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3 **BEFORE THE PUBLIC UTILITY COMMISSION**
4 **OF OREGON**
5 **UM 1121**
6

7 In the Matter of
8 OREGON ELECTRIC UTILITY COMPANY, LLC,
9 et al.,
10 Application for Authorization to Acquire Portland
11 General Electric Company
12
13

14 **REBUTTAL TESTIMONY**
15 **OF**
16 **KELVIN L. DAVIS**
17 **ON BEHALF OF OREGON ELECTRIC**
18 **(REDACTED VERSION)**
19
20

21 **August 16, 2004**
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I. INTRODUCTION

Q. Please state your name.

A. My name is Kelvin L. Davis. I previously offered direct and supplemental direct testimony in this proceeding.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the direct testimony filed by Oregon Public Utility Commission Staff (“Staff”) and various intervenors on July 21, 2004.

Q. Please provide an overview of Oregon Electric’s rebuttal testimony.

A. My rebuttal testimony, along with the rebuttal testimony of others offered in support of Oregon Electric Utility Company, LLC (“Oregon Electric”),¹ will make abundantly clear that this transaction provides a net benefit to PGE’s customers. In addition to the benefits set out in our prior testimony, we will propose concrete, quantitative benefits and qualitative benefits in the form of new conditions. Specifically, Oregon Electric proposes to:

- Provide a \$15 million rate credit to PGE customers
- Make PGE the sole beneficiary of an indemnity against potentially substantial Enron-related liabilities
- Enhance transparency by filing SEC-type disclosure statements quarterly and annually with the Commission
- Accept conditions designed to assure that PGE’s capital structure remains intact and that customers bear no costs attributable to Oregon Electric’s capital structure.

¹ Throughout this testimony, I will use “Oregon Electric” to refer to Oregon Electric Utility Company, LLC, or to all Applicants, as the context may imply.

1 Our rebuttal testimony also will demonstrate that any potential risks or harms of
2 the Proposed Transaction are minimal. Indeed, the primary risks posed by this
3 transaction are those borne solely by the investors in Oregon Electric. We will show that:

- 4 • PGE and its **customers are protected** against risks posed by Oregon
5 Electric's debt. First, PGE's customers are not responsible for Oregon
6 Electric's debt—this debt is the risk of Oregon Electric's equity investors.
7 Second, the capital structure for Oregon Electric is prudent and sound. Our
8 financial modeling and projections, which have been thoroughly reviewed by
9 Commission Staff, show that even in the highly unlikely event that PGE
10 experiences a period of unprecedented financial declines, the dividends from
11 PGE will be sufficient to meet Oregon Electric's debt obligations without
12 impacting PGE's planned O&M and capital expenditures.
- 13 • PGE's **cost of capital is unlikely to rise** as a result of the acquisition. Current
14 guidance suggests that the only PGE credit rating affected will be its
15 unsecured debt rating, and PGE does not currently plan to issue new
16 unsecured debt until 2010. By this time, Oregon Electric will have
17 significantly decreased its debt, which will have a positive impact in PGE's
18 credit rating.
- 19 • In light of the robustness of Oregon Electric's capital structure, PGE will have
20 **no need to cut costs** to produce dividends to Oregon Electric. Rather, the
21 PGE Board can lead PGE in a review of its operations to identify productivity
22 and process improvements that result in sustainable decreases in its cost
23 structure—an activity that mutually benefits PGE's customers and PGE's
24 equity owners.

- 1 • PGE’s customers, the Commission, and PGE’s equity owners are equally
2 aligned on the **value of investing in PGE’s future** and, specifically, in PGE’s
3 ability to continue to provide safe and adequate service at reasonable rates.
4 This will both increase the value of PGE’s equity as well as continue to secure
5 reliable service for customers. Concerns to the contrary are counter to both
6 financial and regulatory theory and practice.

7 The harms alleged are either non-existent or are addressed by conditions that
8 mitigate or eliminate the harms. The benefits far outweigh the remaining *de minimus*
9 harms. The transaction clearly provides customers with a net benefit.

10 **Q. Are others filing rebuttal testimony in support of Oregon Electric?**

11 A. Yes. My testimony is submitted in conjunction with that of the following witnesses, all
12 of whom are providing testimony in support of Oregon Electric’s Application:

- 13 ■ Carrie Wheeler, TPG Principal, who will address aspects of Oregon Electric’s
14 financing and capital structure;
- 15 ■ Jerry Jackson, former Arkansas Public Utility Commission member, energy industry
16 executive, and prospective member of PGE’s Board of Directors, who will discuss the
17 role of a utility board of directors and some of the issues raised by the parties from
18 the point of view of a board member;
- 19 ■ Dr. Karl McDermott, economist and former member of the Illinois Commerce
20 Commission, who will address the strengths and benefits of the Proposed Transaction
21 from the viewpoint of a former regulator and economist;
- 22 ■ Jim Piro, the Chief Financial Officer of PGE, who will confirm his expectations that
23 Oregon Electric’s capital structure will have no negative impact on PGE’s business,
24 and discuss his experience with PGE’s access to capital after Enron filed for
25 bankruptcy, and other matters;
- Patrick Hager/Jay Tinker/Jim Murray of PGE, who will address cost of capital and
 income taxes issues, the impact on costs at PGE of leaving the Enron corporate
 family, and the efficacy of an earnings sharing mechanism;
- Steve Hawke and Bill Elliott of PGE on Staff’s proposed billing accuracy and service
 quality measures; and
- Robert Bingham of Enron, who will address certain claims by the parties as to what
 actions Enron may take in absence of the Proposed Transaction.

1 **Q. Please summarize your own rebuttal testimony.**

2 A. Two themes run throughout the testimony of Staff and certain intervenors that I believe
3 need to be addressed. The first theme suggests that Oregon Electric's interests as an
4 investor in PGE are inconsistent with responsible stewardship of PGE (sometimes
5 referred to as "the company"), now and in the future. Consistent with this assumption,
6 the parties suggest that Oregon Electric may cause PGE to take actions that will harm
7 PGE and its customers. The second theme builds on the first and implies that Oregon
8 Electric will take actions to harm PGE outside the structure of the regulatory framework
9 adopted by the Oregon legislature and interpreted and enforced by the Oregon Public
10 Utility Commission ("Commission").

11 My testimony responds to these suggestions by demonstrating that Oregon
12 Electric's goals as an investor are not only consistent with, but actually require,
13 responsible stewardship of PGE. I also discuss how conscientious adherence to the
14 Commission's policies and requirements are part of this responsible stewardship.

15 Finally, I further describe and define some of the benefits offered by the Proposed
16 Transaction, and address the progress that has been made on conditions to approval to
17 which Oregon Electric, Staff, and other intervenors have stipulated to date.

1 **II. OREGON ELECTRIC’S INVESTMENT IN PGE’S FUTURE**

2 **Q. Throughout their testimony several of the parties suggest, both implicitly and**
3 **explicitly, that Oregon Electric’s interests as an investor in PGE are inconsistent**
4 **with responsible stewardship of the company.² Can you comment?**

5 **A.** Yes. I have reviewed the testimony of Staff and the intervenors and note that they seem
6 to believe that, as an investor, Oregon Electric will somehow benefit by failing to invest
7 in PGE and its customers. These suggestions are without merit. My short answer is that:

- 8 • Oregon Electric does not intend to cut costs at PGE irresponsibly; and
- 9 • Oregon Electric does intend to invest prudently in PGE’s systems.

10 First, as I discussed in my direct and supplemental testimony, Oregon Electric
11 cannot be successful if it does not promote and serve the interests of its customers.³ As is
12 the case with all of the businesses in which TPG has invested over the years, our
13 customers’ success is our success. If Oregon Electric were to take actions to degrade
14 service quality and reliability, or to undermine safety or unjustifiably raise rates, almost
15 every action PGE must take would become more difficult because customers and
16 regulators would be dissatisfied. Industrial customers, many of whom have already been
17 hard-hit by a challenging economic and competitive environment, may choose to leave
18 PGE’s service territory or close their doors altogether. Regardless of what level of
19 practical choices PGE’s customers have, we hope to encourage a company culture that
20 assumes that every customer has choices and that customer loyalty and patronage needs
21 to be re-earned day in and day out.

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24 ² See, e.g., CUB/100, Jenks-Brown/11-12 (CUB suggests that, as a short-term investor, Oregon Electric will “let
25 maintenance slip,” “reap the saved dollars for a few years,” and let a subsequent owner deal with the result while
the owners of Oregon Electric are “sipping martinis elsewhere.”).

³ See Oregon Electric/3, Davis/12-13; Oregon Electric/22, Davis/3-4.

1 TPG has built its reputation on improving the companies in which it invests,
2 including helping them become more responsive to customers and more effective in
3 meeting their needs. Oregon Electric hopes to do the same for PGE. Thus, failing to act
4 in a manner that builds prosperity and loyalty among PGE's customers is completely
5 contrary to Oregon Electric's goals.

6 Moreover, contrary to the parties' suggestions, a failure of Oregon Electric to
7 responsibly steward PGE would be inconsistent with its financial interests. In order for
8 Oregon Electric to realize a profit on its investment, it must build value in PGE. PGE's
9 value is a function of where the company is tomorrow and beyond, and that means that
10 the company's long-term prospects will be an important part of its value when Oregon
11 Electric decides to sell. Thus, maintaining and improving PGE's value requires
12 responsible and prudent management and steady investment in the business. Conversely,
13 harming the company now, or taking actions now that could harm the company in the
14 future, would decrease the company's value. Promoting short-term savings at the
15 expense of long-term growth, stability, and customer prosperity is simply inconsistent
16 with sound investment principles and Oregon Electric's stated goals.

17 Oregon Electric is committed to being a responsible owner of PGE. Oregon
18 Electric recognizes that the success of its investment is entirely dependent on the success
19 of PGE. PGE's success is in turn dependent on providing safe, reliable, and cost-
20 effective electricity in a fashion that builds the trust and confidence of its customers and
21 regulators. Any actions that impair PGE's ability to deliver these services would
22 decrease the value of the company and, therefore, the value of Oregon Electric's
23 investment. That is one important way in which the interests of Oregon Electric, its
24 investors, PGE, and PGE's customers are aligned.

1 **Q. The testimony of many of the intervenors suggests that any cost-cutting would be**
2 **misguided, or not in the interests of PGE’s customers.⁴ Can you comment?**

3 A. I find this suggestion to be short-sighted and contradictory. Not all “cost-cutting” or
4 “savings” are detrimental to the company or its customers. While many intervenors have
5 repeatedly warned the Commission about the dire consequences of irresponsible cost
6 cutting, they also consistently voice concerns about PGE’s electricity rates. Given that
7 rates are cost-based, responsible cost savings will benefit customers over time through
8 lower rates. For this reason, Oregon Electric has committed that, after closing, PGE’s
9 management and Board of Directors will initiate a full review of the company—with the
10 goal of gaining information that will help us operate the company as effectively and
11 efficiently as possible.⁵ Oregon Electric has no incentive to cut costs irresponsibly;
12 rather, it has every incentive to sustainably decrease PGE’s cost structure, if possible,
13 while maintaining the safety and reliability that have been hallmarks of PGE’s service.

14 A. *Oregon Electric’s Incentives to Make Prudent Short- and Long-term Investments in PGE*

15 1. Short-term Investments

16 **Q. Several intervenors argue that short-term cost cutting and postponement of**
17 **necessary capital expenditures will actually increase PGE’s value to a future buyer**
18 **and maximize Oregon Electric’s investment returns.⁶ Is this accurate?**

19 A. No. Pursuing such short-sighted measures would be much more likely to decrease value
20 than increase it. With all due respect to those making these arguments, TPG has invested
21 in over 50 companies and has substantial experience in this area. Our experience
22 confirms that a good business meets its customers’ needs as efficiently and effectively as
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24 ⁴ See, e.g., Staff/300, Durrenberger/3; ICNU/200, Antonuk-Vickroy/13; CUB/100, Jenks-Brown/10-11.

25 ⁵ See Oregon Electric/22, Davis/4-8 (regarding “Review Process Plan”).

⁶ See, e.g., CUB/100, Jenks-Brown/8-9; CUB/200, Dittmer/29.

1 possible. It would be absolutely contrary to the interests of our customers for Oregon
2 Electric to fail to maintain PGE's assets and operations. Our interests as owners – our
3 hopes to build value at PGE – are only served by taking excellent care of our customers.

4 Second, underspending on operations and maintenance could put PGE, and thus
5 Oregon Electric's investment in PGE, at risk. If PGE fails to invest amounts necessary to
6 maintain safety and reliability, the result could well be injury to employees and/or the
7 public, or a plant failure resulting in unplanned downtime. Needless to say, we would be
8 worse than foolish to act in a fashion that increased the risks of such occurrences.

9 Finally, certain intervenors appear to misunderstand the factors that drive PGE's
10 value in the market. The testimony of these intervenors suggests that Oregon Electric
11 will fail to make responsible short- and long-term investments in the company, and yet
12 will still be able to sell PGE for a substantial profit. This notion would have to be
13 predicated on the belief that the market is populated by naïve investors who are willing to
14 spend vast sums of money to purchase a company without determining the condition of
15 the company's assets. This is not the marketplace in which we operate. In fact, if PGE
16 were to irresponsibly cut costs or postpone necessary expenditures in order to increase
17 cash flow and earnings, as feared by the intervenors, then Oregon Electric would not only
18 be unlikely to realize a profit on its investment, but more than likely find it difficult to
19 sell PGE.⁷

20 The due diligence process we followed before deciding to purchase PGE points
21 up the fallacy of the intervenors' concern. Before committing to invest in PGE, TPG
22 conducted intensive due diligence analyses to determine whether to pursue the
23 investment and, if so, the appropriate terms and purchase price. In addition to performing
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25 ⁷ This notion also seems to imply an ability to "quickly" sell PGE. As PGE's experience over the last five years suggests – and my experience over the last two years – no one "quickly" sells (or buys) a utility.

1 its own intensive review of PGE’s financial characteristics – as described in
2 Carrie Wheeler’s testimony – TPG worked with consultants to perform due diligence
3 analyses of PGE’s operations. One group of consultants reviewed PGE’s operations and
4 structure, including PGE’s load forecasts, operational and administrative costs, and rates.
5 This group also examined the electric market and regional macro-economic matters.
6 Another group of consultants reviewed PGE’s physical assets, including generating
7 resources and transmission infrastructure, power marketing operations, energy supply
8 positions, and support systems and functions.

9 Any future potential buyer of PGE is certain to conduct a similar due diligence
10 investigation before making a commitment to acquire PGE. In this process, the potential
11 buyer would surely observe the results of any imprudent cost cutting.⁸ Thus, while a
12 superficial revenue/expenditure might suggest that PGE’s value would be marginally
13 improved by making irresponsible cuts to operations or maintenance, any sophisticated
14 valuation – the type conducted by parties who intend to place billions of dollars at risk –
15 would reflect the diminished value resulting from this type of short-sighted measure.

16 2. Long-term Capital Investment

17 **Q. In a similar vein, several intervenors have argued that because Oregon Electric is a**
18 **“short-term” investor it will lack the incentive to make substantial expenditures to**
19 **further a long-term strategy for PGE.⁹ Can you comment?**

20 **A.** Yes. As I have just explained, we believe that prudent ongoing investment in PGE will
21 actually increase the company’s value. For this reason – among others – Oregon Electric
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23 ⁸ For example, as noted by Staff witness Ed Durrenberger, TPG’s due diligence investigation included the
24 conclusion that the level of deferred maintenance was not an issue at PGE. See Staff/300, Durrenberger/5. Any
25 future buyer is likely to conduct the same investigation. If that future buyer concluded that the level of deferred
maintenance had increased, the value of PGE could decrease.

⁹ See, e.g., COP/100, Anderson/6; CUB/100, Jenks-Brown/8-9, 11-12; ICNU/200, Antonuk-Vickroy/36-37.

1 has every incentive to make such investments. Our incentive is that much greater when it
2 comes to substantial investments in PGE's long-term future.

3 One of the greatest challenges facing PGE today is that it is significantly "energy-
4 short." In today's energy markets, this short position harms the company's owners and
5 customers both directly and indirectly. First, it meaningfully increases PGE's exposure
6 to market volatility, decreasing PGE's earnings stability, and thus diminishing the
7 inherent value of the company. Second, this short position hurts PGE's customers by
8 exacerbating their exposure to unpredictable increases in power costs. Such
9 unpredictable increases may fall especially heavily on customers for whom power cost
10 stability and predictability may be particularly important. And, as I explained above,
11 PGE will only prosper when its customers prosper. Thus, Oregon Electric is motivated to
12 effectively address the company's energy "short" position through long-term investments
13 in cost-effective generation resources or contracting for energy supply that should both
14 enhance earnings stability and reduce power cost volatility.¹⁰

15 In Section III, I will discuss in more detail why Oregon Electric specifically
16 supports the company's planned Port Westward project as an integral part of PGE's
17 overall plan to address its short position. Suffice it to say here that it will require a very
18 significant sum of money to construct Port Westward. If Oregon Electric was not
19 committed to investing in PGE's long-term prospects, it would be unlikely to support this
20 expenditure.

21 I would also note that while Port Westward represents a very positive step in
22 reducing PGE's short position, even after it and the other investments contemplated by
23 the Integrated Resource Plan ("IRP") Action Plan are completed, PGE will continue to
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25 ¹⁰ Although history has convinced us of the risks posed by PGE's short position, it is worth noting that the extent
of these risks was only fully appreciated in the context of the Western power markets crisis during 2000 and 2001.
The 2002 Integrated Resource Plan has been an important first step in responding to this appreciation.

1 have a substantial short position. I am confident that, under Oregon Electric ownership,
2 PGE's Board of Directors will actively look for additional opportunities for PGE to cost-
3 effectively obtain or build long-term generation resources and to enter into long-term
4 contracts as additional investments in PGE's future.

