under the Applicants' analysis, the only "harms" that the Commission may consider would be the inevitable devastation of utility service, unavoidable rate increases, the actual weakening of a utility's financial structure or tangible reductions of utility assets.[24]

There is a more significant range of uncertainty as to how Texas Pacific Group will exercise its control over PGE and how it will dispose of PGE. The Applicants cannot condemn others for arguing from a degree of uncertainty and yet offer little in the way of specifics. At its heart, the Applicant's criticism is directed at the flaws of a proceeding in which the Commission is asked to pass judgment upon a proposed transaction.

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[21] *Staff Opening*, pp. 34-36.
[22] *Enron Opening*, pp. 10-11 and 23.
[23] PGE Opening Brief (*PGE* Opening), pp. 1-2; *Enron Opening*, p. 3 ("house of cards of assumed negative outcomes in an uncertain future"); OEUC Opening Brief (*OEUC Opening*), p. 1 fn 4 (incorporating Enron's arguments by reference).
[24] "[A]ny harm . . . must not be remote." *Enron Opening*, p. 5.

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When only informed projections about the future are possible, the past is instructive. For example, it is a fact that S&P downgraded PGE's credit outlook as a result of OEUC's proposed financial structure.[25] While TPG and PGE argue that this will not directly cause PGE's cost of capital to increase, PGE's witness acknowledged that OEUC's capital structure can be expected to increase PGE's cost of capital.[26]

A. PGE ratepayers will be saddled with new obligations to pay off debt associated with the acquisition.

It is beyond question that after the transaction there will be more debt associated with PGE. While the debt will be nominally held by the holding company, PGE's earnings will be the sole source of revenue for the debt service.[27] "Increased leverage places pressure on the ability to generate revenues which may lead to cutting expenses with resultant negatives on service quality or safety."[28] Correspondingly, "[s]hareholders benefit from double-leveraged financing because it allows them to borrow money at lower cost than the allowed ROE, and pocket the difference."[29]

PGE argues that the additional debt will have no impact upon the price PGE pays for power.[30] However, PGE fails to acknowledge its current reliance upon the power market to cover power generating shortages. Generally, power contracts contain performance assurance conditions tied to the other party's credit worthiness.[31]

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[25] "Rating services responses have uniformly concluded that the TPG transaction [will not be] an improvement over the status quo, if anything, it represents a serious deterioration." *CUB Opening*, p. 30.
[26] PGE/100/Piro 20-21.
[27] Application, p. 6, lines 7-8; OECU revised Ex. 9 (filed July 13, 2004).
[28] *Unisource Energy Corp. (Reorganization)*, Recommended Order, E-04230A-03-0933, p. 36 (November 8, 2004) http://www.cc.state.az.us/utility/electric/uns-0933.pdf (website accessed December 1, 2004).
[29] *CUB Opening*, p. 28 citing Staff 200/Morgan 28.
[30] *PGE Opening*, p. 7.
[31] *See, e.g. Enron N. Am. Corp. v. Media Gen., Inc. (In re Enron Corp.)*, 2004 WL 1197243 (S.D.N.Y. May 28, 2004); *Enron Power Mktg., Inc. v. City of Santa Clara (In re Enron Power Mktg., Inc.)*, 2003 WL 68036 (S.D.N.Y. January 8, 2003).

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> In the regulatory maze, dollars can not be color coded. Increased costs of operation for PGE might be shifted to customers through a variety of mechanisms such as power cost adjustments and revenue decoupling. As debt increases, so does OEUC's need to ensure there is sufficient income to service the debt.[32]

PGE's credit rating has already gone down because of Enron's activities.[33] There might be other impacts of the debt servicing in causing pressures to make questionable cuts in PGE's costs, potentially jeopardizing service quality.[34]

Credit-rating agencies have already expressed concerns over PGE's future financial stability by downgrading its credit watch outlook.[35] The Applicants' apparent lack of concern about PGE's cost of capital underscores their short-term planning horizon.[36] While much can change—both for PGE and for capital markets generally—in the foreseeable future, the lack of concern of PGE's potential owner should be a serious red flag.

B. Evidence in the record shows PGE will have to immediately borrow when the transaction closes.

At the end of the second quarter 2004, PGE had $200 million in cash on hand.[37] Texas Pacific's plan for financing the transaction assumes a simultaneous dividend at closing of approximately $240 million, and leaving $10 million on hand for PGE as cash balance.[38] This leaves a potential gap of $50 million.

How will this shortfall be made up? The most likely scenario is that PGE will borrow to pay the full anticipated dividend amount.[39] "OE's plan is to establish a new $250 million

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[32] *AOI Opening*, p. 18.
[33] *Staff Opening*, p. 20 (describing negative impacts upon credit quality.); *EWEB Opening Brief* (*EWEB Opening*), pp. 4, 14.
[34] *Staff Opening*, p. 21.
[35] ICNU 201/Antonuk-Vickroy1-2.
[36] OEUC 200/Wheeler 15.
[37] Transcript Record (TR) Vol. 1, Piro x-exam by Davison, p. 20, lines 23-24.
[38] *OEUC Opening*, p. 6; Application, p. 17, lines 14-27; OEUC Ex. 20, p. 3.
[39] TR, Vol.1, Piro x-exam by Davison, p. 21, p. 23 lines 17-18; *EWEB Opening*, pp. 13-14 ("PGE will have to borrow to pay the catch up dividend.")