5 The notion that very significant capital investments are desirable and necessary
6 for a company to effectively meet its customers' needs is far from foreign to TPG. In
7 fact, TPG strongly believes in the importance of capital investment for the success of its
8 investments. Some examples of this are:

9 1. **Continental Airlines.** TPG's principals invested in Continental from 1993
10 to 1998. During this six year period, with TPG's full support, Continental revitalized its
11 fleet by taking delivery of approximately \$5.5 billion in new aircraft. This represented a
12 substantial long-term capital investment in the infrastructure of the airline that has proven
13 to be crucial to Continental's ongoing success and strong competitive positioning in the
14 industry.

15 2. **Seagate Technology.** TPG initially invested in Seagate in 2000 and
16 continues to hold an investment in the company. Seagate is an industry leader in the
17 design, manufacturing, and marketing of disc drives. Since TPG's initial investment,
18 Seagate has made approximately \$1.9 billion in capital expenditures, primarily to
19 maintain, upgrade and expand its manufacturing and R&D facilities. As a high tech
20 company, continually being on the cutting edge of the "technology curve" is crucial to
21 Seagate's success. As such, TPG has always supported Seagate in robust capital
22 expenditures and R&D investment programs.

23 3. **PETCO Animal Supplies.** TPG initially invested in PETCO in 2000 and
24 continues to hold an investment in the company. PETCO is the second largest pet food
25 and supply retailer in the United States. During TPG's investment period to date,

1 PETCO has expanded its store base by 33%, growing from 490 stores in 2000 to 654
2 stores today. To support this expansion, PETCO's annual capital expenditures in 2004 is
3 140% higher than 2000 levels. TPG has fully supported this capital expenditures
4 program in recognition that an expanding store base is crucial to PETCO's long-term
5 growth, competitive positioning, and value.

6 4. *J.Crew.* TPG invested in J.Crew in 1997 and continues to hold an
7 investment in the company. J.Crew is a well-known retailer of stylish, quality mens' and
8 womens' clothing. With TPG's support and guidance, J.Crew undertook an expansionary
9 capital expenditures program to grow into new markets and locations. The result: seven
10 years later, J.Crew has expanded its store base by approximately 300%, from 39 stores in
11 1997 to 155 stores today and is well positioned strategically for the future.

12 5. *MEMC Electronic Materials.* TPG invested in MEMC in 2001 and
13 continues to hold an investment in the company. MEMC is one of the top four silicon
14 wafer suppliers in the world. From 2001 to 2003, under TPG's ownership, MEMC's
15 annual capital expenditures increased by 70% from 2001 to 2003, and is forecasted to
16 double by 2004. As with Seagate, TPG has supported a robust capital expenditures
17 program at MEMC in recognition that such investment is crucial to the company's
18 long-term success and value.

19 I would also note that, particularly with respect to PGE's long-term planning
20 process, we understand that the Commission and other stakeholders are integrally
21 involved in these deliberations through the IRP process. In that process, the Commission
22 and all of the stakeholders participate in evaluating PGE's expectations of long-term load
23 requirements and resource planning. The Commission will continue to exercise this
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1 oversight and authority over PGE's long-term planning no matter who owns PGE,¹¹ and
2 we will look forward to working with all stakeholders to chart a course for PGE's future.

3 **Q. Are your arguments on this point undermined by the due diligence reports that**
4 **Staff and certain intervenors claim show that Oregon Electric plans to make cuts to**
5 **O&M and capital expenditures?**

6 A. No. The parties refer to reports produced by TPG's consultants during the due diligence
7 investigation. These reports produced preliminary findings that suggested that certain
8 cost savings might be achieved in PGE's operations and capital expenditures budgets.
9 However, the parties misunderstand the nature and uses of due diligence reports. These
10 reports were never intended to be, and will not be, relied upon for the formulation of any
11 cost-cutting plans at PGE.

12 *B. The Limited Application of Due Diligence Reports*

13 **Q. Please explain what you mean by "due diligence" reports.**

14 A. In the context of a corporate acquisition, the term "due diligence" generally refers to the
15 investigation of a business undertaken by a potential buyer. The purpose of due diligence
16 in this context is to provide the potential buyer with sufficient information to determine
17 whether to pursue the transaction and, if so, the appropriate terms and purchase price to
18 inform the negotiating and documentation process.

19 **Q. What activities does due diligence typically involve?**

20 A. In the course of due diligence, a buyer will seek to identify a company's strengths,
21 weaknesses, assets, liabilities, and opportunities by examining the company's competitive
22 positioning, operations, financial condition, material legal and regulatory issues, the
23 condition of major physical assets, labor and employee issues, and organizational
24 structure, among other things. As part of financial due diligence, prospective buyers will

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¹¹ See OAR 860-038-0080 (requiring resource plans to be filed with the Commission).

1 perform financial modeling in order to predict a broad range of possible scenarios with
2 respect to future financial performance. These scenarios are informed by the buyer's due
3 diligence findings, which are typically limited by the level and quality of information to
4 which the buyer has access.

5 **Q. Staff and several of the intervenors have characterized TPG's due diligence work as**
6 **cost savings proposals or plans.¹² Is this an accurate characterization?**

7 A. No. While due diligence work can provide important information about the status of a
8 company and the value of its assets, it has inherent limitations and is not intended to
9 result in operational plans for the company.

10 Most of the recommendations regarding possible savings produced by TPG's
11 consultants were the result of a number of "benchmarking" exercises they performed to
12 investigate and establish a universe of potential efficiencies for inclusion in TPG's
13 financial modeling. Benchmarking involves the comparison of certain of the target
14 company's financial and operating metrics to information regarding "comparable"
15 companies in the industry. The purpose of this exercise is to identify the target
16 company's relative strengths and weaknesses, as well as potential areas for improvement.

17 In this case, in order to benchmark PGE, TPG's consultants compared PGE to
18 other utilities using information about those other utilities contained in their 2002 FERC
19 Form 1 filings. This data allowed TPG to see how PGE "stacked up" in various areas
20 with other utilities. However, the "comparable" utilities were almost certainly different
21 from PGE with respect to significant factors—including inherent characteristics of
22 service territory, weather patterns, generation resources, and use of outsourcing for
23 various tasks; such differences may significantly undercut the meaningfulness of the
24 benchmarking's conclusions.

25 ¹² See, e.g., ICNU/200, Antonuk-Vickroy/36; CUB/200, Dittmer/29-30.

1 Thus, while the results of the benchmarking performed by TPG’s consultants
2 during the due diligence phase provided some data that could be incorporated into the
3 financial modeling in order to predict a range of plausible results, it is by no means of the
4 character or type of data that could serve as the basis for an operational plan.

5 In addition, all the due diligence analyses performed by TPG’s consultants were
6 necessarily limited by the fact that they were conducted from an external vantage point
7 and with only the limited information provided to TPG and its consultants during the due
8 diligence process. The findings were not vetted by PGE to test their validity. Most
9 importantly, the due diligence analyses on which the findings were based did not consider
10 the potential impact of any cost-cutting measures or productivity enhancements on
11 customer service and reliability. Thus, these preliminary due diligence investigations
12 cannot be regarded as an indication of what ultimately will be achieved; rather, they
13 should be regarded as an indication of where to look for process improvements.¹³

14 **Q. But don’t TPG’s model scenarios assume that Oregon Electric will make cuts to**
15 **PGE’s O&M and capital expenditure budgets?**

16 **A.** As Ms. Wheeler discusses in her testimony, TPG used its financial model to run 48
17 different scenarios in order to gain an understanding of a broad range of potential
18 financial outcomes for PGE and the associated return and value implications under
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22 ¹³ Staff and some of the intervenors suggest that the amount of time and money invested in TPG’s due diligence
23 investigation, as well as the experience and expertise of TPG’s consultants, is an indication that the due diligence
24 reports will be used as the basis for operational plans at PGE. However, such an expenditure of time, money, and
25 resources is not unusual during the due diligence phase of a transaction of this magnitude. Only post-closing,
Board-directed work – with a significant involvement of management – will result in operational plans.

1 each.¹⁴ Certain of TPG's financial model scenarios did include reductions from PGE's
2 forecasted amounts of O&M expenditures. However, many of the model scenarios
3 included no such O&M reductions. Importantly, such reductions are certainly not
4 required in order for PGE to prove successful as an investment.¹⁵

5 Specifically with respect to capital expenditures, I would point out that in *all* of
6 TPG's financial modeling, TPG assumed that PGE would continue to expend
7 maintenance-oriented capital on a basis consistent with historic levels. In some
8 scenarios, the level of expected capital expenditures was varied modestly to reflect the
9 possibility of achieving capital efficiencies, but never to the full extent discussed in the
10 consultants' due diligence analyses. Attached as Oregon Electric/101, Davis/1-2 is a
11 chart depicting capital expenditure forecasts for PGE under two of TPG's model
12 scenarios. As demonstrated by these charts, TPG's projected capital expenditures for
13 PGE exceed historical levels under these scenarios, even when *****BEGIN**
14 **CONFIDENTIAL***** [REDACTED] *****END CONFIDENTIAL***** worth of capital
15 efficiencies are assumed.

16 **Q. Are you suggesting that Oregon Electric does not believe that it will be able to**
17 **operate PGE more efficiently than it is being operated today?**

18 A. No, not at all. TPG has had great success in helping the companies in which it invests
19 operate more efficiently and effectively, while at the same time continually improving
20 their customer service. It certainly hopes to do the same for PGE. Furthermore, our
21 ambitions in this regard are shared by the members of the prospective Board of Directors
22 for PGE. Oregon Electric is quite confident that it can help PGE operate more efficiently
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24 ¹⁴ See Oregon Electric/200, Wheeler/3-4.

25 ¹⁵ See Oregon Electric/200, Wheeler/8-9. As I testified in my Supplemental Testimony, we do not expect that the Board of Directors or management would pursue any plan to significantly reduce costs unless and until such a plan were recommended as a result of an Internal Review Process.

1 without decreasing the reliability, safety, and service quality for which PGE is so well
2 known.¹⁶

3 *C. Regulatory Oversight*

4 **Q. You said that the second theme running through the parties' testimony is the**
5 **implication that Oregon Electric will make decisions and take actions with respect**
6 **to PGE outside the strictures that the regulatory framework has put in place to**
7 **protect PGE's customers. Could you comment?**

8 **A.** Yes. In conjunction with the parties' arguments that Oregon Electric's interests will be
9 served by imprudent management of PGE is their implicit assumption that Oregon
10 Electric will be able to carry out this imprudent management beyond the oversight and
11 control of the Commission.

12 First, I hope I have been clear that Oregon Electric's interests are advanced by
13 acting prudently and working in the best interests of the utility and its customers.
14 Furthermore, we have a profound appreciation for the importance of the regulatory
15 relationship and of the regulator's trust and confidence in company management and
16 ownership. To this end, Oregon Electric itself and in its role as PGE equity owner will
17 make every effort to continue to earn this trust and confidence.

18 It would be foolish for Oregon Electric to do otherwise. PGE is a heavily
19 regulated utility carrying out its operations under the scrutiny of effective regulators. As
20 Dr. McDermott explains in his testimony, the Commission has broad statutory authority

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22 ¹⁶ See Oregon Electric/22, Davis/3-8. I also note that any cost savings would not represent an overpayment by
23 customers, much less a "substantial" overpayment, as suggested by ICNU witness Schoenbeck. See ICNU 100,
24 Schoenbeck/19 ("Without an offsetting reduction in rate levels...cost savings represent a substantial overpayment
25 by ratepayers for the service being provided by PGE."). That is because, during the period between rate cases,
costs are managed by a utility on an aggregate basis. See PGE/100, Piro/*. Where, as is currently the case at
PGE, earnings fall, it is entirely appropriate – indeed prudent – to seek cost savings, provided service is not
adversely affected. Cost savings that result from merger synergies, on the other hand, although arguably a
justifiable basis for a customer rate credit, should not be confused with the entirely different and distinguishable
situation presented here, namely, that there will be no synergies.

1 with full investigatory powers and power to regulate the rates, terms, and conditions of
2 PGE's electric services.¹⁷ Under this statutory scheme, the Commission can review
3 PGE's operations and spending and question PGE's management about any concerns
4 their review may raise. As discussed above, the Commission, through the IRP process,
5 has ongoing regulatory oversight to ensure that PGE makes prudent decisions and
6 appropriate capital expenditures regarding its long-term resource needs.

7 Finally, we have increased the Commission's ability and authority to oversee
8 Oregon Electric's management of PGE through our agreement to a ten-year extension of
9 the service quality program first put in place by Enron. This program not only measures
10 actual results, but requires regular communication with the Commission regarding a long
11 list of PGE programs related to the safety and reliability of its distribution system. Few
12 actions, or failures to act, will escape Commission attention or response.

13 We disagree with those parties who claim that Oregon Electric's commitment to
14 the service quality program is not a benefit to customers. ICNU witnesses Antonuk and
15 Vickroy provide no support for their assertion that the service quality program provides
16 no protection because it incorporates only "lagging indicators."¹⁸ The witnesses may not
17 be aware that the program requires an annual and, in some cases quarterly, programmatic
18 review, so the "lag," as it were, certainly would not allow for any meaningful harm
19 before it is detected. Rather, we agree strongly with Staff's conclusion that these
20 measures are "an important regulatory tool," and that Oregon Electric's commitment in
21 this regard "provides a benefit to the customers."¹⁹ The measures have proven
22 themselves over the seven years of Enron ownership; their extension for ten years is a

23
24 ¹⁷ See Oregon Electric/400, McDermott/*.

¹⁸ See ICNU/200, Antonuk-Vickroy/6, 8, 34.

25 ¹⁹ Staff states that the service quality measures are an improvement and a benefit of the Proposed Transaction.
See Staff/600, Murray-Sipler/2; Staff/100, Conway/25.

1 clear benefit to PGE and its customers. We certainly believe that this Commission has
2 the authority, ability, and will to oversee PGE and ensure that the company is being
3 responsibly operated and maintained. We do not accept the parties' suggestions to the
4 contrary.

5 **Q. Are the Commission's and stakeholders' goals with respect to prudent stewardship**
6 **of PGE at odds with Oregon Electric's investment goals?**

7 A. No. To the extent the parties suggest that the interests of regulators and utilities are
8 always at odds, I couldn't disagree more. All these parties share the goal of customer
9 satisfaction.

10 The investors want a financially healthy utility, growing in value over time, as an
11 active partner with residents and businesses in a healthy and prosperous economic
12 environment. The customers want a healthy utility, providing safe, reliable utility service
13 at reasonable prices. The Board of Directors is responsible for ensuring management acts
14 in support of this goal, and the Commission is charged with ensuring the achievement of
15 this goal. If PGE were able to cut costs drastically and postpone necessary expenditures
16 to the point where PGE's ability to deliver safe, reliable, and cost-effective electrical
17 service was impaired, then everyone – including the Commission, stakeholder
18 representatives, Company management, and the PGE Board – would have completely
19 failed to do their jobs. We find this prospect unlikely.

20 **Q. Does TPG have any experience in other regulated industries?**

21 A. Yes. TPG, through its portfolio companies, has had considerable experience in assuring
22 that its portfolio companies work closely with regulatory bodies charged with governing
23 the industries in which those portfolio companies operate. We have held long-term and
24 substantial investments in companies in the airline, financial services, and healthcare
25 industries. From these experiences, TPG has gained a great deal of respect for regulatory

1 authority and the role that regulators play in furthering the public good. We understand
2 that the success of our investments in regulated companies depends in large part on
3 careful adherence to the applicable statutes and rules administered by the regulators. We
4 also have learned that it is essential for regulated companies to build relationships with
5 the regulators founded on mutual respect and trust. Significantly, TPG understands that,
6 as an investor, it cannot and must not influence a company to take actions that could
7 jeopardize these relationships. We also recognize that the economic regulation which
8 applies to PGE is perhaps the most comprehensive form of regulation, and we will
9 comply with the substance and spirit of that regulation.

10 **Q. Can you provide some examples of TPG's experience in working with regulators?**

11 A. Yes. As mentioned above, companies in which TPG has invested have had good success
12 working with regulators and have actively and successfully partnered with governmental
13 regulatory bodies in certain instances. In addition, TPG principals themselves (prior to
14 TPG's founding) developed a keen understanding of how to work with regulators in a
15 regulated environment. Specifically, TPG's founder, David Bonderman, was selected by
16 United States bank regulators to take over America's largest failed thrift institution,
17 American Savings, in an innovative partnership with regulators that resulted in
18 government recovery of substantial amounts of federal depositor assistance funds. The
19 thrift was rehabilitated into a sound, profitable home lender and ultimately sold to
20 Washington Mutual in a transaction that netted the Federal Deposit Insurance
21 Corporation over \$100 million. In partnership with local banking authorities, TPG
22 affiliates have pursued similar troubled bank resuscitation transactions in Germany,
23 Korea, and China.

24 In connection with the acquisition of American Savings, Mr. Bonderman was
25 approved as a "controlling person" by U.S. financial regulators, and during his oversight

1 and investment in American Savings, TPG principals were subject to the highly regulated
2 environment of financial institution controlling persons. Throughout, they maintained
3 excellent relations with bank regulators, and the FDIC entered into a second partnership
4 with the group (this one to dispose of real estate assets) following the success of the first.

5 The United States bank regulatory system is widely acknowledged to be among
6 the most comprehensive and strict governmental oversight systems, and the experience of
7 Mr. Bonderman in operating successfully in this environment testifies not only to TPG's
8 willingness to undertake commitments to partner with regulators in furtherance of
9 regulatory goals, but also their success in carrying out such commitments under actual
10 operating conditions.

11 In addition, as I mentioned in my Direct Testimony, TPG has had extensive
12 experience in the airline industry—another industry subject to broad and intense
13 regulatory scrutiny led by the Federal Aviation Administration (“FAA”). In the case of
14 Continental Airlines, TPG principals led the reorganization of the company and its
15 successful bankruptcy emergence. After the recapitalization, we installed new
16 management who effected a complete turnaround of the business. This was achieved
17 with no compromise whatsoever in regard to the safety or reliability of Continental's
18 operations, or to any other regulatory obligation. Under our sponsorship, Continental
19 recovered from bankruptcy to outperform all other airlines across a spectrum of financial,
20 safety, and customer service metrics.

21 As another example, I would point to our substantial investment in Oxford Health,
22 a large health insurer. When we purchased significant equity securities in Oxford, it was
23 experiencing terrible financial problems. The situation was so bad that doctors were
24 threatening to stop accepting Oxford patients. In order for the acquisition to close, TPG
25 needed to gain regulatory approval from the insurance departments of at least five states,

1 which required a showing of TPG's "trustworthiness," as that term is defined by the
2 regulators. That acquisition was approved and, after closing, TPG supported
3 management's intensive efforts to restore the company's financial health while
4 dramatically improving its customer service practices. During the term of TPG's
5 investment, Oxford built and maintained excellent relationships with the regulators that
6 continue to this day.

7 **III. OREGON ELECTRIC'S COMMITMENT TO PORT WESTWARD**

8 **Q. Staff and some intervenors have expressed concern that Oregon Electric is not**
9 **adequately committed to the building of Port Westward.²⁰ Can you clarify Oregon**
10 **Electric's commitment?**

11 A. Yes. The Commission has acknowledged PGE's IRP, which includes constructing a
12 generic generation facility such as Port Westward. We fully support that IRP and in
13 particular the construction of a highly efficient, gas-fired generation facility to help fill
14 PGE's energy short position and enable it to better serve its customers over the long term.
15 As a consequence of the acknowledgment of that plan, PGE is now in the process of
16 evaluating and negotiating the details of its implementation, including construction of
17 Port Westward. PGE has not made a final decision on constructing Port Westward, and
18 is keeping Oregon Electric advised on this matter, as it is obligated to do under the Stock
19 Purchase Agreement. We expect PGE will be in a position in the near term to make that
20 decision and we fully expect to support the company's position.

21 **Q. On what basis did you come to this conclusion?**

22 A. Thank you for asking. I know some in this process have expressed doubt about Oregon
23 Electric's commitment to support PGE investment in significant capital projects. By
24 explaining the process we used to examine the company's decision-making regarding

25 ²⁰ See, e.g., Staff/100, Conway/9; Staff/200, Morgan/37; ICNU/200, Antonuk-Vickroy/36.

1 Port Westward, I hope to illustrate that, as the future owners of PGE, Oregon Electric will
2 not hesitate to support capital projects that make good sense for the company and its
3 customers. The process we employed will also illustrate the thorough analysis that
4 Oregon Electric would expect to precede any such decision in order to ensure that it is the
5 best decision in the circumstances and in light of all relevant factors.

6 Our decision to support construction of a generation facility as part of PGE's plan
7 was a lengthy process that required intensive review and rigorous analysis. This analysis
8 occurred in two stages: first, we examined PGE's evolving plans to build Port Westward
9 within the context of our due diligence work during the Summer and Fall of 2003 and
10 prior to signing the Stock Purchase Agreement. During this time period, we had limited
11 access to company information; PGE was in the midst of conducting its Request for
12 Proposals ("RFP") regarding generation alternatives, and the company had not reached a
13 final conclusion on its resource options. It was only after entering into the Stock
14 Purchase Agreement that we were able to examine the issue in more detail. During this
15 second investigation in the Spring of 2004, TPG had access to significantly greater data
16 from, and interaction with, PGE. This allowed us to conduct a more complete
17 independent analysis, and, for the first time, examine Port Westward within the context of
18 PGE's draft IRP Action Plan, which detailed PGE's other proposed resource
19 commitments.

20 Based on our initial instincts and original pre-signing analysis, we had some
21 concerns about Port Westward was the best alternative for PGE and its customers. At
22 that time, we felt that there were potentially lower-cost, near-term market-based
23 alternatives that would provide customers with the benefit of attractive market pricing for
24 short- to intermediate-term electricity purchases. I'd like to note, however, that despite
25 these preliminary views, we continued to include in many of our modeling scenarios

1 sufficient capital expenditures for investment in substantial new generation capacity. We
2 have always believed that adding new generation resources to serve PGE's load
3 requirements was important to PGE's long-term prospects.

4 After entering into the Stock Purchase Agreement, and with the knowledge that
5 PGE was gaining confidence in its preliminary plans for Port Westward, we decided to
6 conduct a significantly more intensive review in order to come to our own point of view
7 on whether building Port Westward was in the long-term best interest of PGE and its
8 customers. To address this question, we focused on answering two fundamental
9 questions:

10 (1) how does Port Westward compare to other long-term energy supply
11 options for PGE; and

12 (2) is a potential delay in the building of Port Westward warranted to take
13 advantage of short-term depressed wholesale prices and excess generation capacity in the
14 Pacific Northwest?

15 It is important to note that our analysis of Port Westward did not address the value
16 of Port Westward versus other options from an investor perspective; our analysis focused
17 solely on what was in the best interests of PGE and its customers.

18 The second stage of review in the Spring of 2004 required extensive independent
19 research and thorough analysis. Overall, the research and analysis included an
20 assessment of such items as load growth forecasts, regional reserve margins, current
21 wholesale market forward curves, comparative turbine technologies, construction cost
22 estimates, transmission issues, and a detailed review of the RFP evaluation process.
23 Assisting us in this more rigorous analysis were the same consultants that had contributed
24 to our Summer 2003 evaluation. This process involved our team working closely with
25 PGE, not only to gather data, but also to take advantage of PGE's wealth of experience

1 and knowledge by vetting interim analyses and conclusions with company experts.
2 Importantly, it was at this stage of our analysis that we were able to look at the totality of
3 PGE's energy portfolio options – including short, intermediate, and long-term resources –
4 and consider how Port Westward would fit into that overall portfolio. This process was
5 thorough and data-driven and is an example of “best-practice” decision making with
6 respect to a major capital investment decision.

7 **Q. What conclusions did you reach as a result of this analysis?**

8 A. After studying the results of the second phase of our analysis, we reached the conclusion
9 that the inclusion of construction of a highly efficient, gas-fired generation facility in
10 PGE's IRP Action Plan is a prudent long-term choice, if PGE successfully completes the
11 construction agreements it is currently negotiating.

12 **Q. You said that after the first stage of your analysis, you thought there could be lower-**
13 **cost market-based alternatives that might meet PGE's energy needs more cost-**
14 **effectively than building Port Westward. Why did your thinking on this point**
15 **change?**

16 A. As I previously stated, after the initial phase of our analysis we had some concerns about
17 whether building Port Westward was the optimal choice for PGE and its customers.
18 There has been a broad overbuild of new gas-fired generation capacity in the Pacific
19 Northwest that has depressed spark spreads²¹ and left certain new gas generation units
20 unable to cover their fixed O&M and financing costs. Spark spreads at these levels
21 would normally enable a buyer of electricity to purchase power at a lower cost than the
22 cost implied by the expense required to build a new generation unit. The initial work
23 performed by our team suggested that the lower spark spreads and economic conditions
24 faced by owners of new generation units might make it more prudent for PGE to take

25 ²¹ “Spark spreads” is a term that describes the margin between the market price of electricity and the cost to make the electricity by converting natural gas into electricity at a given efficiency rate (or “heat rate”).

1 advantage of the depressed wholesale power market than to proceed in a timely fashion
2 with building Port Westward.

3 There were three primary reasons this thinking changed: (1) we came to
4 understand the impact of transmission congestion and uncertainty on the cost and
5 availability of market-based options; (2) we better appreciated the extent to which PGE
6 was already intending to take advantage of short- and intermediate-term market-based
7 resources; and (3) we saw the manner in which Port Westward fits into PGE's overall
8 energy portfolio as a highly efficient, long-term, gas-fired resource.

9 1. **Transmission:** For PGE to take advantage of the available lower-cost
10 generation capacity in the Pacific Northwest region, PGE must be assured of sufficient
11 transmission capacity for reliable delivery throughout a contract term. Although PGE has
12 access to some extra transmission capacity, that amount is not sufficient to accommodate
13 PGE's requirements. Therefore, when market-based options are considered, they must be
14 "loaded" with additional costs for transmission to PGE's control area. In addition, given
15 the amount of existing transmission capacity in the region, PGE cannot be assured that it
16 will have long-term access to sufficient transmission when it is required. The extent of
17 the transmission congestion, the uncertainty surrounding its long-term availability, and
18 the resulting impact on the cost and availability of purchased power were only clear to us
19 during the second phase of our analysis.

20 2. **PGE's Current Use of Market Resources:** Once we had access to PGE's
21 complete draft IRP Action Plan and its broader intentions with regard to its energy
22 portfolio options, we more fully appreciated the extent to which the company is intending
23 to capture cost benefits provided by the current low spark spread environment through
24 short- and intermediate-term power purchase agreements. We realized it was not
25

1 necessary to avoid or delay the building of Port Westward to take advantage of the new
2 generation overbuild in the region.

3 3. **Port Westward as Part of an Overall Portfolio:** During the second phase
4 of our analysis, we were able to see Port Westward within the context of PGE's evolving
5 IRP Action Plan addressing a portfolio of short, intermediate, and long-term resources.
6 This overall energy portfolio must balance short-term cost opportunities with long-term
7 availability and price stability, as well as overall reliability and service. There is value
8 inherent in resource diversity. Viewed in this light, we became convinced that the
9 benefits of Port Westward – including its operational flexibility, technological
10 efficiencies, transmission certainty, location advantages, and overall long-term reliability
11 – could not be favorably duplicated by market-based options.

12 **Q. Can you summarize the specific reasons that caused you to conclude Port Westward**
13 **is a better overall long-term resource option for PGE than other available**
14 **alternatives?**

15 A. Broadly stated, the following reasons were central to our conclusion that Port Westward
16 was significantly advantaged over other available in-region supply alternatives, as
17 revealed through the RFP and IRP processes:

- 18 • As a self-build option within PGE's service territory, Port Westward gives
19 PGE more control of operations and maintenance, allowing for more
20 flexibility and higher reliability.
 - 21 ○ More flexibility yields more opportunities for asset optimization;
 - 22 ○ Higher reliability lowers the likelihood of plant outages and service
23 interruptions; and
 - 24 ○ Proximity to PGE's interstate pipeline and Beaver CCGT enhances fuel
25 supply optimization opportunities.

- 1 • Port Westward is directly connected to PGE’s transmission system, providing
2 three benefits:
- 3 ○ Higher reliability due to less dependence on longer, more congested
4 transmission paths;
 - 5 ○ Lower likelihood of incurring transmission congestion prices should
6 firm capacity not be available through other contracts; and
 - 7 ○ From a capacity balance perspective, it does not exhaust limited
8 available firm transmission capacity on congested paths to PGE’s
9 transmission system (which would be required for other supply options).
- 10 • Port Westward uses a newer, more efficient turbine technology that has a
11 lower relative heat rate (*i.e.*, variable fuel cost) than other resource alternatives
12 in the Pacific Northwest region. As a result, it will dispatch more frequently
13 than other gas-fired generation in the region.
- 14 • Long-term, coal-fired resources are typically less expensive than gas-fired
15 generation, less available for contracting in the Pacific Northwest region, and
16 were not available in sufficient quantity at attractive pricing to supplant
17 generation resources to be provided by Port Westward.

18 **Q. Why did you determine a delay in building Port Westward is not warranted?**

19 A. Once we determined that Port Westward was a prudent choice for meeting long-term load
20 requirements, we then considered whether a delay in construction would best serve PGE
21 and its customers’ interests. In our analysis of this issue (again aided by our consultants),
22 we determined that there were many critical factors that required examination, including
23 the length of the delay, the capital cost of Port Westward at the time it is built, the cost of
24 alternative market supply delivered to a point other than PGE’s control area, the cost for
25 the transmission of power delivered outside PGE’s control area to the service territory,

1 and the cost of gas transport to Port Westward. Our analysis focused on establishing
2 appropriate values for these individual factors to construct a reasonable base case for
3 modeling and evaluation.

4 Ultimately, we and PGE became comfortable with establishing reasonably narrow
5 bands of assumed values for most of these variables. However, neither party could get
6 comfortable establishing a tight value range for one crucial factor—the gas transport
7 costs that PGE would face if the construction of Port Westward was materially delayed.

8 The gas transport system that would provide fuel to Port Westward has some
9 overcapacity today, but could quickly become full as others compete for that capacity.
10 Although there were firm transmission rights available to fuel Port Westward at the time
11 of the analysis, new incremental capacity would have to be added should existing
12 overcapacity be contracted during the delay period. In this case, the gas transmission
13 tariff that would be required to fuel Port Westward could more than double. In fact, from
14 a customer's point of view, the gas transport issue could have a \$90 million swing in net
15 present value based on the difference between the cost of firm transport at the time of our
16 analysis and what it might cost under a delay scenario. Given this uncertainty – and the
17 inability to lock in today's rates without significant spending on capacity that would not
18 be utilized – a delay would pose significant risk to customers.

19 Therefore, appreciating the benefits the other components of PGE's final action
20 plan offer in the short, intermediate, and long-term, we came to the point of view that
21 PGE's decision to move forward with the construction of Port Westward in a timely
22 manner is prudent and in the long-term best interests of PGE and its customers.

1 **IV. EARNINGS SHARING MECHANISM**

2 **Q. Staff and intervenors are critical of Oregon Electric’s earnings sharing proposal,**
3 **arguing instead that Oregon Electric should be offering up-front rate credits.²²**

4 **What is your response?**

5 **A.** Oregon Electric believes that an earnings sharing mechanism makes perfect sense in the
6 context of this transaction. Recognizing that for the last few years the company has not
7 earned its authorized rate of return by a substantial margin and that this acquisition would
8 not result in any cost savings from synergies to be shared with customers, we believe this
9 proposal is quite appropriate. Indeed, it reflects Oregon Electric’s optimism that within a
10 few years, PGE’s profitability will meaningfully improve as we distance the company
11 from Enron ownership and participate in an Oregon economic recovery. We would look
12 forward to sharing such increased earnings with our customers.

13 That said, we have heard from Staff and certain of the intervenors, in no uncertain
14 terms, that they regard our offer to have little or no value because the potential benefits
15 are “contingent” or “uncertain.”²³ Accordingly, they have been quite clear that they are
16 not interested in working with Oregon Electric to develop the details of an earnings
17 sharing mechanism along the lines we have presented.

18 Although we respectfully disagree that a rate credit tied to profit sharing is not a
19 benefit, we are prepared to offer a rate credit based on the same principle – sharing of
20 profits – but to offer certainty. Thus, in lieu of the sharing mechanism we have
21 suggested, we propose to make our offer unconditional—by guaranteeing to provide
22 customers with a rate credit in the amount of \$15 million. This amount is based on our
23 estimate of the amounts that would have been shared with customers in the form of profit

24 ²² See Staff/100, Conway/14-15.

25 ²³ See, e.g., Staff/100, Conway/14-15; ICNU/100, Schoenbeck/9-10; CUB/100, Jenks-Brown/27; CUB/200,
Dittmer/22-23.

1 sharing over a period of seven years from the closing. It represents approximately 50%
2 of the projected earnings in excess of a return on equity of 10.5% during this period,
3 based upon an average of numerous of the modeled financial scenarios that we have
4 provided to the Commission and requesting parties. This guaranteed benefit would be
5 paid in the form of a rate credit of \$3 million per year for five years beginning in 2007.

6 I would note that, as I explained in my Supplemental Direct Testimony, we expect
7 that it will take the first several years under our ownership to get the company back to
8 earning its authorized rate of return on equity. Consistent with this fact, our projections
9 show that PGE is unlikely to exceed its authorized rate of return until 2008. However, to
10 allow the customers to receive the benefit of our proposal a year earlier, we propose now
11 to begin the rate credits in 2007 instead of 2008. Thus, PGE's customers will receive the
12 very real guarantee of future rate credits while Oregon Electric will take the risk of
13 having to pay out this guaranteed benefit whether or not the company's financial
14 performance improves to the point of achieving its authorized rate of return.

15 To make it perfectly clear that this guarantee is concrete, it will remain in place
16 even if there is an intervening general rate case. This guarantee will also continue in the
17 event Oregon Electric sells its interest in PGE. This is an irrefutable net benefit.²⁴

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25 ²⁴ See Staff/100, Conway/9.

1 **V. INDEMNIFICATION PROVISIONS OF THE STOCK PURCHASE**
2 **AGREEMENT**

3 **Q. In his testimony, Staff witness Thomas Morgan discusses the indemnifications that**
4 **Enron has provided for certain potential liabilities facing PGE²⁵ and poses a**
5 **number of questions as to the nature of the indemnifications and any possible**
6 **benefit they might provide to PGE. Can you comment?**

7 A. Yes. As Mr. Morgan observes, the Stock Purchase Agreement states that Enron will
8 provide various indemnifications for potential liabilities facing PGE. The structure and
9 meaning of these indemnities are complex and I can see why some have found them to be
10 less than a model of clarity. In this section of my testimony, I hope to provide a clear and
11 straightforward understanding of the indemnities and, in doing so, demonstrate that,
12 overall, these indemnities provide PGE with substantial benefits that would not exist
13 absent the Proposed Transaction.