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revolver at PGE which will be available at closing but is expected to be undrawn."[40] Yet, PGE may draw on its revolver to provide the required dividend.[41] Thus, despite claims that PGE will not need to borrow to fund debt service dividends, "the first thing that PGE will have to do at the close of the transaction is issue debt to fund a dividend payout."[42]

As PGE otherwise notes, a gap of $50 million represents approximately one percent shift in PGE's debt/equity ratio.[43] The new unsecured line of credit will increase debt ratio to 50-52%, decreasing equity to a range of 48-50%.[44]

Oregon Electric's double leverage debt will impose pressure upon PGE to deliver regular, high dividends. This fact is already shown in the "catch-up" dividend to be paid to Enron as part of the purchase agreement. "If PGE were to have a poor financial performance, PGE could be forced to borrow on its line of credit to fund its dividend to OEUC, which could result in credit rating companies lowering PGE's credit rating."[45]

PGE is not unique in paying dividends.[46] There is no controversial aspect to this fact. What is different is that this is a regulated utility with captive customers. Oregon Electric is borrowing in anticipation of servicing the debt with PGE's dividends, which will be its unique and sole source of revenues.[47] PGE does not currently operate in a business environment that places it under such financial pressures to pay dividends to its parent company.[48] But for Oregon

[40] OEUC Ex. 20, p. 1, fn. 3.
[41] TR, Vol. 1, x-exam of Piro by Davison p. 21.
[42] *ICNU Opening*, p. 25.
[43] *PGE Opening*, p. 11, Exhibit 1. PGE does not cite its sources for this calculation. However, perhaps some deference is owed as PGE possesses unique "knowledge" and "experience" regarding its finances. *PGE Opening*, p. 2.
[44] TR Vol. 1, Piro x-exam by Davison, p. 21 lines 10-14.
[45] Staff/200, Morgan/28.
[46] *Enron Opening*, p. 22.
[47] Application, p. 6, lines 7-8; OEUC revised Exhibit 9 (filed July 13, 2004).
[48] *ICNU Opening*, p. 11; Application, p. 17, line 11 (noting that PGE has not paid a cash dividend to Enron since 2001).

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Electric's proposed acquisition, PGE would not be saddled with a new, non-productive debt burden of $700 million.

Enron argues that Oregon Electric would be no more motivated than any other shareholder to withdraw dividends from PGE.[49] However, this ignores the reality that Oregon Electric has a very limited reason for being. It will receive dividends from PGE, and then turn around and pay the debt service on the $700 million being borrowed to acquire PGE. Oregon Electric is not necessarily differently motivated; it simply has a different time horizon in which to achieve its investment objectives. It has to squeeze its investment expectations into a truncated timeline, different from the normal expectations of utility investors.

Oregon Electric suggests that applying dividends to pay off the transaction debt would benefit ratepayers.[50] However, no testimony indicates that paying ahead defers obligations to make the next regularly scheduled debt payment.

C. The Applicants have not provided evidence that costs will be prudently reduced, while preserving system safety and reliability.

The Applicants argue that "[p]rudent cost-cutting will benefit customers in the long-term, because lower costs result in lower rates."[51] However, lower costs result in lower rates only to the extent that these reduced costs are taken into account in a rate proceeding. Otherwise, reductions in costs merely go directly to the utility's bottom line.[52]

It is difficult to ascertain the full scope of potential risks posed to PGE customers of cost cutting where "few of the specifics have been put into a written plan."[53] Risks of cost cutting

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[49] *Enron Opening*, pp. 11-12.
[50] *OEUC Opening*, p. 35.
[51] *Enron Opening* , p. 12.
[52] *Cf.*, *PGE Opening*, p. 9 (arguing that increases in PGE's costs due to Enron bankruptcy did not result in higher rates for PGE customers, as no rate adjustment occurred during that time period).
[53] *See also*, Staff 1000/Durrenberger 4. The essential difficulty is "determining how much can be cut without affecting system safety and reliability." Staff 1000/Durrenberger 3. Customers will have to

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may be acceptable to customers of fast food restaurants and clothing chains, who have the ability to obtain hamburgers or sweaters from another, fungible provider.[54] However, these risks are unacceptable to customers who are dependant upon the provision of an essential utility service.