14 **Q. Can you briefly explain why the indemnifications are included in the Stock**
15 **Purchase Agreement?**

16 A. Yes. In negotiating the Stock Purchase Agreement with Enron, TPG was aware that PGE
17 was exposed to certain liabilities that potentially could have a significant financial impact
18 on PGE. Some of these liabilities arose as a result of the Enron bankruptcy while others
19 arose as a result of PGE's normal business operations. Whatever their genesis, in our
20 view these liabilities could impose significant risks on PGE – and Oregon Electric as its
21 acquirer – and could substantially affect PGE's value and the prospects for Oregon
22 Electric's investment in PGE. For these reasons, TPG negotiated for Enron to provide
23 indemnifications for many of these potential liabilities as a part of the Stock Purchase
24 Agreement.

25 _____
²⁵ See Staff/200, Morgan/8.

1 **Q. Can you summarize the indemnifications provided in the Stock Purchase**
2 **Agreement?**

3 A. Yes.²⁶ Attached as Oregon Electric/102, Davis/1-4 is a chart listing the known
4 significant potential liabilities or losses currently facing PGE and describing PGE's and
5 Oregon Electric's rights to indemnification under the Stock Purchase Agreement. In
6 addition, this chart shows which company currently bears the risk of the liability and
7 which company would bear the risk in the event the Proposed Transaction does not close.

8 Under the Stock Purchase Agreement, there are four general categories of
9 indemnification provisions: (1) shared indemnity items ("Shared Special Indemnity
10 Matters"); (2) non-shared indemnity items ("Non-Shared Special Indemnity Matters");
11 (3) the indemnity items for which recovery is capped at the Purchase Price ("Tax and
12 Benefit Matters"); and (4) breaches of post-closing covenants. Categories (1) and (2)
13 would be paid out of an escrow account, subject to a \$94 million cap. Category (3) is
14 capped at the Purchase Price, and Category (4) is uncapped in amount. A more detailed
15 description is set out below with the exception of Category (4), which is not relevant to
16 Staff's concerns.

17 1. Shared Special Indemnity Matters. The Stock Purchase Agreement
18 provides that, after closing, Enron will indemnify and hold PGE and Oregon Electric²⁷
19 harmless from losses actually suffered or incurred as a result of the Shared Special
20
21

22 ²⁶ The following summary is a simplified explanation of the indemnification provisions of the Stock Purchase
23 Agreement. The indemnification provisions are found in Sections 9.2, 10.8 and 10.9 of the Stock Purchase
24 Agreement (Exhibit 6 to the Application). For a more detailed summary, see Oregon Electric/108, Davis/4-10.

25 ²⁷ The Stock Purchase Agreement provides that Enron agrees to indemnify "Purchaser, the Company and their
respective Affiliates, and their respective officers, directors, employees, agents, partners, successors, and
assigns...against and hold them harmless from all liabilities, damages, claims, reasonable and documented costs
and expenses (including reasonable attorney's fees) actually suffered or incurred by them..." Stock Purchase
Agreement, Section 9.2(a) (Exhibit 6 to the Application).

1 Indemnity Matters. Exhibit A lists all of the known liabilities in this category.²⁸ PGE
2 and Oregon Electric have the right to seek indemnification for 90% of the post-tax-
3 effected losses related to these liabilities, subject to a cap of \$94 million (the amount in
4 escrow).²⁹

5 2. Non-Shared Special Indemnity Matters. The Stock Purchase Agreement
6 provides that, after closing, Enron will indemnify and hold PGE and Oregon Electric
7 harmless from losses actually suffered or incurred as a result of the Non-Shared Special
8 Indemnity Matters. Exhibit A lists all of the known liabilities in this category. In
9 addition, PGE and Oregon Electric have the right to seek indemnification for losses
10 arising out of a breach of any representation or warranty included in the Stock Purchase
11 Agreement or any covenant or agreement made by Enron that requires performance
12 before closing.³⁰ PGE and Oregon Electric have the right to seek indemnification for
13 100% of the post-tax-effected losses related to these liabilities, subject to the \$94 million
14 cap discussed above.

15 3. Tax and Benefit Matters. The Stock Purchase Agreement provides that,
16 after closing, Enron will indemnify and hold PGE and Oregon Electric harmless from
17 losses actually suffered or incurred as a result of the Tax and Benefit Matters. Exhibit A

18
19 ²⁸ In addition, proceedings or matters that arise from the same or related facts and/or circumstances as the
20 identified matters are also treated as "Shared Special Indemnity Matters" to the extent such claims arise out of
21 conduct or activities prior to closing.

22 ²⁹ Post-tax-effected losses take into account any tax benefits (i.e., deductions) available to the party that originally
23 bears the loss associated with the liability. The Stock Purchase Agreement includes a mechanism for "tax-
24 effecting" any losses incurred as a result of the liabilities discussed above. The mechanism assumes a tax benefit
25 of 37.5%, unless the party that bore the loss does not claim a tax deduction for those costs and delivers an opinion
of counsel that the tax deduction would likely not be allowable. The purpose of this mechanism is to provide
indemnification for the actual costs incurred by the indemnified party.

For example, if we assume that PGE incurs losses of \$10 million associated with one of the Shared Special
Indemnity Matters, unless PGE shows that it is not deducting those \$10 million of losses when preparing its tax
return, PGE is deemed to have received a benefit of \$3.75 million (37.5% of \$10 million). As a result, Enron
would indemnify PGE for 90% of the remaining \$6.25 million.

³⁰ This provision is subject to a \$12.5 million "basket."

1 lists all of the known liabilities in this category. PGE and Oregon Electric have the right
2 to seek indemnification for 100% of the post-tax-effected losses related to these
3 liabilities, subject to a cap at the purchase price (approximately \$1.25 billion).

4 These indemnifications are certain to exist only in the context of the Proposed
5 Transaction, with the possible exception of the control group liabilities.³¹

6 **Q. Staff has expressed concern that PGE is not adequately protected from those**
7 **potential liabilities associated with Enron's bankruptcy.³² Under the terms of the**
8 **Proposed Transaction, is PGE adequately protected from such liabilities?**

9 A. Yes. To clarify, there are only two groups of potential liabilities resulting from Enron's
10 bankruptcy for which PGE may be liable: (1) certain tax liabilities relating to the period
11 when PGE was a member of the Enron consolidated tax group; and (2) certain liabilities
12 relating to Enron's benefits plans. These two groups of liabilities have been collectively
13 referred to as the "control group liabilities." PGE's potential "joint and several" liability
14 for these control group liabilities arises by operation of law.³³

15 Under the Stock Purchase Agreement, PGE and Oregon Electric are indemnified
16 for these control group liabilities. Enron agreed to indemnify PGE and Oregon Electric
17 for 100% of the post-tax-effected losses related to these liabilities, subject to a cap at the
18 purchase price (approximately \$1.25 billion). We have no reason to expect any such
19 liabilities would approach – much less exceed – this amount.

20 **Q. Does the Stock Purchase Agreement provide additional protections for PGE for**
21 **other liabilities?**

22 A. Yes. As mentioned above, PGE faces other potential liabilities that are not a result of
23 Enron's bankruptcy. None of the items included in the Shared and Non-Shared

24 ³¹ See Enron/*, Bingham/*.

25 ³² See Staff/200, Morgan/8.

³³ See PGE's Form 10-Q, attached as Oregon Electric/103, Davis/1-6.

1 Indemnity Matters are a result of Enron's bankruptcy, and absent the Proposed
2 Transaction, Enron is under no obligation whatsoever to indemnify PGE on any of these
3 matters.

4 **Q. Staff indicates that only Oregon Electric and TPG are indemnified under the Stock**
5 **Purchase Agreement for certain liabilities.³⁴ Is this correct?**

6 A. No. Both Oregon Electric and PGE are indemnified under the Stock Purchase
7 Agreement. TPG is not indemnified for any liabilities. Staff's summary of the Stock
8 Purchase Agreement appears to have been based upon a presentation given to TPG's
9 Investment Review Committee on August 25, 2003—almost three months before the
10 final Stock Purchase Agreement was signed.³⁵ The indemnification provisions went
11 through many iterations during the final three months of negotiations. Thus, Staff's
12 analysis of the indemnification provisions is based on a preliminary proposal that was
13 ultimately rejected.³⁶ The final version of the Stock Purchase Agreement was attached to
14 the Application as Exhibit 6.

15 **Q. Is PGE indemnified for any of the potential liabilities discussed above if the**
16 **Proposed Transaction does not close?**

17 A. No. If the Proposed Transaction does not close, PGE will likely be in the same position
18 that it is in today. PGE is currently liable for all of the potential liabilities discussed
19 above.

22
23 ³⁴ See Staff/200, Morgan/11-12.

24 ³⁵ *Id.* (citing Staff/202, Morgan/153-155, 164-165).

25 ³⁶ This fact also explains the discrepancies mentioned by Mr. Morgan between Applicants' Response to Request Staff/OEUC 141 (Staff/202, Morgan/188-189) and Mr. Morgan's summary of the indemnification provisions. Applicants' Response to Request Staff/OEUC 141 was based on the final, executed version of the Stock Purchase Agreement.

1 **Q. Does the Stock Purchase Agreement shift liability for any matters from Enron to**
2 **PGE or Oregon Electric?**

3 A. Absolutely not. In fact, Oregon Electric negotiated to shift a certain portion of PGE's
4 liabilities to Enron. The Stock Purchase Agreement provides indemnification to PGE and
5 Oregon Electric for matters for which PGE is *currently potentially liable*. If the Proposed
6 Transaction does not close, PGE is certain not to be indemnified for many of the potential
7 liabilities. Rather than shifting liability from Enron to PGE and increasing PGE's
8 potential losses, the terms of the Proposed Transaction actually do the opposite: they
9 increase the protection provided to PGE and its customers through the indemnification
10 provisions. This is a clear benefit.

11 **Q. Under Oregon Electric ownership, would PGE seek to recover the losses (if any)**
12 **incurred as a result of the "control group liabilities" from PGE's customers?**

13 A. No.

14 **Q. Under Oregon Electric ownership, would PGE anticipate seeking recovery from**
15 **customers for the losses (if any) incurred as a result of any of the other potential**
16 **liabilities facing PGE?**

17 A. Possibly. I would refer you to PGE witness Jim Piro's testimony on this point.

18 **Q. In your opinion, do the indemnification provisions of the Stock Purchase Agreement**
19 **provide a benefit to PGE's customers?**

20 A. Absolutely. As I noted earlier, it is important to understand that PGE faces these
21 potential liabilities whether or not this Proposed Transaction closes, and these liabilities
22 could be substantial. If this transaction does not close, PGE is not certain to be
23 indemnified for any of these potential liabilities. Indeed, with the exception of the
24 control group liabilities, there is no reason to anticipate indemnification for any other
25 liabilities.

1 As stated above, the indemnification provisions in the Stock Purchase Agreement
2 are available to both Oregon Electric and PGE. These provisions were specifically
3 negotiated in this manner to protect both Oregon Electric as an investor and PGE as the
4 potentially liable corporation. For these reasons, we strongly believe the indemnification
5 provisions that we negotiated on behalf of Oregon Electric and PGE provide a substantial
6 benefit to PGE and its customers, as well as to Oregon Electric. Staff would appear to
7 agree, stating that “[c]onditions that protect PGE’s customers from any Enron-related
8 liabilities would provide a *clear* benefit to PGE’s customers.”³⁷

9 **Q. Is Oregon Electric prepared to enhance the benefit of this indemnification**
10 **protection to PGE?**

11 A. Yes. In order to strengthen Oregon Electric’s commitment and ensure that the benefit
12 flows exclusively to PGE, Oregon Electric is willing to guarantee that with regard to the
13 control group liabilities, if PGE suffers a covered loss, the benefit of the indemnification
14 protections embodied in the Stock Purchase Agreement will be realized solely by PGE.

15 **VI. OREGON ELECTRIC’S COMMITMENT TO TRANSPARENCY**

16 **Q. In his testimony, Staff witness Bryan Conway expresses his concern that the**
17 **Applicants, and in particular the TPG Applicants, are not prepared for the level of**
18 **transparency that the Commission will require of PGE’s owners.³⁸ Do you agree?**

19 A. Respectfully no. As I have described above, TPG has had significant experience
20 investing in regulated businesses. We understand the importance of assuring that the
21 companies we invest in cooperate with regulators, including promptly and adequately
22 responding to requests for information. Accordingly, Oregon Electric has provided Staff
23 and other parties with an enormous amount of information within a short amount of time.

24
25 ³⁷ See Staff/200, Morgan/9 (emphasis added).

³⁸ See Staff/100, Conway/10-11.

1 In addition, we have agreed to a number of significant conditions to approval regarding
2 access to books and records. We understand Staff's concern that Oregon Electric must be
3 prepared for an extraordinary degree of transparency, and we will certainly redouble our
4 efforts in this respect. However, given the seriousness of Staff's claims, we believe that
5 it is important to provide some context and, on some points, to set the record straight.

6 **Q. Staff asserts that Oregon Electric has not been forthcoming with information and
7 has not been able to respond to data requests in a timely fashion.³⁹ Is this accurate?**

8 A. No. Oregon Electric has been extremely forthcoming and reasonably timely given the
9 circumstances it has faced in this proceeding. Despite Staff's arguments to the contrary,
10 Oregon Electric has provided an enormous amount of information and thousands of pages
11 of responsive documents in a short period of time. In the four months from the date that
12 Oregon Electric received its first data request to the date of Staff's direct testimony,
13 Oregon Electric has responded to 469 data requests and produced 16,757 pages of
14 responsive documents. The vast majority of the hundreds of data requests that Oregon
15 Electric has received required substantive responses following evaluation and input from
16 a variety of sources on numerous technical, financial, and other complex matters. Oregon
17 Electric employed persons during evenings and weekends in an effort to respond in a
18 timely and thoughtful manner.

19 While Oregon Electric did produce some responses past the usual 10-day
20 deadline, in most cases, the party that had submitted the requests stipulated to the
21 extensions, and the extensions were brief. Attached as Oregon Electric/104, Davis/1-2 is
22 a chart listing each set of data requests which required substantive responses, along with
23 the original due dates and actual dates the answers and materials were produced. In
24

25 ³⁹ *Id.*

1 addition, at no time did any of the brief extensions noted on Exhibit Oregon/Electric/104
2 result in a delay in the docket.

3 Finally, in support of the assertion that Oregon Electric has not been forthcoming,
4 Staff unfairly points to a *single* data request (Staff/OEUC 129) – *out of the 161 requests*
5 *served by Staff* – to which Oregon Electric initially objected and did not provide a
6 response.⁴⁰ Despite the legitimate objection, Oregon Electric fully answered the request
7 and produced the precise information requested by Staff.⁴¹

8 **Q. Staff also asserts that Oregon Electric has “filed numerous motions regarding**
9 **confidentiality.”⁴² Is this assertion accurate?**

10 A. No. Oregon Electric filed two motions seeking additional protection under the Standard
11 Protective Order. Oregon Electric voluntarily withdrew its first motion (Applicants’
12 Motion for Modified Protective Order, withdrawn April 15, 2004). Oregon Electric
13 pursued only the second motion (Applicants’ Motion for Additional Protection Under the
14 Protective Order, filed April 20, 2004), which resulted in a Ruling on May 28, 2004 (the
15 “Ruling”). Both motions requested additional protection for TPG’s most sensitive,
16 confidential information and trade secrets.

17 Staff also incorrectly implies that Oregon Electric is in violation of the ALJ’s
18 order regarding the Motion for Additional Protection.⁴³ Staff characterizes this Order as
19 requiring Oregon Electric to produce to requesting parties all of the documents provided
20 to Staff. On the contrary, the ALJ’s Ruling required Oregon Electric to work with the
21

22 ⁴⁰ Oregon Electric also objected to Request Staff/OEUC 60, but provided a response to the question despite the
objection.

23 ⁴¹ See Staff/100, Conway/11; Staff 102, Conway/2-3.

24 ⁴² See Staff/100, Conway/11.

25 ⁴³ Staff witness Thomas Morgan states that there has been confusion regarding whether some information has
been given to other parties that has not been provided to Staff, and vice versa. To clarify, there is no information
that has been provided to other parties that has not been provided to Staff.

1 requesting parties to reach a compromise to allow reasonable access to the requested
2 information. Oregon Electric and the requesting parties succeeded in reaching a
3 compromise on all issues, in accordance with the Ruling.

4 **Q. Staff and several intervenors express concern that Oregon Electric has not yet**
5 **provided a Master Services Agreement or an Operating Agreement.⁴⁴ Can you**
6 **address this concern?**

7 A. Yes, attached as Oregon Electric/105, Davis/1-24 is a copy of the draft Master Services
8 Agreement, which governs the provision of services between Oregon Electric and PGE.
9 As Staff is aware, we have been working cooperatively with Staff and intervenors to have
10 this Agreement be acceptable to all.

11 A draft of the Operating Agreement for Oregon Electric Utility Company, LLC, is
12 attached as Oregon Electric/106, Davis/1-33. This agreement will govern the
13 management of Oregon Electric and the relationship between Oregon Electric and its
14 members.

15 **Q. Has Oregon Electric agreed to any conditions of approval that may alleviate Staff's**
16 **concerns regarding transparency?**

17 A. Yes. As acknowledged in Mr. Conway's testimony, Oregon Electric has agreed to
18 conditions of approval that we hope will alleviate Staff's concerns. Staff, ICNU, CUB,
19 and the City of Portland have signed a Partial Stipulation, that will be incorporated into
20 the final order approving the Application. In this Stipulation, Oregon Electric has agreed
21 to the following conditions of approval related to transparency issues:

- 22 • PGE and Oregon Electric shall maintain separate books and records. All PGE
23 and Oregon Electric financial books and records shall be kept in Portland,
24 Oregon.

25 ⁴⁴ See, e.g., Staff/100, Conway/25; Staff/400, Hatthorn/2.