D. Negative consent rights are merely one aspect of how investor and customer interests may come into conflict.

"[N]egative consent rights could impair PGE's ability to effectively run the utility and . . . substantially increase the risk of impairing PGE's financial integrity."[55] While the Applicants may defer to management on day to day operations, the negative consent rights provide veto authority over significant operational aspects of PGE.[56] Such control being wielded by an entity with no prior experience in the public utility sector is troubling and potentially harmful to ratepayers. If the acquisition is approved, the risk of operational and financial decay increases because the new owners have no practical experience in the regulated electric utility business.[57]

E. If the Applicants' assumptions are incorrect, the ratepayers will suffer the consequences.

The Applicants assert that it would be a "complete departure from the regulatory compact under which PGE currently operates" and "extremely difficult to imagine" that Commission would not allow PGE "to recover its costs in rates over sustained periods of time."[58] "If the conditions were beyond PGE's immediate control, PGE management would certainly recommend to its board that it seek assistance from the Commission to allow PGE an opportunity to earn its authorized rate of return."[59] These statements cannot be reconciled with

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suffer the long term consequences of short-term cost slashing long after TPG may be gone. *AOI Opening*, p.16.

[54] "TPG is no more interested in owning and operating an electric utility than it is in making hamburgers or yellow cardigan sweaters." *CUB Opening*, p. 2.

[55] *ICNU Opening*, p. 5.

[56] *BOMA Opening*, p. 6.

[57] In contrast, there is no current risk of an outside entity vetoing board decisions. *ICNU Opening*, p. 17.

[58] *OEUC Opening*, p. 24.

[59] *PGE Opening*, p. 6.

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other assurances that "if Oregon Electric's ownership results in a higher cost of capital or revenue requirement at any time during the period of its ownership, then PGE's customers will be held harmless."[60] In the end, the Commission does not provide revenues to PGE – the ratepayers are the ones who ultimately serve as the source of these revenues. The Commission merely determines if the utility's request is reasonable, and then divides up the revenue requirement among customer classifications.

F. The proposed transaction will impose new, multiple layers of complex organizational structure over PGE.

The Applicants have proposed creating a unique and highly complex holding company structure that is designed for the sole purpose of avoiding regulations intended to protect customers.[61] PGE could wind up "mired in a needlessly complex holding company structure [facing] credit rating downgrades, increased cost of revolver debt and the prospect of unreasonable cost cutting at the hands of a firm that claims such 'efficiencies' as its specialty."[62]

G. Corporate restructuring to accommodate the new multilevel organization, and avoid PUHCA, poses additional risks for ratepayers.

Oregon Electric has set out to create a separate subsidiary, the Portland General Term Power Procurement Company (PPC), solely for the purposes of having interstate trading activities attributed to PGE.[63] This spin-off is essential to Oregon Electric's ability to secure exemption from regulation under PUHCA.[64] This creates significant affiliate concerns for PGE that would not exist in absence of this proposal.[65] PGE and Oregon Electric have asked for

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[60] *OEUC Opening*, p. 34. *See also*, *PGE Opening*, p. 3 (Oregon Electric has agreed PGE's customers will not pay higher rates due to its ownership.)
[61] *ICNU Opening*, p. 13. *See also*, *ICNU Opening*, pp. 14-15 (describing the proposed "PUHCA pretzel" that will be created between and among Texas Pacific, OEUC and PGE).
[62] *ICNU Opening*, p. 11 (citations omitted).
[63] *ICNU Opening*, p. 19.
[64] TR, Vol. 2, x-exam of Schifter by Davison p. 184.
[65] Staff observes that "The risks inherent with this transaction, . . ., especially the amount of the debt involved, make it prudent for the Commission to keep control over the actions taken by the companies to

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waivers of affiliate transfer pricing policies for transactions between PPC and PGE.[66] This is otherwise contrary to the argument that federal oversight of PGE is unwarranted because state oversight will be "sufficient."[67] Recent investigations of past trading practices between PGE and Enron demonstrate the difficulty of monitoring and controlling affiliate trading practices. Additional risk of abuse in affiliate trading would not be present in the absence of Oregon Electric ownership.[68]

H. Numerous layers of corporate structure will obscure how the related entities interact.

Oregon Electric argues that one of its beneficial aspects is that it will have lower overhead costs because it will be a "lean company with few employees."[69] However, there is no assurance that acquiring "legal, financial, accounting, and other general business advice . . . from outside the company" will necessarily hold costs to a reasonable minimum.[70] There is no evidence that this is necessarily the case. In contrast, Texas Pacific is willing to provide "ongoing monitoring and advice" to Oregon Electric, much as it does with its other portfolio company investments, at an annual rate of $5 million per year.[71]

V. Any beneficial aspects of the proposed acquistion will accrue primarily to investors.

> While [the Applicant's] alleged benefits are certainly laudable, their value is reduced because they are relatively nebulous in nature. Further, most of these benefits represent a "given" in that the Commission expects PGE to have safe, reliable service (indeed it is required to do so by law), that it be accountable to the community, etc.[72]

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expand into new lines of business." *Staff Opening*, p. 33 lines 14-17. However, Staff is apparently not similarly concerned with spinning off the trading unit.

[66] *ICNU Opening*, pp. 19-20.
[67] OEUC 5/Schifter 4.
[68] *ICNU Opening*, pp 20-21.
[69] *OEUC Opening*, p. 36.
[70] *Id*.
[71] *Id*., at 38 – 39, *citing* OEUC 600/Wheeler 18-19.
[72] *Staff Opening*, p. 21

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Commitments to make expenditures that would have to be made in any event in order to provide adequate services at reasonable rates can not be viewed as a benefit of the transaction.[73]

A. Local headquarters and charitable donations are status quo aspects of PGE, not benefits created by the proposed acquisition.

A review of the Applicants' list of benefits reveals that the Applicants are arguing that the appropriate base case against which to compare the proposed acquisition would be the sale of PGE to another entity that would relocate its corporate headquarters, replace its senior management and slash its corporate giving program. However, there is no evidence in the record showing any basis for believing that PGE's current headquarters or charitable giving would change if this merger were not approved. While there may be benefits to retaining the current management team, PGE's current operations and its relative success cannot be attributed solely to the performance of the two individuals who have been identified as continuing on post-merger. PGE has been a generous supporter of Oregon communities and charities in the past, and the efforts of the company and its employees are to be applauded. There is no evidence in the record, however, that charitable giving programs would be cut or curtailed if the proposed acquisition did not occur.

In any case, the Commission would be in a position to weigh in on any such future transaction. The impact upon local communities could, and likely would, be weighed by the Commission in such a transaction.

B. Indemnification of PGE for Enron-related liabilities will certainly provide more benefits to investors than for ratepayers.

The Commission has authority to deny PGE the ability to recover from ratepayers costs

[73] ORS 757.020 requires public utilities to "furnish adequate and safe service, equipment and facilities." Maintaining capital expenditures at levels adequate to meet this standard is a current legal requirement for PGE, not a benefit to PGE's customers to be provided by the proposed acquisition. *ICNU Opening*, p. 38.

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associated with Enron-related liabilities.[74] Part of the value of the indemnifications arises from the highly leveraged nature of the transaction. As a stand alone entity, PGE might be better suited to take a liability hit than it would on top of its burden for generating revenues to service Oregon Electric's debt. Thus, the indemnification is a benefit to Oregon Electric and Texas Pacific, not the ratepayers.

VI. Fundamental questions about how PGE will be operated after the proposed acquisition remain unanswered.

The record lacks basic, fundamental information on the details of the financial aspects of the proposed transaction.[75] There are still no final financing contracts or operating agreements for the Staff, intervenors or the Commission to review.[76] Fundamental aspects of the proposed transaction are still unsettled, unresolved or simply vague as to details. Financing has not been secured, SEC approval has not been obtained, and details of basic aspects of the transaction have not been provided. The Commission should not take it on faith that things will work out for the best and that OEUC has the interests of PGE's ratepayers in mind.[77] Intervenors have been unable to provide an in-depth analysis of PGE's finances if the acquisition is approved because the financing instruments have not been finalized with the potential lenders.

One of the few sources of comparative data available to staff, intervenors and the Commission is the Applicants' due diligence reports and presentations to rating agencies, which all assume substantial cost reductions and specify target areas for cost reductions.[78] Due diligence may not stand for more than "possible areas where Oregon Electric may look for

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[74] *Staff Opening*, p. 22; *AOI Opening*, p. 27; Staff 200/Morgan 8-9.
[75] *ICNU Opening*, p. 23
[76] *Staff Opening*, p. 20.
[77] *ICNU Opening*, p. 2.
[78] *ICNU Opening*, p. 30. "Although there are few, if any, operating synergies [between new owners and PGE], many of TPG's financial model runs indicate operating cost and capital reductions." ICNU/200, Antonuk-Vickroy/13).

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improvements."[79] However, at this point in time these are the best source of information as to Texas Pacific's intentions. One of the other sources of information is Texas Pacific Group's private plans for PGE, which were designated as confidential.[80]

A. The negative consent rights are not yet finalized.

The Securities and Exchange Commission (SEC) is currently considering applications from Texas Pacific and Oregon Electric for exemption from regulation under PUHCA. The transaction cannot close without the issuance of a No-Action Letter for Texas Pacific from the SEC.[81] SEC staff have indicated that they will not recommend issuing a No-Action Letter but instead have asked Texas Pacific to file a standard application, which it did in August 2004.[82] OEUC has provided a revised list of consent rights it is proposing to the SEC, but these are subject to further modification through the SEC proceeding now underway.[83] Until the SEC puts its blessing on TPG's relationship with OEUC, the consent rights can't be considered final. This is simply another moving target.

B. The overall value of any indemnification for PGE has not been determined.

Another unquantifiable aspect of the acquisition is the specific amount of potential liabilities which may be covered by the OEUC indemnification. Four general categories of potential liability have been identified, with varying limits on payments.[84] The value of indemnifications is uncertain because "Applicants [have] failed to provide valuation data underlying the potential liabilities for which the Applicants are offering the indemnification."[85]

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[79] *OEUC Opening*, p. 43.
[80] *CUB Opening*, p. 17 (Noting distinction between TPG's public statements regarding corporate governance and private thoughts). "Any specific plans about PGE's future have been kept wrapped up in confidentiality." *AOI Opening*, p. 14, citing ICNU 104/Schoenbeck 17-22 (Confidential).
[81] Enron 2/Bingham 5.
[82] OEUC 900/Schifter3; TR, Vol. 2, x-exam of Schifter by Davison, p. 179.
[83] OEUC 901/Schifter 1-2.
[84] *AOI Opening*, p. 25.
[85] *Staff Opening*, p. 23.