- 1 • Unless such a disclosure is unlawful, Oregon Electric shall notify the
2 Commission of: (a) Its intention to transfer more than 5 % of PGE's retained
3 earnings to Oregon Electric over a six-month period, at least 60 days before
4 such a transfer begins; (b) Its intention to declare a special dividend from
5 PGE, at least 30 days before declaring each such dividend; and (c) Its most
6 recent quarterly common stock cash dividend payment from PGE within 30
7 days after declaring each such dividend.

8 In addition, based on extensive discussions at the July 29, 2004 and August 11,
9 2004 Settlement Conferences, Oregon Electric has agreed to the following conditions
10 related to transparency issues:

- 11 • The Commission or its agents may audit the accounts of Oregon Electric, its
12 affiliates, and any subsidiaries that are the bases for charges to PGE to
13 determine the reasonableness of allocation factors used by Oregon Electric to
14 assign costs to PGE and amounts subject to allocation or direct charges.
15 Oregon Electric agrees to cooperate fully with such Commission audits.
- 16 • Oregon Electric and its affiliates shall not allocate to or directly charge to
17 PGE expenses not authorized by the Commission to be so allocated or directly
18 charged.
- 19 • PGE shall maintain its own accounting system. PGE and Oregon Electric
20 shall maintain separate books and records, both of which shall be kept in
21 Portland, Oregon.
- 22 • PGE and Oregon Electric shall notify the Commission within 30 days of the
23 formation of a subsidiary of either of them. For any subsidiaries created, such
24 notice shall include a copy of the business plan (including a description of any
25 goods or services to be sold) and capitalization strategy.
- 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 laws or the MSA.
- Oregon Electric shall maintain and provide the Commission unrestricted
access to a record of each instance in which TPG Applicants withhold their
consent to a decision of the PGE Board of Directors. The record shall detail
the basis for the decision, including any governing report or document that
memorializes the exercising of the consent rights and shall identify the
persons involved in making the TPG Applicant Consent Rights decision.
Oregon Electric shall provide the records to the Commission upon request.
Nothing in this condition shall be deemed to be a waiver of Oregon Electric's
or PGE's right to seek protection of the information.
- Oregon Electric and PGE shall maintain and provide the Commission
unrestricted access to all books and records of Oregon Electric and PGE that
are reasonably calculated to lead to information relating to PGE, including but

1 not limited to, Board of Directors' Minutes, Board Subcommittee Minutes,
2 and other Board Documents. Nothing in this condition shall be deemed to be
a waiver of Oregon Electric's or PGE's right to seek protection of the
information.

3 **Q. Has Oregon Electric considered any additional conditions that may address some of**
4 **the Staff and intervenors' concerns regarding access to information?**

5 A. To address CUB's and Staff's concern that Oregon Electric's ownership will result in a
6 loss of transparency,⁴⁵ Oregon Electric reiterates its commitment to make its books and
7 records available and adds a commitment to file with the Commission (and make
8 available to interested parties) financial disclosure reports equivalent to that of SEC
9 Form 10-K and Form 10-Q, annually and quarterly.

10 **VII. PUBLIC POLICY ISSUES**

11 **Q. What testimony are you addressing in this section?**

12 A. In this section, I will address the conditions various public interest groups suggest that the
13 Commission adopt in approving Oregon Electric's acquisition of PGE. A summary of
14 these requests is as follows:

- 15 • Hydropower Reform Coalition: commitments related to the relicensing of
16 PGE's hydroelectric generating facilities;⁴⁶
- 17 • Joint Public Interest Parties: commitments relating to Oregon's restructuring
18 law – SB 1149 – and related implementation and to the funding of additional
19 energy efficiency measures;⁴⁷
- 20 • Renewable Northwest Project: commitments related to PGE's future
21 development and support of renewable resources;⁴⁸

22
23 ⁴⁵ See CUB/100, Jenks-Brown/15-16; Staff/200, Morgan/54.

24 ⁴⁶ See HRC/100, Sherman & Swift/6-7.

25 ⁴⁷ See Joint Public Interest Parties/100, Public Interest Witnesses/3-7.

⁴⁸ See RNP/1, Gravatt/11.

- 1 • CADO-OECA: an \$11 million annual contribution from Oregon Electric's
2 funds for low-income bill payment assistance and various commitments
3 around support for additional programs to assist low income customers to
4 receive adequate electricity services;⁴⁹ and
- 5 • Multnomah County: a \$12.6 million annual contribution from Oregon
6 Electric's funds for low income bill payment assistance through a County-
7 designed program and related commitments for further work on assistance to
8 low-income electricity customers.⁵⁰

9 The City of Portland also supports some of these proposed commitments.

10 **Q. What is your overall response?**

11 A. Oregon Electric agrees with the above parties that the interests they represent are
12 extremely important to any utility focused on providing safe, reliable, and cost-effective
13 electric service. Under Oregon Electric's ownership, PGE will engage regularly and
14 constructively with all of these groups. In addition, I have already testified to Oregon
15 Electric's willingness to increase PGE's donations to the low-income bill payment
16 assistance group, Oregon HEAT, and to take all feasible steps to acquire a sizable amount
17 of new renewable resources for the portfolio from which it will serve its customers in the
18 future. For a variety of reasons I will explain below, however, the additional conditions
19 and commitments suggested by the above parties are beyond what would be in the
20 interests of customers and shareholders.

21 **Q. Please explain Oregon Electric's position regarding SB 1149.**

22 A. Oregon Electric strongly endorses the policy objectives that underlie SB 1149 and
23 expects to support those objectives well into the future. Moreover, Oregon Electric
24

25 ⁴⁹ See CADO-OECA/100, Abrahamson/11-23.

⁵⁰ See Multnomah County/1-2.

1 understands that SB 1149 is presently Oregon law and policy. Accordingly, under
2 Oregon Electric ownership, PGE will support SB 1149 and the steps identified by the
3 Commission as necessary to implement it. However, no one can predict today the
4 circumstances under which the stakeholders and public might decide to revisit existing
5 policy in this area and deliberate regarding changes to SB 1149. If such circumstances
6 arise, Oregon Electric would expect PGE to contribute to the deliberations its expertise
7 regarding the electric system, customers' requirements, and measures needed to ensure
8 safe and reliable service at reasonable rates. Committing PGE now to support the *status*
9 *quo* in any such future deliberations simply does not make sense. For these reasons,
10 Oregon Electric believes it would be unwise to make commitments in this context.

11 **Q. Please address the commitments requested by the Hydropower Reform Coalition**
12 **and American Rivers.**

13 A. First, I want to be clear that Oregon Electric agrees fully with these parties regarding the
14 value of PGE's existing hydroelectric generating resources and the importance of the
15 relicensing process to the future value – as resources and as structures within an
16 ecosystem – of these resources. We reviewed PGE's relicensing program during our due
17 diligence and agree with the Hydropower Reform Coalition and American Rivers
18 (“HRC/AR”) that it is a high-quality program. Further, we share the environmental
19 values that PGE has brought to this program. Last, it should be obvious that
20 hydroelectric plants with expired FERC licenses (not to mention a utility with poor
21 relationships with the environmental community that is critical to relicensing) would not
22 be attractive to any prospective buyer. It is in Oregon Electric's business interest – in the
23 short-term and long-term – to maintain PGE's present course.

1 Oregon Electric is willing to agree to HRC/AR's proposal that it commit to
2 funding PGE's hydropower program "at the budget and breadth it requires."⁵¹ Oregon
3 Electric also is committed to working with interested parties on maintaining the
4 momentum of PGE's program initiatives and the relicensing process for the Clackamas
5 River projects, including the retention of independent technical advisors to assist
6 stakeholders. Lastly, Oregon Electric will commit to have PGE provide only Low Impact
7 Hydropower Institute-Certified ("LIHI-certified") hydropower within its green power
8 portfolio options; to seek LIHI certification for its hydropower facilities where
9 reasonably prospectively successful; and to exclude PGE's own hydropower generation
10 from use in its green power portfolios unless it is certified by LIHI.

11 Although Oregon Electric is generally supportive of HRC/AR's other proposals, it
12 does not believe it is helpful or necessary to ask the Commission to enforce additional
13 commitments regarding PGE's relicensing program as a condition of approval of this
14 transaction. We understand that PGE is regularly updating the Commission regarding its
15 relicensing efforts. Any expenditures or investments will, of course, receive Commission
16 review, and the standard for recovery requires that PGE act prudently to preserve the
17 value of these resources for its customers. We expect that the Commission would require
18 an explanation from PGE were it to significantly change course in how it is pursuing
19 relicensing. Within these requirements and standards, however, PGE's approach to
20 relicensing should remain its to manage.

21
22
23
24
25

⁵¹ See HRC/100, Sherman & Swift/6.

1 **Q. Before responding to the requests by Renewable Northwest Project (“RNP”) and**
2 **others regarding renewables, will you please recap the commitment for a renewable**
3 **resource target that you offered in Supplemental Testimony?**

4 A. Yes. I said that Oregon Electric was willing to commit to have PGE vigorously pursue a
5 target of 10% of 1:2 peak capacity for load, whether contracted or owned, from
6 renewable resources by 2012, provided it can be accomplished economically.⁵²

7 **Q. Can you quantify this target?**

8 A. Yes. This commitment means Oregon Electric would cause PGE to have about 400
9 MWs of capacity from renewable resources by 2012 if economical. We continue to
10 believe our original proposal is a very meaningful commitment. We nonetheless would
11 be willing to discuss this target further.

12 **Q. Please clarify what is meant by “economically.”**

13 A. It is important to remember that PGE’s obligation is to assemble a least cost energy
14 portfolio for the benefit of its customers. The planning for that portfolio is the subject of
15 an integrated resource planning process that occurs every two years, with the next one
16 due to start next year. What I intended to communicate by the use of the word
17 “economically” is better said by reference to the integrated resource planning process.
18 This process, under the Commission’s current guidelines, explicitly requires that PGE
19 consider the many risks of non-renewable resources and the many benefits of renewable
20 resources in identifying a least cost resource plan. These are the very attributes that RNP
21 discusses and which we agree are critical considerations in selecting resources for the
22 future.

23 The integrated resource planning process is also the process by which PGE
24 establishes a common base of understanding and some consensus around its future

25 ⁵² See Oregon Electric/22, Davis/12.

1 resource plans, culminating in a Commission acknowledgment. While acknowledgment
2 does not bind the Commission to future ratemaking action, it is strong evidence that
3 PGE's selection of resources was prudent at the time made. This enables PGE to raise
4 capital for new resources, or make long-term contractual commitments. Should PGE
5 propose a resource plan to meet a renewable resource percentage target that the
6 Commission does not acknowledge, it could not proceed. The risk of disallowance
7 would increase the cost of capital far above its ability to meet it.

8 Having observed the integrated resource planning process now for many months,
9 I am confident that it is the right process within which to rest this commitment. This
10 process elicits a full range of views and well-supported analytical work from all
11 participants. The Commission can rely on it to ensure these long-term decisions are as
12 well-considered as possible. And Oregon Electric will ensure that PGE is innovative in
13 its approach to demonstrating the value of renewable resources, including taking into
14 consideration the risk mitigation benefits of renewable resources.

15 **Q. Please respond to the proposals for increased shareholder support for low-income**
16 **bill payment assistance.**

17 A. I very much appreciated the testimony by CADO-OECA and Multnomah County. It
18 convinced me of the need for utility providers of basic necessities and advocates for
19 needy households to work together on solutions that fit with social services provided by
20 government and non-profit agencies. Oregon Electric repeats its commitment to engage
21 in such a process with enough resources from PGE to enable progress. In addition,
22 Oregon Electric has committed to doubling PGE's annual cash donation to Oregon
23 HEAT for 10 years. To clarify, this commitment increases PGE's total annual cash
24 donation to \$100,000 per year. This will be paid from shareholder, not customer, funds.
25

1 I cannot agree, however, that Oregon Electric as the new owner of PGE, bears
2 responsibility to also double the amount of government and non-profit assistance
3 currently available, in addition to its previous commitment to double PGE's current cash
4 donation.⁵³ PGE is an electric utility. Its primary responsibility to its customers is to
5 provide safe, reliable, and cost-effective utility service – as the Commission defines that
6 from time to time – at reasonable rates. Certainly, if PGE can lower its net cost of
7 providing safe and adequate service through innovative approaches to those who cannot
8 pay their energy bills, it has an obligation to do so. Its responsibility to its investors is to
9 obtain approval of rates that allow it an opportunity to recover its cost of capital,
10 including equity capital, and manage its costs to do this within the revenue produced by
11 the rates granted. Certainly, it also has an obligation to participate and engage in its
12 community, which PGE does through its charitable giving, through the many volunteer
13 efforts of its employees, and through the PGE Foundation. I disagree, however, that PGE
14 investors must assume a disproportionate share of the responsibility for equalizing the
15 percentage of income that households pay for electricity services. Oregon Electric has
16 committed to double the current cash donation, and we believe that this is a very positive
17 indication of our commitment to help resolve this problem.

18 Oregon Electric remains committed to finding the most effective way for PGE to
19 participate in achieving sustainable solutions to the problem of electricity affordability
20 and at the same time lower costs for all of its customers. If innovative solutions exist,
21 Oregon Electric is willing to commit reasonable amounts of its funds to exploring options
22 before seeking permanent Commission approval to include any solutions in its rate spread
23 and design.

24
25

⁵³ See CADO-OECA/100, Abrahamson/11-12.

1 **VIII. FRANCHISE AGREEMENT WITH THE CITY OF PORTLAND**

2 **Q. The City of Portland (“City”) filed testimony that, among other things, suggested**
3 **that the Commission condition approval of this application on an agreement that**
4 **PGE make all reasonable efforts to develop and obtain a new franchise with the City**
5 **within two years after the transaction closes. The City also presented testimony by**
6 **Alan Richardson, President and CEO of the American Public Power Association.**
7 **Please comment on the suggested condition and testimony.**

8 A. We support the development of a modern utility franchise agreement between PGE and
9 the City. The City is a major customer, as well as a large municipality within PGE’s
10 service territory, and it makes good business sense to work cooperatively with the City.
11 However, for the reasons stated in the testimony of PGE witness Jim Piro, Oregon
12 Electric does not support the adoption of the suggested condition. PGE is already
13 engaged in negotiating a new franchise with the City as part of the utility’s normal
14 business. It makes no sense to entwine that normal business negotiation in this
15 proceeding.

16 With respect to Mr. Richardson’s testimony, I find it interesting but puzzling. It
17 is not clear what relevance Mr. Richardson’s review of the benefits of public ownership
18 has to this proceeding. We have not checked his statements for accuracy because we do
19 not see how his testimony applies to the issues of this case.

20 **IX. CONDITIONS OF APPROVAL**

21 **Q. What is the status of the parties’ negotiations with respect to conditions to**
22 **approval?**

23 A. Some level of agreement has been achieved. I fully expect progress to continue. Oregon
24 Electric is committing to conditions equal to or greater in force than those approved in
25 the Enron merger.

1 **Q. Have any conditions been made part of a formal stipulation?**

2 A. Yes. Oregon Electric, Staff, ICNU, CUB, and the City of Portland have signed a Partial
3 Stipulation, which will be incorporated into the final order approving the Application. In
4 this Stipulation, Oregon Electric agreed to the conditions designated as 1-6 in Exhibit 107
5 as “Stipulated Conditions.”

6 **Q. Has Oregon Electric indicated a willingness to commit to any other conditions of
7 approval sought by Staff or intervenors?**

8 A. Yes. Based on extensive discussions with Staff and numerous intervenors at the
9 Settlement Conferences on July 29, 2004, and August 11, 2004, Oregon Electric has
10 agreed to the conditions of approval designated as 7-10 in Exhibit 107 as “Conditions
11 Ready for Stipulation.”

12 **Q. Are there additional conditions acceptable to Oregon Electric?**

13 A. Yes. Oregon Electric is proposing a group of conditions for acceptance. These particular
14 conditions are similar in scope to the conditions that were adopted by the Commission in
15 prior approved mergers. These are the “Proposed Conditions” on Exhibit 107.

16 **Q. How should the Commission view the conditions which Oregon Electric has
17 proposed?**

18 A. Oregon Electric is presenting these proposed conditions as a package. None of these
19 conditions should be viewed or considered in isolation.

20 **Q. Do any of the Proposed Conditions involve transparency-related issues?**

21 A. Yes. There are a number of conditions that provide additional assurance that there is
22 sufficient transparency for the Commission in its regulation of PGE. These transparency-
23 related conditions are Proposed Conditions 11-14 in Exhibit 107.

1 **Q. Do any of the Proposed Conditions assist the Commission in its regulatory oversight**
2 **function?**

3 A. Yes. Proposed Condition 15 in Exhibit 107 provides for an expedited process for
4 handling any disputes regarding a Staff request made pursuant to the Acquisition
5 Conditions.

6 **Q. Do any of the Proposed Conditions cover distributions that PGE may make to**
7 **Oregon Electric?**

8 A. Yes. Proposed Condition 16 in Exhibit 107 concerns the circumstances under which
9 distributions from PGE can be made to Oregon Electric. In the Enron merger and the
10 other proposed mergers in Oregon, the acquirors of PGE agreed to a provision prohibiting
11 the holding company from taking distribution from PGE unless the equity level at the
12 utility was at or above 48%. Oregon Electric accepts this condition. Staff has proposed a
13 new condition that sets an absolute 48% equity floor. This proposal is unacceptable
14 because it in effect converts PGE's nonassessable common shares into assessable shares.
15 This means that if the equity in PGE were to fall below 48%, Oregon Electric would have
16 to put additional equity into PGE to bring the equity level back to 48%. This Enron
17 condition has worked well protecting Oregon utilities, and PGE in particular, despite the
18 Enron bankruptcy. The Enron provision is adequate and the proposed expansion of it is
19 simply not acceptable to Oregon Electric and, I suspect, any investor who would consider
20 purchasing PGE's shares because it breaches a basic tenet of equity investing.

21 With respect to the calculation of long-term debt, Staff has proposed to expand
22 the definition from what it was in the Commission-approved Enron merger stipulation.
23 Proposed Condition 16 treats hybrid securities as debt.

1 **Q. Do any of the Proposed Conditions cover distributions that Oregon Electric might**
2 **make to its shareholders/members?**

3 A. Yes. Staff and ICNU requested that Oregon Electric consider a provision agreeing to use
4 dividends from PGE to pay down debt rather than Oregon Electric paying dividends to its
5 shareholders/member. In Proposed Condition 23 in Exhibit 107, Oregon Electric
6 commits to use dividends it receives from PGE after the completion of closing solely to
7 pay interest, debt, operating and other expenses for three years. This means Oregon
8 Electric will not pay dividends to its shareholders/members for three years.

9 **Q. Do any Proposed Conditions provide assurance that PGE's customers will not bear**
10 **any incremental costs associated with Oregon Electric's capital structure?**

11 A. Yes. Proposed Conditions 17-18 in Exhibit 107 provide that if the acquisition results in
12 higher cost of capital or a higher revenue requirement for PGE, customers will not bear
13 those costs.

14 **Q. Do any Proposed Conditions provide the Commission with access to analyst reports**
15 **pertaining to PGE?**

16 A. Yes. Proposed Condition 19 in Exhibit 107 grants the Commission with unfettered
17 access to all written information provided to stock and bond analysts pertaining to PGE.
18 This Proposed Condition is also based on the Commission-approved Enron merger
19 stipulations. We have been working with Staff and intervenors to further improve this
20 condition and expect to come to agreement.

21 **Q. Do you have any other comments about the Proposed Conditions?**

22 A. Yes. There are three new conditions referred to elsewhere in this and Carrie Wheeler's
23 testimony that are contained in the Proposed Conditions 20-22 in Exhibit 107. These
24 proposed conditions embody the \$15 million rate credit, the flow-through of the Enron
25

1 indemnification benefit relating to control group liabilities to PGE, and a limitation on
2 payment of dividends by Oregon Electric for three years.

3 **Q. Why do Proposed Conditions 16-18 and 23 contain a qualification that the condition**
4 **will be in effect only so long as the Commission continues to treat PGE on a stand-**
5 **alone basis for purposes of determining PGE's revenue requirement?**

6 A. These conditions are intended to help protect and preserve the status of the utility as a
7 stand-alone entity. Oregon Electric accepts these conditions because PGE is currently
8 treated as a stand-alone entity by the Commission for ratemaking and other regulatory
9 purposes. The testimony of some intervenors raise the issue of treating PGE on a
10 consolidated basis with Oregon Electric. We believe there is no reason to change the
11 Commission's long-standing practice and, in particular, believe that selective application
12 of this approach is inappropriate. Thus, we believe there is no need for the Commission
13 to change the current regulatory paradigm. The qualifying language in the Proposed
14 Conditions is to make it clear that these conditions contemplate the *status quo* and would
15 not apply if there is such a fundamental change in approach. The Proposed Condition is
16 in full effect so long as the regulatory landscape under which we agreed to the condition
17 is maintained, that is, under a regulatory scheme whereby PGE is regulated as a stand-
18 alone utility.

19 **X. EXIT CONSIDERATIONS**

20 **Q. Several intervenors have expressed concern over the timing and manner of Oregon**
21 **Electric's exit from PGE. How do you respond to these concerns?**

22 A. First, I want to be clear – Oregon Electric expects to hold PGE for a significant period of
23 time. TPG's investment goals for PGE, which include stabilizing the company and its
24 earnings, building a more efficient and effective utility, addressing the company's energy
25 short position, and realizing profitable, long-term growth, will take substantial time and

1 attention. However, given our fiduciary duties to our investors, we cannot promise an
2 indefinite holding period. As we have said, we will necessarily exit PGE within 12 years.

3 We see two primary exit options. First, we could list PGE's equity securities on a
4 national stock exchange through an initial public offering ("IPO"), at which point PGE's
5 securities would be publicly traded, as they were for almost 15 years on the New York
6 Stock Exchange.⁵⁴ The actual sale of Oregon Electric's shares would most likely be
7 achieved in stages, by meting out shares periodically over several years subsequent to the
8 IPO. Indeed, for all of the reasons discussed in my Direct Testimony, we are optimistic
9 that the public markets, at some point in the future, will be receptive to such an offering.
10 Incidentally, it should be noted that several of our prospective PGE Board members have
11 publicly stated their preference for this option for PGE's future.

12 Our second exit option would be a strategic merger of PGE with another utility.
13 While any such transaction would require extensive vetting and analysis, a strategic
14 merger could present PGE customers with significant benefits in the form of cost savings
15 from operational synergies.

16 We were surprised that strong concern was expressed by some parties over the
17 possibility of this option. Consequently, we do not see the wisdom of the Commission
18 today doing anything that would restrict the option of allowing PGE's customers the
19 opportunity to possibly enjoy significant cost savings from a strategic merger, or
20 reducing the likelihood of such an outcome by imposing potentially perverse incentives
21 for Oregon Electric to exit the investment in a certain way.

22 Several parties have suggested that they would like to see Oregon Electric commit
23 to particular exit strategies and thus limit its options in the future. This course of action
24 would be unwise. No one can predict today what circumstances may exist tomorrow in

25

⁵⁴ See PGE/100, Piro/*.

1 the industry, markets, or the State. The Commission has all the power it needs, and the
2 intervenors all the rights they need, to thoroughly vet any proposed future sale of PGE,
3 and customers would be best served by preserving all options for any future ownership.

4 For that reason, we do not believe that a conditions limiting or disincenting any
5 particular exit would be a benefit.

6 XI. BENEFITS OF PROPOSED TRANSACTION

7 **Q. How do you respond to intervenor suggestions that items such as a first-class Board**
8 **of Directors, local representation, or high-quality service are not benefits, because**
9 **they are prudent utility practice?**⁵⁵

10 A. I disagree. None of these items can accurately be described simply as prudent utility
11 practice.

12 Exceptional leadership is never a given, in any business. Oregon Electric will
13 bring to PGE the unique talents and diverse experience of the professionals at TPG and
14 the business, industry and community leaders selected for the PGE Board of Directors.
15 Their contributions to PGE would not be present in the absence of the Proposed
16 Transaction, and should certainly be considered a benefit over the *status quo*.

17 With regard to service quality, Staff confirmed in its testimony what we have
18 stated—the extension of the Enron service quality measures for 10 years is clearly a
19 benefit of the Proposed Transaction.⁵⁶

20 With regard to local representation, as Mr. Jackson discusses in his testimony,⁵⁷
21 by committing to having at least five board members be Oregonians, and committing to
22 having the Chair of the Board be an Oregonian, Oregon Electric has far exceeded the

23
24 ⁵⁵ See, e.g., CUB/100, Jenks-Brown/25; CUB/200, Dittmer/19-20; ICNU/100, Schoenbeck/2, 8-9; ICNU/200,
Antonuk-Vickroy/12; COP/100, Anderson/8.

25 ⁵⁶ See Staff/100, Conway/26-27.

⁵⁷ See Oregon Electric/300, Jackson/9-10.

1 extent of local representation presently enjoyed by PGE and its customers, and
2 guaranteed that this benefit will be enjoyed for years to come.

3 In sum, Oregon Electric will bring uniquely skilled leadership, extend service
4 quality measures, and guarantee a high degree of local representation on the PGE Board
5 of Directors, all of which represent a clear benefit to PGE, its customers, and the public
6 interest.

7 **Q. How do you respond to intervenors who say that periodic access to the Board is not**
8 **a benefit?**

9 A. I am puzzled. We have met with many interested parties who have expressed their desire
10 to express their concerns on certain issues directly to PGE's Board of Directors. We
11 responded by providing a vehicle to give them access to the highest level of corporate
12 governance at the utility. Interestingly, no alternatives were offered. In our view, the
13 periodic access is a clear benefit because it provides certain key groups with access to the
14 highest level of the company in a manner that does not currently exist.

15 **Q. Does the Proposed Transaction result in a net benefit to PGE, its customers, and the**
16 **public interest?**

17 A. Yes. The Proposed Transaction would result in significant benefits to PGE's customers
18 and to the public interest:

- 19 • Strong local representation and leadership on PGE's Board of Directors,
20 ensuring accountability to customers and sensitivity to community concerns.
- 21 • A first-class Board of Directors, ensuring that PGE management has the best
22 advice on how to navigate the challenges ahead.
- 23 • Reinvigorated Board-level strategic direction, ensuring PGE's long-term
24 health.
- 25 • Capital reinvestment in PGE, ensuring reliability and efficiency from existing
assets and the acquisition and development of new resources, including
generation resources.
- Guaranteed rate credit of \$15 million.

- 1 • PGE will get the sole benefit of a contract indemnification for potentially significant control group liabilities currently facing PGE as a result of the Enron bankruptcy.
- 2
- 3 • PGE will potentially get the benefit of indemnification for two different classes of potential liabilities, one in an amount up to about \$94 million and the other in an amount up to \$1.25 billion.
- 4
- 5 • A commitment to reinforcing high-quality service while instilling financial discipline to ensure that customers receive safe, reliable and efficient electric service.
- 6
- 7 • 10-year extension of the commitment to service quality measures.
- 8 • Oregon Electric will be an Oregon taxpayer.
- 9 • An immediate end to Enron's ownership of PGE, ensuring stability and unified ownership.
- 10 • PGE's headquarters will stay in Portland, jobs will stay in Oregon and the Company will continue its charitable leadership in the community.
- 11
- 12 • Commitment to work vigorously to have 10% of PGE's resources to meet peak capacity to be from renewable resources, if economical.
- 13 • Appointment of a manager within PGE with appropriate responsibility and authority to work with the advocacy groups for renewable energy sources, sustainability, energy efficiency, and environmental matters.
- 14
- 15 • 10-year extension of PGE's cash and in-kind donations to Oregon HEAT and a doubling of the cash portion of the donation.
- 16
- 17 • Periodic access to PGE's Board of Directors for various customer and environmental advocacy groups.
- 18 • Commitment to work on additional programs for low income assistance through a work group led by PGE.
- 19

20 XII. SEC UPDATE

- 21 **Q. In its testimony, Staff requested an update on Oregon Electric's progress with**
- 22 **regard to its request for a No-Action Letter and the restructuring efforts necessary**
- 23 **to obtain an exemption from the Public Utility Holding Company Act (PUHCA).**
- 24 **A. No-Action Letter:** As described in the Direct Testimony of Richard Schifter, receipt of a
- 25 no-action letter from the U.S. Securities and Exchange Commission Division of

1 Investment Management (“SEC”) is a condition to closing the Proposed Transaction.
2 Oregon Electric has submitted a draft request for a no-action letter to the SEC.
3 However, consistent with SEC practice, Oregon Electric will not file this request formally
4 until SEC staff is prepared to issue a response. We expect to meet with the SEC in the
5 next several weeks.

6 **PUHCA Exemption:** As a general matter, electric utility holding companies must
7 register with the SEC as a “holding company” under PUHCA, unless the company
8 qualifies for an exemption. In order to obtain the exemption, Oregon Electric will need
9 to obtain approval of a plan to restructure PGE’s energy trading business. Oregon
10 Electric is currently in the process of finalizing its plans in this regard. Approval of an
11 exemption request is not a condition of closing the Proposed Transaction. Accordingly,
12 although relevant to the future operation of PGE for purposes of reducing the risk of
13 overlapping regulation and consequent possible conflicting regulatory outcomes, Oregon
14 Electric does not believe its restructuring proposal should be considered in the context of
15 the present docket.

16 **Q. Are you providing additional information to Staff and intervenors regarding the**
17 **matters you have discussed?**

18 A. Yes. I have attached to my testimony some of the many data responses Oregon Electric
19 prepared for Staff and intervenors, which I believe may also be helpful in addressing
20 some of the concerns raised by these parties in their testimony.⁵⁸

21 **Q. Does this conclude your testimony?**

22 A. Yes.

23
24
25

⁵⁸ See Oregon Electric/108, Davis/1-35.

REVISED EXHIBIT A
 APPLICANTS' RESPONSE TO REQUEST
 STAFF/OEUC 158

INDEMNIFICATION CATEGORY UNDER THE STOCK PURCHASE AGREEMENT	LIST OF LIABILITIES ²	PARTY CURRENTLY BEARING THE RISK	PGE'S RIGHTS UNDER THE STOCK PURCHASE AGREEMENT	PARTY TO BEAR RISK IF STOCK PURCHASE AGREEMENTS TERMINATED
Shared Special Indemnity Matters (Settled)	<ul style="list-style-type: none"> • FERC Docket No. EL02-114 (2003 10-K, pp. 23 & 114) • FERC Docket No. EL03-165 (2003 10-K, p. 60) • People of the State of California ex rel. Bill Lockyer, Attorney General v. Portland General Electric Company and Does 1 through 100 (2003 10-K, pp. 23 & 114) 	PGE is responsible for the settlement amount.	These matters have been settled prior to the Closing; as a result, they are not covered by the indemnity, but are instead addressed through the purchase price adjustment mechanism (as described in greater detail in Paragraph 1(c) of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE is responsible for the settlement amount.
Shared Special Indemnity Matters ³ (Pending)	<ul style="list-style-type: none"> • FERC Docket No. EL00-95 (First Quarter 2004 10-Q, p. 19-20; see also 2003 10-K, pp. 59-60 & 112-113; Second Quarter 2004 10-Q, p. 21). • FERC Docket No. EL01-10 (First Quarter 2004 10-Q, p. 20; see also 2003 10-K, pp. 60 & 113; Second Quarter 2004 10-Q, p. 21) • In re Wholesale Electricity Antitrust Cases I & II (2003 10-K, pp. 22-23) • Civil Investigative Demands by the Oregon Attorney General (2003 10-K, p. 4; Second Quarter 2004 10-Q, p. 67) • Colville Indian Tribe (2003 10-K, p. 57) • Port of Seattle v. Avista et. al. (2003 10-K, p. 23-24; Second Quarter 2004 10-Q, p. 66) 	PGE bears 100%.	In the event of resolution following the Closing, PGE and Oregon Electric would have the right to seek indemnification for 90% of the post-tax-effected losses related to these liabilities, subject to a \$94 million cap (as described in greater detail in Paragraph 1 of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE would bear 100%.

(continued next page)

¹ Please see Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47 for a description of the different indemnification categories under the Stock Purchase Agreement.

² A detailed description of these liabilities can be found in PGE's First and Second Quarter 2004 10-Q and/or PGE's 2003 10-K (unless otherwise indicated). A specific reference to the relevant SEC document is included with each liability (if applicable). A copy of PGE's First Quarter 2004 10-Q is attached as Exhibit B to Applicants' Response to Request Staff/OEUC 158. A copy of PGE's 2003 10-K is attached as Exhibit C to Applicants' Response to Request Staff/OEUC 158. A copy of PGE's Second Quarter 2004 10-Q is attached as Exhibit D to Applicants' Response to Request Staff/OEUC 158.

³ There were two other potential claims included in the "Shared Special Indemnity Matters" under the Stock Purchase Agreement: (1) Subpoena by the CFTC (discussed in the First Quarter 2003 10-Q, p. 53); and (2) Nick A. Symonds v. Dynegy Inc., et al. (discussed in the First Quarter 2003 10-Q, p. 63). PGE responded to the CFTC subpoena in early 2003 and there has not been any further activity in this matter. The Symonds case was voluntarily dismissed on May 5, 2003.

REVISED EXHIBIT A
 APPLICANTS' RESPONSE TO REQUEST
 STAFF/OEUC 158

INDEMNIFICATION CATEGORY UNDER THE STOCK PURCHASE AGREEMENT	LIST OF LIABILITIES	PARTY CURRENTLY BEARING THE RISK	PGE'S RIGHTS UNDER THE STOCK PURCHASE AGREEMENT	PARTY TO BEAR RISK IF STOCK PURCHASE AGREEMENT IS TERMINATED
Shared Special Indemnity Matters (Pending) (continued)	<ul style="list-style-type: none"> City of Tacoma et al v. American Electric Power Service Corporation, et. al. (Second Quarter 2004 10-Q, p. 67) Wah Chang, a division of TDY Industries, Inc. v. Avista Corporation, et. al. (Second Quarter 2004 10-Q, p. 66) Other Related Claims⁴ 	PGE bears 100%.	In the event of resolution following the Closing, PGE and Oregon Electric would have the right to seek indemnification for 90% of the post-tax-effected losses related to these liabilities, subject to a \$94 million cap (as described in greater detail in Paragraph 1 of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE would bear 100%.
Non-Shared Special Indemnity Matters	<ul style="list-style-type: none"> Other Claims relating to Western Power Markets⁵ Enron Control⁶ 	PGE bears 100%.	In the event any losses are incurred following the Closing, PGE and Oregon Electric would have the right to seek indemnification for 100% of the post-tax-effected losses related to these liabilities, subject to a \$94 million cap (as described in greater detail in Paragraph 2 of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE would bear 100%.

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⁴ The Stock Purchase Agreement provides that Enron would indemnify PGE and Oregon Electric for additional matters or proceedings that may arise from the same or related facts and/or circumstances as the Shared Special Indemnity Matters listed above.

⁵ The Stock Purchase Agreement provides that Enron would indemnify PGE and Oregon Electric for any additional proceedings that may be commenced that arise from, relate to, or are based on (i) alleged market manipulation and/or illegal trading activities in the U.S. Western power markets, or (ii) improper action or inaction in connection with any alleged market manipulation and/or illegal trading activities in the U.S. Western power markets.