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C. The value of local representatives is an unquantifiable unknown.

TPG argues that local representatives would bring "a higher degree of accountability and greater sensitivity to local issues."[86] However the record is empty of any evidence of how the other Oregon electric utilities have benefited from having local representation.[87] PGE is already a local company, with a functional board of directors focused on providing safe, reliable and cost-effective energy to its customers.[88] Moreover, the assertion of local representation on the PGE Board is illusory. Texas Pacific's control over PGE's decision will trump.[89]

D. While it is one of the fundamental statutory criteria, the Applicants lack any prior operating experience in the utility sector.

ORS 757.511(2)(g) requires the applicant to provide "detailed information" regarding applicant's experience in operating public utilities. Texas Pacific and Oregon Electric have no prior operating experience in managing a fully regulated, monopoly utility.[90] The value that Texas Pacific may bring in terms of business acumen cannot be meaningfully ascertained.

E. Even at this late juncture, there are apparently no final partnership agreements or financing documents.

The partnership agreements for Oregon Electric have not been finalized.[91] Among other important aspects, this agreement will serve to delineate key obligations between Texas Pacific and the Local Applicants. Yet this information is not available for the Commission's consideration.[92]

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[86] *OEUC Opening*, p. 18.
[87] *ICNU Opening*, p. 11; *COP Opening*, pp. 27-28 (other local utilities operate with local representatives).
[88] *ICNU Opening*, p. 16; ICNU/906 at p. 5, lines 14-17, p. 18, lines 14-18 and p. 30 line 13 (Fowler Deposition).
[89] *AOI Opening*, p. 11.
[90] *Id.*, p. 12.
[91] TR, Vol. 2, x-exam of Schifter by Walters, p. 187.
[92] As a further indication of delays in providing complete details of basic, essential information, at the eleventh hour the Commission has received an application from Oregon Electric's general counsel to appear *pro hac vice*. The application is limited to participating in oral argument at the December 13th hearing and does not address the numerous pleadings already filed with the Commission in this

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VII. Imposing conditions upon the proposed acquisition does not result in this transaction being in the public interest.

The Applicants assert that their proposed conditions are more than sufficient to address the "perceived risks" of the proposed acquisition.[93] The Applicant's proposed conditions fall into two broad categories: 1) tending to provide some beneficial aspects of the transaction flow through to customers, e.g. rate credit, indemnification and extension of service quality measures; or, 2) tending to protect PGE and its customers from potential risks and harms posed by the transaction, e.g., ring-fencing, access to books and records.[94] Applicants' conditions are offered as a package only.[95] Staff also views its conditions as a package. However, Staff has designated some conditions as more important than others.[96] In the end, Staff acknowledges that any proposed "conditions are imperfect – time will tell if they are in fact sufficient to protect PGE's customers at the public at large."[97]

The Applicants complain that Staff's proposed conditions are "unique" or not applied to previous mergers and acquisitions.[98] For example, PGE complains of Staff's proposed change in the calculation of the equity ratio.[99] However, Oregon Electric acknowledges that the Commission must approach each merger based upon its unique qualities.[100] The Commission's consideration of any conditions must be occur in the "context of unique circumstances of this

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proceeding. *See, OEUC's Motion to Allow Thad Miller to Appear Pro Hac Vice at Oral Argument* (filed December 2, 2004).

[93] *Id.*, pp. 13-14.

[94] *OEUC Opening*, pp. 12-13.

[95] *OEUC Opening*, p. 12 ("comprehensive package of conditions"); OEUC 500/Davis 34.

[96] *Staff Opening*, p. 5.

[97] *Staff Opening*, p.2.

[98] *PGE Opening*, pp. 10-11. *But see*, Application, p. 4 "The proposed acquisition is unlike any this Commission has addressed in the past."

[99] *PGE Opening*, pp. 11-12.

[100] *OEUC Opening*, p.15. Compare, *Enron Opening* , p. 24 (discussing Commission's consideration of the prior six proceedings under ORS 757.511). Enron spends a good portion of its Opening Brief essentially arguing for reconsideration of the *Legal Standards for Mergers* Order. *Enron Opening*, pp. 6-9.

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transaction, including regulatory complexities and risks inherent in the proposed ownership structure, the dynamics and incentives of short-term ownership, and the potential risks of the high level of debt."[101]

Overall, the Applicants' conditions simply fail to provide adequate protection and transparency.[102]

A. The proposed rate credits do not provide sufficient benefits to PGE's customers to outweigh the risks of additional debt and an owner with no prior operating experience.