⁶ The Stock Purchase Agreement provides that Enron would indemnify PGE and Oregon Electric for additional proceedings that may arise that result from Enron's direct or indirect ownership or control of PGE and its subsidiaries.

REVISED EXHIBIT A
 APPLICANTS' RESPONSE TO REQUEST
 STAFF/OEUC 158

IDENTIFICATION CATEGORY UNDER THE STOCK PURCHASE AGREEMENT	LIST OF LIABILITIES	PARTY CURRENTLY BEARING THE RISK	PGE'S RIGHTS UNDER THE STOCK PURCHASE AGREEMENT	PARTY TO BEAR RISK OF STOCK PURCHASE AGREEMENTS TERMINATED
Tax and Benefit Matters <ul style="list-style-type: none"> • Enron Consolidated Group Federal Income Tax Liabilities (First Quarter 2004 10-Q, pp. 24-25 & 44-45; see also 2003 10-K, pp. 52-53 & 118; Second Quarter 2004 10-Q, pp. 26, 27) • Enron Consolidated Group State Income Tax Liabilities⁷ • Enron Pension Plan (First Quarter 2004 10-Q, pp. 21-23; see also 2003 10-K, pp. 49-51 & 116-117; Second Quarter 2004 10-Q, pp. 45-48) • Enron COBRA Retiree Health Benefits (First Quarter 2004 10-Q, pp. 23-24 & 43-44; see also 2003 10-K, pp. 51-52 & 117; Second Quarter 2004 10-Q, pp. 25-26, 48-49) 	PGE bears 100%, but may seek contribution from Enron and/or other members of Enron's control group.	In the event any losses are incurred following the Closing, PGE and Oregon Electric would have the right to seek indemnification for 100% of the post-tax effected losses related to these liabilities, subject to a cap at the purchase price (as described in greater detail in Paragraph 4 of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE would bear 100%, but may seek contribution from Enron and/or other members of Enron's control group.	
Tax and Benefit Matters <ul style="list-style-type: none"> • IBEW Litigation (First Quarter 2004 10-Q, p. 13; 2003 10-K, pp. 25 & 102; Second Quarter 2004 10-Q, p. 14) • Deferred Compensation and Supplemental Executive Retirement Plans (First Quarter 2004 10-Q, pp. 46-47; Second Quarter 2004 10-Q, pp. 51-52) • Other Related Claims⁸ 	PGE bears 100%.	In the event any losses are incurred following the Closing, PGE and Oregon Electric would have the right to seek indemnification for 100% of the post-tax effected losses related to these liabilities, subject to a cap at the purchase price (as described in greater detail in Paragraph 4 of Exhibit A to Applicants' Supplemental Response to Request Staff/OEUC 47).	PGE would bear 100%.	

⁷ Certain state tax laws may hold PGE jointly and severally liable for Enron's consolidated state income tax liabilities for the periods when PGE was a member of the Enron consolidated group.
⁸ Additional claims that may arise relating to PGE's participation in the Enron Corp. Savings Plan.

REVISED EXHIBIT A
 APPLICANTS' RESPONSE TO REQUEST
 STAFF/OEUC 158

INDIFICATION CATEGORY UNDER THE STOCK PURCHASE AGREEMENT	LIST OF LAWFULS	PARTY CURRENTLY BEARING THE RISK	PGE'S RIGHTS UNDER THE STOCK PURCHASE AGREEMENT	PARTY TO BEAR RISK IN STOCK PURCHASE AGREEMENTS (IF APPLICABLE)
Non-Indemnified Matters	<ul style="list-style-type: none"> • Trojan Nuclear Plant Decommissioning Process (2003 10-K, pp. 57-58) • Trojan Class Action Lawsuits (First Quarter 2004 10-Q, pp. 12-13, 50-51 & 60; see also 2003 10-K, pp. 22 & 102; Second Quarter 2004 10-Q, pp. 13-14, 56-57) • Challenge of Oregon Public Utility Commission's Settlement regarding Trojan (First Quarter 2004 10-Q, pp. 13 & 51; see also 2003 10-K, pp. 21-22, 61-62 & 101-102; Second Quarter 2004 10-Q, pp. 56-57) • Portland Harbor (First Quarter 2004 10-Q, pp. 14 & 51-52; see also 2003 10-K, pp. 63, 103; Second Quarter 2004 10-Q, p. 58) • Harbor Oil (First Quarter 2004 10-Q, pp. 14 & 52; see also 2003 10-K, pp. 63 & 103) • Colstrip Power Plants (First Quarter 2004 10-Q, p. 53; Second Quarter 2004 10-Q, pp. 58-59) • State of Montana v. Williams, et. al. (2003 10-K, p. 24) • OPUC Docket UCB-13; complaint with the Oregon Public Utility Commission with respect to the amount of federal, state, and local taxes paid by PGE since 1997 (Second Quarter 2004 10-Q, p. 52) 	PGE bears 100%.	There is no indemnification – the risk remains with PGE.	PGE would bear 100%.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2004**
OR
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the Transition period from _____ v _____ to _____**

Commission File Number 1-5532-99

PORTLAND GENERAL ELECTRIC COMPANY

(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of
incorporation or organization)

93-0256820
(I.R.S. Employer
Identification No.)

121 SW Salmon Street, Portland, Oregon 97204
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: **(503) 464-8000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No .

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of July 31, 2004: 42,758,877 shares of Common Stock, \$3.75 par value. (All shares are owned by Enron Corp.)

Notwithstanding the above, PGE may have potential exposure to certain liabilities and asset impairments as a result of Enron's bankruptcy. These are:

- 1. Amounts Due from Enron and Enron-Supported Affiliates in Bankruptcy** - As described in Note 5, Related Party Transactions, PGE is owed approximately \$73 million by Enron at June 30, 2004 (Merger Receivable). Such amount was to have been paid to the Company for customer price reductions granted to customers, as agreed to by Enron at the time it acquired PGE in 1997. Because of uncertainties associated with Enron's bankruptcy, PGE has established a reserve for the full amount of this receivable, which was recorded in December 2001. On October 15, 2002, PGE submitted proofs of claim to the Bankruptcy Court for amounts owed PGE by Enron and other bankrupt Enron subsidiaries, including approximately \$73 million (including accrued interest) for the Merger Receivable balance as of December 2, 2001, the date of Enron's bankruptcy filing. In addition, at June 30, 2004, PGE has outstanding accounts receivable of \$8 million from Enron and its subsidiary companies which are part of the bankruptcy proceedings, consisting of \$5 million due from PGH, \$2 million from EPMI, and \$1 million from Enron. Based on management's assessment of the realizability of these balances, a reserve of \$4 million has been established.
- 2. Controlled Group Liability** - Enron's bankruptcy has raised questions regarding potential PGE liability for certain employee benefit plan and tax obligations of Enron.

Pension Plans

The pension plan for the employees of PGE (the PGE Plan) is separate from the Enron Corp. Cash Balance Plan (the Enron Plan). Although at December 31, 2003, the total fair value of PGE Plan assets was \$15 million higher than the projected benefit obligation on a SFAS No. 87 (Employers' Accounting for Pensions) basis, the PGE Plan was overfunded on an accumulated benefit obligation basis by about \$68 million as of December 31, 2003. Enron's management has informed PGE that, as of December 31, 2003, the assets of the Enron Plan were less than the present value of all accrued benefits by approximately \$60 million on a SFAS No. 87 basis and approximately \$162 million on a plan termination basis. The Pension Benefit Guaranty Corporation (PBGC) insures pension plans, including the PGE Plan and the Enron Plan and the pension plans of other Debtors. Enron's management has informed PGE that the PBGC has filed claims in the Enron bankruptcy cases with respect to the Enron Plan and the plans of the other Debtors (Pension Plans). The claims are duplicative in nature because certain liability under ERISA is joint and several. Five of the PBGC's claims represent unliquidated claims for PBGC insurance premiums (the Premium Claims), five are unliquidated claims for due but unpaid minimum funding contributions (the Contribution Claims) under the Internal Revenue Code of 1986, as amended, and ERISA, 26 U.S.C. Section 412, and 29 U.S.C. Section 1082, and the remaining five claims are for unfunded benefit liabilities (the UBL Claims). PBGC has amended the UBL Claims several times, up to an aggregate high of \$424.1 million. PBGC has informed the Debtors that it has reduced its aggregate estimate of the UBL Claims for the Pension Plans to an aggregate of \$321.8 million, including \$240.2 million for the Enron Plan and \$64.6 million related to the PGE Plan, although it has not amended the UBL Claims to reflect those amounts. The Debtors are current on their PBGC premiums and their minimum funding contributions to the Pension Plans. Therefore, the Debtors' value the Premium Claims and the Contribution Claims at \$0. Enron management has informed

PGE that the PBGC has informally alleged in pleadings filed with the Bankruptcy Court that the UBL claim related to the Enron Plan could increase by as much as 100%. PBGC has not provided support (statutory or otherwise) for this assertion and Enron management disputes the validity of any such claim.

Subject to applicable law, separate pension plans established by companies in the same controlled group may be merged. If the Enron Plan and PGE Plan were merged, any excess assets in the PGE Plan would reduce the deficiency in the Enron Plan. However, if the plans are not merged, the deficiency in the Enron Plan could become the responsibility of the PBGC and the PGE Plan assets would be undiminished.

Because the Enron Plan is underfunded and Enron is in bankruptcy, in certain circumstances the Enron Plan may be terminated and taken control of by the PBGC upon approval of a Federal District Court. In addition, with consent of the PBGC, Enron could seek to terminate the Enron Plan while it is underfunded. Moreover, if it satisfies certain statutory requirements, Enron can commence a voluntary termination by fully funding the Enron Plan, in accordance with the Enron Plan terms, and terminating it in a "standard" termination in accordance with the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Upon termination of an underfunded pension plan, all of the members of the ERISA controlled group of the plan sponsor become jointly and severally liable for the plan's underfunding. The PBGC can demand payment from one or more of the members of the controlled group. If payment is not made, a lien in favor of the PBGC automatically arises against the members of the controlled group. The amount of the lien is equal to the lesser of the underfunding or 30% of the aggregate net worth of all of the controlled group members. In addition, if the sponsor of a pension plan does not timely satisfy its minimum funding obligation to the pension plan, once the aggregate missed amounts exceed \$1 million, a lien in favor of the plan in the amount of the missed funding automatically arises against the assets of every member of the controlled group. In either case, the PBGC may file to perfect the lien and attempt to enforce it against the assets of plan sponsor and the members of its controlled group. PGE management believes that such a lien would be subordinate to prior perfected liens on the assets of the members of the controlled group. Substantially all of PGE's assets are subject to a prior perfected lien in favor of the holders of its First Mortgage Bonds. PGE management believes that any lien asserted by the PBGC would be subordinate to that lien. In addition, the PBGC retains an interest in any sales proceeds generated by the Enron auction process for PGE. Based on discussions with Enron's management, PGE's management understands that Enron has made all required contributions to date.

On January 30, 2004, the Bankruptcy Court entered the order authorizing Enron and certain of its affiliated Debtors to contribute \$200 million to the Pension Plans and terminate them in a manner that should eliminate the PBGC's claims. However, there can be no assurance that Enron will have the ability to obtain funding for accrued benefits on acceptable terms, that certain funding contingencies will be met, or that the required government agencies that review pension plan terminations will approve the termination of the Pension Plans. If the proposal to fund and terminate the Enron Plan, as stated in the Disclosure Statement and as set forth in Enron's motion, is approved and consummated, it should eliminate any need for the PBGC to attempt to collect from PGE any liability related to the Enron Plan.

On June 2, 2004, the PBGC issued notices to Enron and Enron Facility Services, Inc. (EFS), an Enron affiliate, stating that the PBGC had determined that the Pension Plans should be terminated. On June 3, 2004, the PBGC filed a complaint (PBGC Complaint) in the District Court for the Southern District of Texas against Enron seeking an order (i) terminating the Pension Plans; (ii) appointing the PBGC the statutory trustee of the Pension Plans; (iii) requiring transfer to the PBGC of all records, assets or other property of the Pension Plans required to determine the benefits payable to the Pension Plans' participants; and (iv) establishing June 3, 2004 as the termination date of the Pension Plans.

The PGE Plan was not included in the above Complaint, nor was PGE issued a similar notice of determination regarding the PGE Plan. The PBGC has taken no action to terminate the PGE Plan.

On August 4, 2004, Enron, EFS and certain Debtors filed a complaint with the Bankruptcy Court (Enron Complaint) seeking (i) a declaration that the PBGC Complaint is void; and (ii) orders staying, restraining and enjoining the PBGC from continuing the prosecution of the PBGC Complaint and preliminarily and permanently enjoining the PBGC to cease prosecution of, and to dismiss with prejudice, the PBGC Complaint.

Enron management has informed PGE management that Enron will continue to work with the PBGC and other affected parties to resolve all disagreements and allow Enron to continue the process of seeking standard termination of the Pension Plans as previously authorized by the Bankruptcy Court on January 30, 2004. If the parties cannot reach agreement, and if the relief sought in the Enron Complaint is not obtained, Enron may be precluded from funding and terminating the Pension Plans as previously authorized by the Bankruptcy Court until, if at all, after resolution of the PBGC Complaint.

Until the District Court authorizes the PBGC to terminate the Pension Plans and the PBGC makes a demand on PGE to pay some or all of any unfunded benefit liabilities under the Pension Plans, PGE has no liability for the unfunded benefit liabilities and no termination liens arise against any PGE property.

PGE management cannot predict the outcome of the above matters or estimate any potential loss. In addition, if the PBGC did look solely to PGE to pay any amount with respect to the Enron Plan, PGE would exercise all legal rights, if any, available to it to defend against such a demand and to recover any contributions from the other solvent members of the controlled group. No reserves have been established by PGE for any amounts related to this issue.

Retiree Health Benefits

PGE management understands, based on discussions with Enron management, that Enron maintains a group health plan for certain of its retirees. If retirees of Enron lose coverage under Enron's group health plan for retirees due to Enron's bankruptcy proceedings, the retirees must be provided the opportunity to purchase continuing coverage (known as COBRA Coverage) from an Enron group health plan, if any, or the appropriate group health plan of another member of Enron's controlled group. The liability for benefits under the Enron group health plan for retirees (other than potential liability to provide

COBRA Coverage) is not a joint and several obligation of other members of the Enron controlled group, including PGE, so PGE would not be required to assume from Enron, or otherwise pay, any liabilities from the Enron group health plan. Neither PGE nor any other member of Enron's controlled group would be required to create new plans to provide COBRA Coverage for Enron's retirees, and the retirees would not be entitled to choose the plan from which to obtain coverage. Retirees electing to purchase COBRA Coverage would be provided the same coverage that is provided to similarly situated retirees under the most appropriate plan in the Enron controlled group. Retirees electing to purchase COBRA Coverage would be required to pay for the COBRA Coverage, up to an amount not to exceed 102% of the cost of coverage for similarly situated beneficiaries. Retirees are not required to acquire COBRA Coverage. Retirees will be able to shop for coverage from third party sources and determine which is the least expensive coverage.

PGE management believes that in the event Enron terminates retiree coverage, any material liability to PGE associated with Enron retiree health benefits is unlikely for two reasons. First, based on discussions with Enron management, PGE management understands that most of the retirees that would be affected by termination of the Enron plan are from solvent members of the controlled group and few, if any, live in Oregon. PGE management believes that it is unlikely that any PGE plans would be found to be the most appropriate to provide COBRA Coverage. Second, even if a PGE plan were selected, PGE management believes that retirees in good health should be able to find less expensive coverage from other providers, which will reduce the number of retirees electing COBRA Coverage. PGE management believes that the additional cost to PGE to provide COBRA Coverage to a limited number of retirees that are unable to acquire other coverage because they are hard to insure or have preexisting conditions will not have a material adverse effect on the financial statements. No reserves have been established by PGE for any amounts related to this issue.

Income Taxes

Under regulations issued by the U.S. Treasury Department, each member of a consolidated group during any part of a consolidated federal income tax return year is severally liable for the tax liability of the consolidated group for that year. PGE became a member of Enron's consolidated group on July 2, 1997, the date of Enron's merger with PGC. Based on discussions with Enron's management, PGE management understands that Enron has treated PGE as having ceased to be a member of Enron's consolidated group on May 7, 2001 and becoming a member of Enron's consolidated group once again on December 24, 2002. On December 31, 2002, PGE and Enron entered into a tax allocation agreement pursuant to which PGE agreed to make payments to Enron that approximate the income taxes for which PGE would be liable if it were not a member of Enron's consolidated group. Enron obtained an agreement from the IRS on February 2, 2004 stipulating that PGE did become a member of the Enron consolidated group on December 24, 2002. Due to the uncertainty with the reconsolidation during 2003, PGE held certain tax payments due Enron. PGE resumed tax payments due Enron in early 2004.

Enron's management has provided the following information to PGE:

- A. Enron's consolidated tax returns through 1995 have been audited and are closed. Management understands that the IRS has completed an audit of the consolidated tax returns for 1996-2001.
- B. For years 1996 through 1999, Enron and its subsidiaries generated substantial net operating losses (NOLs). For 2000, Enron and its subsidiaries paid an alternative minimum tax. Enron's 2001 consolidated tax return showed a substantial net operating loss, which was carried back to the tax year 2000, for which Enron seeks a tax refund for taxes paid in 2000. The carryback of the 2001 loss to 2000 is expected to provide Enron and its subsidiaries with substantial NOLs which may be used to offset additional income tax liabilities that may result from negotiation of the IRS audit for the taxable periods PGE was a member of Enron's consolidated federal income tax returns.
- C. Enron's 2002 tax return was filed on September 12, 2003. As noted in paragraph B. above, Enron expects to have substantial NOLs from operations in years preceding 2002. Enron had 2002 NOLs sufficient to eliminate Enron's regular and alternative minimum income tax liabilities for 2002 and expects to have sufficient NOLs to offset its regular income tax liability for all subsequent periods through the date of consummation of its plan of reorganization.