The Applicants have proposed a rate credit "based upon what OEUC believed might be an achievable level of savings in the next general rate case."[103] However, the Applicants did not provide documentation "to support any claim that rate credit is in an amount 'achievable' in savings in the next rate case."[104] .[105]

Staff proposed a rate credit of $75 million spread over fifteen years. Staff offers various rationales to support this rate credit. The rate credit "is intended to offset . . .worrisome concerns that remain despite a related condition."[106] Staff then argues that the "[r]ate credits should correspond to applicants' projected returns on their short-term investment in PGE."[107] On the other hand, Staff suggests that the rate credit will recapture the tax benefits created by the structure of the proposed acquisition:

> The acquisition proposed in this proceeding will lead to substantially increased debt leverage at the consolidated level . . . On an expected basis, this increased leverage will yield an income tax benefit of approximately $15 million annually. These savings, along with system efficiencies, will be available to OEUC to fund

[101] *AOI Opening*, p. 29.
[102] *ICNU Opening*, p. 2.
[103] OEUC 500/Davis 23.
[104] *ICNU Opening*, p. 34; ICNU 501.
[105] *Staff Opening*, p. 17.
[106] *Id.*, p. 19.
[107] Staff 800/Conway 12.

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> rate credits the Commission finds necessary as part of this transaction.[108]

Having ratepayers fund the rate credit is simply "no benefit at all."[109] In the end, Staff's proposed rate credit serves too many masters, rendering it inadequate for its many tasks.

Determining the amount of the rate credit must start by considering the "complexities and risks inherent in the proposed ownership structure, the dynamics and incentives of short-term ownership, and the potential risks of the high level of debt."[110] In estimated 2004 amounts, the rate credits established in prior merger proceedings ranged between $57 million for Scottish Power (with identified synergies of merging two utilities) to $164 million for Enron (with no associated synergies).[111]

In comparison, a reasonable starting point for the proposed acquisition would be the $97 million rate credit established in the Sierra Pacific proceeding.[112] A rate credit in this amount would be roughly proportional to the benefits that the Applicants will enjoy as a result of the merger.[113] It would also serve to offset the substantial risks and potential harms that will be imposed upon PGE's customers.

Enron argues that rate credits are inappropriate to the proposed acquisition, citing prior proceedings in which ORS 757.511(3) was applied but no rate credits imposed.[114] Each of these transactions involved corporate reorganizations, not acquisitions of the utility by a previously

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[108] Staff 1200/Johnson 4, lines 15-21; *CUB Opening*, p. 36 (Identifying staff's proposed rate credit as being the same amount as the identified tax benefit that TPG will enjoy from the double leveraged debt.)
[109] *CUB Opening*, p. 41.
[110] *AOI Opening*, p. 29.
[111] *ICNU Opening*, p. 34 Table 2. *Cf.*, *Enron Opening* , p. 25 (undisputed that this transaction involves no cost savings or synergies similar to Sierra Pacific).
[112] *ICNU Opening*, p. 35.
[113] *See*, Staff 200/Morgan 22-23 (noting that investor returns will be increased by almost $40 million per year due to the double leverage of OEUC's debt).
[114] *In re PGE, UF 3972 Order No. 86-106* at 8 (January 31, 1986); *Idaho Power*, UM 877 Order No. 98-056, 1998 WL 460304 (Feb. 17, 1998); *Pacificorp, UM 1021*, Order No. 01-573 (July 10, 2001) (http://www.puc.state.or.us/orders/2001ords/01-573.pdf).

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unaffiliated third-party.

The Commission has itself previously distinguished *PGE*, saying:

> In Order No. 86-106, we determined that under ORS 757.511 we had jurisdiction over the transaction under which Portland General Electric Company became a wholly owned subsidiary of Portland General Company. We did not enunciate a legal standard for mergers in that order. Our discussion there is therefore not dispositive as precedent here.

Legal Standard for Approval of Mergers, Order No. 01-778, 212 PUR4th, 449 2001 WL 1285993 (2001).

In *Idaho Power*, new affiliated entities were created for the express purpose of business efficiency and separating marketing activities from other subsidiaries. No parties objected to the restructuring of the company. In *Pacificorp*, all of PacifiCorp's common stock was transferred to a newly formed, nonoperating U. S. holding company in exchange for 100 percent of the capital stock of the holding company. No other consideration was involved, and no financing was required. The restructuring served to further separate PacifiCorp's non-utility business from its utility operations, reducing risks to ratepayers. None of those prior proceedings bears any similarity to the current application.[115]

B. The Commission's ability to obtain information on how post-merger PGE will be controlled is not adequately addressed.

The Commission's access to Oregon Electric's records would be limited to information pertaining to PGE. Proposed Condition No. 12. Why is this necessary if PGE will be Oregon Electric's only asset?[116] The Applicants' tendencies to seek to withhold essential information have already been demonstrated in this proceeding.[117] These are the actions of an entity

[115] *Compare*, Application p. 4 "The proposed acquisition is unlike any this Commission has addressed in the past.
[116] Application, p. 6 lines 7-8.
[117] *See, e.g.*, Applicants' Motion for Additional Protection under Protective Order (filed April 20, 2001).

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unaccustomed to the level of transparency normally provided in the setting of utility regulation.[118]

> If the Commission cannot access information from the true decisionmaker, . . . 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.[119]

C. The Commission must plan for the future by anticipating the eventual resale of PGE.

Enron argues that no endgame conditions should be considered "because Oregon Electric's acquisition of PGE does not increase uncertainty about PGE's future ownership."[120] Concerns on the endgame are due entirely to the structure of the proposed acquisition: The entity acquiring the utility has absolutely no interest in holding on to the company for an extended period of time. The proposed acquisition increases uncertainty because the certainty of a future change in ownership is absolute. Knowing that PGE will have to be resold, Texas Pacific has devoted significant resources to planning on how to set up PGE for resale.[121] Ignoring this situation would constitute "a dereliction of the Commission's duty to protect and enhance the interests of current and future PGE customers."[122]

A condition addressing endgame concerns would correspondingly provide PGE customers with assurances for the future. A condition addressing the endgame would address on-going problems of revolving door ownership by providing a means for transitioning to stable, long-term ownership of PGE. This would benefit PGE's customers, employees and the general community. These concerns are entirely within the Commission's fundamental charge to protect the public interest.

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[118] *ICNU Opening*, p. 24 fn. 9.
[119] *CUB Opening*, pp. 20, 36-37.
[120] *Enron Opening* , p. 16.
[121] *CUB Opening*, p. 20, citing CUB 107, 108, 109 and 110; ICNU 104/7-14 and 17-20 and ICNU 10.

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"[A]n option to buy . . . for an Oregon local government or consortium of local governments"[123] could take the form of a right of first refusal or an option to purchase. Under a right of first refusal, the utility owner would still receive top dollar for their asset. A right of first refusal merely may serve as a starting point in the bidding process. Similarly, an option to purchase doesn't necessarily equate with ultimately prevailing, but may constitute a right to meet a top dollar offer.

D. The Commission's authority to protect the public interest is an inextricable aspect of its manifest responsibilities to protect the utility's ratepayers.

Enron argues that the Commission authority to impose conditions applies only to applications that would otherwise fail the statutory test, and that the conditions must remedy harms that customers would suffer.[124] Enron cites *Edgar v. MITE Corp*, 457 US 624 (1982) for the proposition that the Commerce Clause only permits "incidental regulation of interstate commerce by the States; direct regulation is prohibited." Enron fails to note was that the plurality decision determined that the state statute was incompatible with federal statutes governing securities regulation, and was thus preempted. [125] Enron's brief does not correspondingly discuss any federal statutes that preempt ORS 757.511.[126]

The local interest of the State in regulating utility mergers is to prevent utility assets from being endangered. If the proposed transaction harmed the utility's net worth or jeopardized its

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[122] *CUB Opening*, p. 33.
[123] *Id.*, p. 41.
[124] *Enron Opening*, pp. 15-26.
[125] *Cf.. CTS Corp. v. Dynamics Corp.*, 481 US 69 (1987) (noting, in discussing a different section of the *MITE* plurality opinion, that "[a]s the plurality opinion in *MITE* did not represent the views of a majority of the Court, we are not bound by its reasoning")
[126] *Cf., S.D. Myers, Inc. v. City and County of San Francisco*, 253 F.3d 461 (9th Cir 2001). ("Upon close examination of Supreme Court precedent it is apparent that the Court has never invalidated a state or local law under the dormant Commerce Clause based upon mere speculation about the possibility of conflicting legislation.")

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financial well-being, the utility would seek higher rates from captive ratepayers for survival.[127] The ratepayers have a corresponding right to be protected from being placed in such jeopardy.

Oregon Electric argues that the Commission may protect PGE's customers simply by wielding a "wide variety of regulatory tools that collectively provide a comprehensive system that effectively protects customers."[128] This begs the question of what happens if Oregon Electric later takes the position that the "Commission lacked authority to impose restrictions on [PGE's] decision-making regarding payment of dividends to shareholders"?[129] What if Oregon Electric asserts that the conditions are unlawful because "[t]he Commission is not the financial manager of the corporation, and it is not empowered to substitute its judgment for that of the directors of the corporation"?[130] These arguments align with another argument made by Staff:

> [A] request to bind a future Commission, . . ., is contrary to the Commission's authority under ORS 756.568, which allows the Commission to rescind, suspend or amend an order at any time. The only potential way that this Commission could bind a future commission would be if the Commission entered into a contract with a utility or customer group. There is nothing in ORS 757.511 that suggests the conditions the Commission may impose on an application rise to the level of a contract that a future Commission may not alter.[131]

ORS 756.568 authorizes the Commission to "rescind, suspend or amend any order made by the commission." The Commission has previously exercised this authority when there has been "good cause to reopen a proceeding and further examine a matter essential to the

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[127] *OEUC Opening*, p. 24; *PGE Opening*, p. 6. *Compare*, *Arizona Corp. Comm'n v. State ex rel Woods*, 171 Ariz 286, 830 P2d 807 (1992), discussed in *Unisource Energy Corp. (Reorganization)*, Recommended Order, E-04230A-03-0933, pp. 7-8 (November 8, 2004) http://www.cc.state.az.us/utility/electric/uns-0933.pdf (website accessed December 1, 2004).
[128] *OEUC Opening*, p. 44.
[129] *OEUC Opening*, p. 33 fn. 156 (citations omitted).
[130] *Id.*, p. 33 (citations omitted).
[131] *Staff Opening*, p. 38 fn 10.

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decision."[132] The Commission has previously found "good cause" encompassed by changed circumstances or correction of a prior erroneous conclusion.[133] Under this scenario, what assurances are there that any conditions imposed by the Commission won't be subject to reconsideration? The apparent answer is none. Every one of the proposed conditions is only as valuable as the future Commission's willingness to abide by it and enforce it. In the end, the only certainty in the future is that it is coming, all else is merely a range of probabilities.

VIII. Conclusion

The level of "acceptable" risk and potential harms must necessarily be lower for a regulated electric utility than for a competitive business. There is no viable alternative to electric service for the vast bulk of PGE's customers. The loss of electric service could jeopardize lives, while skyrocketing rates would sink local economies. The proposed acquisition introduces risks for ratepayers to which they would not otherwise be exposed. The purported benefits claimed by the Applicants are insufficient to outweigh the potential detriments and risks of increased leverage and power over key utility decisions concentrated in an entity that lacks experience in the public utility sector. For all of the reasons set forth above, the Applicants' request for approval of the proposed acquisition should be denied.

If, however, the Commission decides to approve the transaction, it must impose conditions to assure comprehensive financial protections; transparency and access to information; continuity of programs benefiting customers; rate credits necessary to assure a net

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[132] *PacifiCorp*, UE 121 UE 127 Order No. 02-853, 2002 WL 31991885 (December 10, 2002) (Finding good cause to reopen proceeding to approve stipulation resolving some issues between some of the parties.) *See also*, OAR 860-014-0095(3) (Administrative rule identifying circumstances under which Commission will consider reconsideration.)

[133] *See, e.g., Application of PGE for Approval of Customer Choice Plan*, Order No. 98-279, UE 102 (July 15, 1998) (change in procedural postures of case warranted modification); *Application of PGE and PP&L for Territorial Allocation*, Order No. 92-557, UA37/UA41, 133 PUR 4th 145 (April 16, 1992) (revising territorial allocation order).

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benefit for customers and enforcement rights for all parties. The Commission should also consider low-income issues and conditions to address those as part of public interest,[134] as well as environmental concerns that are cost-effective and provide a diverse, lower risk resource investment policy.[135] These types of conditions were considered in the Commission's net benefits determination in Scottish Power.[136] The City finally supports Staff's purported condition No. 38 regarding the timely completion of franchise negotiations between the City of Portland and PGE. Such a condition would address long-standing questions regarding PGE's legal authority to occupy the public right-of-way within the Portland city limits.[137]

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[134] ORS 757.612(7)(f). "[P]aying 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." *CUB Opening*, p. 43.

[135] ORS 469.010. *See also*, UM 550, Order No. 94-727, p. 1 "[O]bstacle to [development of renewable resources] should be removed and policies to promote renewable resource development should be adopted." The Applicants' proposed condition would give PGE another "eight years to match the same amount of renewables that PGE's IRP says that they will do in the next two years." *CUB Opening*, p. 44.

[136] *Id.*, p. 8.

[137] *Cf. Application of PGE and PP&L for Territorial Allocation*, Order No. 92-557, *supra* (concluding that no conflict existed between territorial allocation statutes and municipal franchising authority because a utility must obtain authority from municipality to provide service within the city and must separately obtain Commission's approval for exclusive service territory).

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The City joins with other intervenors in asking that if the Commission determines to approve the proposed acquisition, that it consider imposing conditions as suggested by CUB, ICNU, AOI, Renewable Northwest Project, CADO-OEAC, EWEB and BPA[138], American Hydropower and others. The gaps that are otherwise left by this Application are simply too large to overcome. As proposed, the acquisition will not serve the public interest as that standard has been most recently interpreted by the Commission.

DATED this 3rd day of December, 2004.

Respectfully submitted,

/s/ Benjamin Walters

Benjamin Walters, OSB #85354
Senior Deputy City Attorney
City of Portland

[138] EWEB asks that PGE ratepayers and the public at large be protected from the potential financial consequences of PGE forcing unanticipated Trojan expenses. *EWEB Opening*, p. 3. These are the types of risks that the Commission should consider in weighing possible conditions.

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CERTIFICATE OF SERVICE

I hereby certify that I caused to be served the foregoing REPLY BRIEF OF THE CITY OF PORTLAND, OREGON, on behalf of the City of Portland, Oregon, upon the parties shown on the attached official service list for Docket No. UM 1121, by causing the same to be electronically served on all parties who have an e-mail address on the official service list, and by U.S. Mail, postage prepaid, to those parties who do not have an e-mail address on the official service list.

DATED this 3rd day of December, 2004.

/s/ Benjamin Walters

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