On March 28, 2003, the IRS filed various proofs of claim for taxes in the Enron bankruptcy, including a claim for approximately \$111 million with respect to income tax, interest, and penalties for taxable years in which PGE was included in Enron's consolidated tax return. The IRS seeks to apply \$63 million in tax refunds admittedly due Enron against these claims. IRS claims for taxes and pre-petition interest have a priority over claims of general unsecured creditors, but claims for pre-petition penalties have no priority and claims for post-petition interest are not allowable in bankruptcy. The Company, along with other corporations in Enron's consolidated tax returns that are not in bankruptcy, are severally liable for pre-petition penalties and post-petition interest, as well as any portion of the claim allowed in the bankruptcy that the IRS does not collect from the debtors.

Enron's management has informed PGE management that Enron is negotiating with the IRS in an attempt to resolve issues raised by the IRS claims. If the parties do not reach a settlement, the Bankruptcy Court will decide the actual amount, if any, owed to the government with respect to tax, interest, and penalties.

To the extent, if any, that the IRS would look to PGE to pay any assessment not paid by Enron, PGE would exercise whatever legal rights, if any, that are available for recovery in Enron's bankruptcy proceedings, or to otherwise seek to obtain contributions from the other solvent members of the consolidated group. As a result, management believes the income tax, interest, and penalty exposure to PGE (related to any future liabilities from Enron's consolidated tax returns during the period PGE was a member of Enron's consolidated returns) would not have a material adverse effect on the financial statements. No reserves have been established by PGE for any amounts related to this issue.

*In the Matter of Oregon Electric Utility Company, LLC, et al., Application
for Authorization to Acquire Portland General Electric Company
Docket No. UM 1121*

DATE RECEIVED	DATA REQUEST	ORIGINAL DUE DATE	DATE PRODUCED	NO OF REQ.
03/11/2004	Staff's First Set of Data Requests to Applicants (OEUC 1-74)	03/24/2004	03/26/2004	74
03/16/2004	Staff's Second Set of Data Requests to Applicants (OEUC 75-86)	03/30/2004	04/05/2004	12
03/18/2004	Staff's Third Set of Data Requests to Applicants (OEUC 87-93)	04/01/2004	04/05/2004	7
03/19/2004	Staff's Fourth Set of Data Requests to Applicants (OEUC 94-108)	04/02/2004	04/09/2004	15
03/25/2004	ICNU's First Data Request to OEUC (ICNU 1.1)	04/08/2004	04/14/2004	1
03/25/2004	CUB's First Set of Data Requests to Applicants (CUB/OEUC 1-27)	04/05/2004	04/22/2004	27
03/29/2004	ICNU's Second Set of Data Requests to OEUC (ICNU 2.1)	04/12/2004	04/29/2004	1
04/12/2004	Dan Meek's First Data Request to OEUC	None	04/15/2004	1
04/14/2004	Eugene Water & Electric Board's First Set of Data Requests to Applicants	04/26/2004	04/26/2004	1
04/29/2004	PacifiCorp's First Data Request to OEUC (OEUC 1-2)	04/23/2004	04/26/2004	2
04/23/2004	City of Portland's First Data Requests to Applicants (Portland 1-27)	05/07/2004	05/07/2004	27
04/27/2004	PacifiCorp's Second Data Request to OEUC (OEUC 3)	05/12/2004	05/12/2004	1
04/29/2004	ICNU's Third Set of Data Requests to OEUC (ICNU 3.1-3.9)	05/13/2004	05/13/2004	9
05/07/2004	ICNU's Fourth Set of Data Requests to OEUC (ICNU 4.1-4.6)	05/21/2004	05/21/2004	6
05/18/2004	Staff's Fifth Set of Data Requests to Applicants (OEUC 109-127)	06/02/2004	06/08/2004	19
05/20/2004	City of Portland's Second Data Request to OEUC (Nos. 28-45)	06/04/2004	06/04/2004	18
05/21/2004	ICNU's Fifth Set of Data Requests to Applicants (ICNU 5.1-5.55) [With Responses]	06/07/2004	06/07/2004	55
05/25/2004	CUB's Second Set of Data Requests to Applicants (CUB/OEUC 28-62)	06/04/2004	06/16/2004	35
05/25/2004	Staff's Sixth Set of Data Requests to Applicants (OEUC 128-129)	06/09/2004	06/16/2004	2
06/04/2004	Dan Meek's Second Data Request to OEUC	None	06/16/2004	1

DATE RECEIVED	DATA REQUEST	ORIGINAL DUE DATE	DATE PRODUCED	NO OF REQ.
06/10/2004	ICNU's Sixth Set of Data Requests to Applicants (ICNU 6.1-6.11)	06/24/2004	06/24/2004	11
06/11/2004	Staff's Seventh Set of Data Requests to Applicants (OEUC 130-141)	06/25/2004	06/25/2004	12
06/15/2004	City of Portland's Third Set of Data Requests to Applicants and PGE (Portland 46-75)	06/25/2004	06/29/2004	31
06/15/2004	Staff's Eighth Set of Data Requests to Applicants (OEUC 142-154)	06/29/2004	06/29/2004	13
06/17/2004	CUB'S Third Set of Data Requests to Applicants (CUB/OEUC 63-102)	07/01/2004	07/01/2004 & 07/06/2004	40
06/23/2004	Multnomah County's First Set of Data Requests to Applicants (MC/OEUC 6)	07/05/2004	06/28/2004	1
06/25/2004	EWEB's Second Set of Data Requests (1-15)	07/09/2004	07/13/2004	15
06/28/2004	URP's First Set of Data Requests to Applicants (URP 1-5)	07/14/2004	07/16/2004	5
06/28/2004	Staff's Ninth Set of Data Requests to Applicants (OEUC 155)	07/14/2004	07/14/2004	1
06/29/2004	City of Portland's Fourth Set of Data Requests to Applicants (No. 76)	07/15/2004	07/15/2004	1
06/30/2004	Renewable Northwest Project's First Set of Data Requests to Applicants	07/15/2004	07/06/2004	6
07/07/2004	ICNU's Seventh Set of Data Requests to Applicants (ICNU 7.1-ICNU 7.2)	07/21/2004	07/21/2004	2
07/12/2004	ICNU's Eighth Set of Data Requests to Applicants (ICNU 8.1-ICNU 8.9)	07/26/2004	07/26/2004	9
07/16/2004	Staff's Tenth Set of Data Requests to Applicants (OEUC 156-161)	07/30/2004	07/30/2004	6
08/04/2004	ICNU's Ninth Set of Data Requests to Applicants (No. 9.1)	08/18/2004	08/13/2004	1
08/06/2004	City of Portland's Fifth Set of Data Requests to Applicants (No. 77)	08/20/2004	08/13/2004	1
	Total data requests:			469

DRAFT

MASTER SERVICE AGREEMENT

THIS AGREEMENT, dated ~~June 16, 1997~~ _____, ~~2004~~, including addenda, is between PORTLAND GENERAL ELECTRIC COMPANY, an Oregon corporation ("PGE"), and its affiliates ~~and subsidiaries~~ ("Master Service Agreement"). PGE's affiliates include ~~ENRON Corp.~~ ("ENE"), OREGON ELECTRIC UTILITY COMPANY, LLC ("OEUC"), an Oregon limited liability ~~C~~corporation, and the ~~subsidiaries of Enron~~ affiliates and subsidiaries of OEUC and PGE as listed in ~~Addendum 1A~~ Exhibit B, as may be amended periodically ("affiliate").

RECITALS

- A. PGE is a regulated electric utility operating within the state of Oregon. Its headquarter office is located in Portland, Oregon.
- B. PGE is a subsidiary of ~~ENE~~ OEUC with operations as relevant to this Agreement described in each of the attached addenda.
- C. ~~ENE~~ OEUC owns all of the issued and outstanding shares of common stock of PGE.

- D. PGE employs certain expert personnel capable of performing needed management, analytical, professional, and administrative services in furtherance of its affiliates operations.
- E. PGE's affiliates employ certain expert personnel capable of performing needed services in furtherance of— PGE's operations.
- F. PGE and its affiliates agree that in some cases it would be more economical for each to provide the —other— with management, administrative, and other professional services, rather than for each to obtain such services by employing additional staff or by retaining independent contractors or consultants.
- G. PGE desires to make available to its affiliates such personnel and management, administrative, and other professional services as the Board of Directors or officers of those affiliates shall reasonably request in the future, without detriment to its utility functions.
- H. PGE's affiliates desire to make available to PGE such personnel and— management, administrative, and other professional services the board of directors or officers of PGE shall reasonably request in the future, without detriment to its corporate functions.

THEREFORE, the parties hereto agree as follows:

PGE Services

1. Upon the request of the Board of Directors, officers, or managers of ~~ENE, PGE-OEUC, PGE~~ will furnish to its affiliates the following administrative services as required, upon the terms and conditions set forth herein:

<u>Services</u>	<u>Service Description</u>
A. Office Support	Word Processing, secretarial services, communications, mail services, printing, records management, facilities management, office space, conference room services, office supplies, furniture and equipment, computer services, library services for affiliates' employees located in the World Trade Center or other buildings.
B. Business Analysis	Tax, regulatory, accounting, budgeting, and financial reporting assistance. Also, tax planning, financial and strategic studies, internal auditing services, market intelligence, marketing and product development support, engineering.
C. Finance and Treasury Support	Cash management services, maintain banking relationships, oversee financing, manage corporate and pension investment funds, and provide analytical support.
D. Human Resources	Administration of human resources and management of payroll.
E. Aircraft and Transport	Use of aircraft and transport, including use of Travel Services Department.
<u>E</u> F. Investor Relations	Provide information for investors. Provide corporate communications.

<u>EG. Legal Services</u>	Legal services provided by PGE's Legal Department in support of legal proceedings and other activity.
<u>GH. Construction and Transmission Engineering Services</u>	Transmission-Engineering Purchasing materials and supplies, hiring contractors.
<u>HI. Purchasing</u>	Purchasing goods and materials through PGE's Purchasing Department.
<u>IJ. Consulting/Training Services</u>	Providing PGE labor, materials and expertise for consulting/training.
<u>K. Analytical Testing Services</u>	Environmental and Chemical testing provided by Oregon Analytical Lab.
<u>L. Transition Services</u>	Employees who transfer from affiliates to PGE may, when requested, bill affiliates to complete projects.
<u>JM. Other Services</u>	Other services as defined and priced in the Addenda, signed by PGE and appropriate entity, and approved by the OPUC.

2. Affiliate Services

Upon the request of the Board of Directors, officers, or managers of PGE, OEUCENE or its subsidiaries, will furnish to PGE services as required, upon the terms and conditions set forth herein and in the attached Addenda. Affiliates of OEUC's parent corporation having total annual transactions with PGE of less than one-tenth of one percent of PGE's previous calendar year's utility operating revenues will be covered by this agreement. Affiliates of OEUC's parent corporation having total annual transactions with PGE of more than one-tenth of one percent of PGE's previous calendar year's utility operating revenues will be subject to regulatory applications pursuant to OAR 860-027-0040. For all transactions between PGE and affiliates that are covered by this agreement, no separate filing for Commission approval will be needed or requested under OAR 860-027-0040 or informational filings under OAR 860-027-0041.

3. Requests for Service

All services provided will be based on a mutually agreeable work scope, specifying the scope of services, personnel, and budget for services. Changes in the scope of work will be agreed to by the parties.

4. Basis of Charges

If the service cost or benefit is intended for inclusion in PGE's retail revenue requirement, then

- a. All billing by PGE to an affiliate will be at the higher of cost or market, unless otherwise specified and approved by the OPUC; and
- b. All billings by an affiliate to PGE will be at the lower of cost or market, unless otherwise specified and approved by the OPUC.
- c. All billings between PGE and an affiliate resulting from a "blind exchange transaction" ~~will be at the amount of such transaction~~ and all billings resulting from transactions involving products and/or services that are offered to the market at prices generally available to similarly situated customers will be at the amount of such transaction.

For the purpose of this agreement, "cost" shall include:

- a. All out-of-pocket expenses of the provider of services incurred in connection with the services rendered including salaries and benefits; amounts paid for independent technical and professional services; and all overhead expenses, including but not limited to space utilization; and
- b. A reasonable return on any investment in assets, equipment, or plant supporting the provision of services ("tangible assets") in the following amounts:
 - (i) For services provided by PGE, the return on tangible assets employed, if any, will be no less than the authorized rate of return of PGE on its investment serving its electric ratepayers; and
 - (ii) For services provided by an affiliate, the return on tangible assets employed, if any, will be no more than the authorized rate of return of PGE on its investment serving its Oregon electric ratepayers.

Costs shall include both direct and indirect costs of operation. Where a cost incurred by an affiliate is allocable to related and/or unrelated third parties, which include PGE, an allocation of such costs will be used. Exhibit A to this agreement describes the method used for allocating common costs to be used by the affiliate.

5. Method of Charging for Services

Once the appropriate cost for a service has been determined in accordance with No. 4 above, a charge will be made between PGE and the affiliate on the basis of either a direct relationship between costs incurred and the entity creating the cost or on the basis of an allocation of common costs when several affiliates are responsible for creating a cost.

PGE Charges to Affiliates

PGE will directly assign charges to affiliates for services involving labor provided to affiliates on the basis of the number of hours worked by PGE employees multiplied by the cost rate per hour applicable to those employees. The hourly rate will be adjusted to include all appropriate payroll loadings (for benefits, taxes, etc). In addition, the applicable Administration & General (A&G) loading rate will be applied to derive the fully loaded cost of employee time associated with services provided. Materials, supplies, and other vouchered items will similarly be charged to affiliates on the basis of the full cost of the items supplied. Supporting documentation on the cost

of non-labor items will be available to affiliates to substantiate the charges billed. Non-labor costs will not have an A&G loading rate applied.

Affiliate Charges to PGE

Affiliates will assign charges to PGE on the basis of direct assignment. Periodically, ~~Enron~~ the OEUC Board will review the work functions supplied to affiliates under each of the services described in ~~section 2~~ paragraph 1 above. The review will include a determination of the functions supplied and the relationship between costs incurred (Direct and Allocable) and the entities creating those costs, and establish allocation factors for budgeting and for assigning the allocable costs. Direct assignment costs will be based on actual labor costs plus appropriate payroll loadings and actual non-labor costs. In addition, the applicable Administration & General (A&G) loading rate will be applied to derive the fully loaded cost of employee time associated with services provided. Allocable costs which meet the four-point test described herein will be allocated based on methods described in Exhibit A to this agreement. The four points that allocable costs must meet are: (1) they must be a necessary, just and reasonable regulated utility expense; (2) they must be for functions that PGE would perform as a stand-alone utility; (3) they must not arise from non-regulated activities; and (4) they must not duplicate functions already performed at PGE.

6. **Invoicing**

- a. As soon as practicable after the last day of each month, the provider of services will invoice the recipient for services and expenses for the month concluded, computed pursuant to Section 3 above.
- b. All invoice charges will be supported by documentation satisfactory to the recipient. Charges for services will be entered into the accounting records in the month following the period in which services were rendered. However, if the invoice is less than \$50,000, charges will not be entered until either (1) total invoices are more than \$50,000 or (2) quarterly, whichever comes first.

7. **Billing Disputes**

Disputes on billings for services will be resolved through negotiations between ~~the Controller, Enron Corp. an OEUC Board representative,~~ and the Vice President of the department at PGE responsible for providing services or their respective designees.

8. **Books and Records**

- a. All transactions made under this agreement will be recorded by PGE in accordance with the uniform system of accounts prescribed by the regulatory authorities having jurisdiction over PGE.
- b. Each party shall have the right at all reasonable times to examine the books and records of the other for the purpose of verifying the cost of the services performed by the other party.

9. **Limitations on Service**

- a. PGE shall render diligently and competently all services reasonably requested by affiliates to the extent PGE can make available its resources without detriment to its utility functions.
- b. Affiliates shall render diligently and competently all services reasonably requested by PGE to the extent those affiliates can make available their resources without detriment to its corporate functions, and to the extent that affiliate services to PGE are specified in the attached Addenda to this Master Service Agreement.
- c. PGE and affiliates shall coordinate and administer all services being rendered under this Master Service Agreement in order that such services shall be furnished as efficiently and economically as possible.
- d. Neither PGE nor its affiliates shall have priority over the other in obtaining services under this Master Service Agreement.

10. **Limitation of Authority**

The parties agree that no party shall assume nor create any obligation on behalf of the other party other than such as are specifically provided for herein. Each party reserves to itself the right to make commitments for loans, financing, mortgages, and other commitments necessary and proper for its corporate purposes.

11. **Inspection and Reporting**

a. All relevant books, records, and other data in possession of either of the parties relating to the operations under the administration of this agreement shall at all times, during normal business hours, be made available to any regulatory agency having jurisdiction when engaged in the performance of its lawful functions.

b. ~~PGE and its affiliates will timely furnish to the other such information with regard to its operations as shall be reasonably required.~~

be. Upon approval of the application filed in UM 1121 and the completion of the transaction, PGE will provide the OPUC with a list of its vendors from whom PGE has purchased goods and services in the past year denoted to identify all affiliates. This vendor/affiliate identification list will be updated and filed with the OPUC not less than annually thereafter in PGE's Affiliated Interest Report.

12. **Regulatory Jurisdiction**

It is recognized by the parties that PGE is a public utility company subject to regulation and control by various state and federal governmental regulatory agencies. The provisions of this agreement shall be construed in aid of and not in derogation of the lawful control and regulatory power of any such agency.

13. **Damages**

IN NO EVENT SHALL A PARTY BE LIABLE TO ANOTHER PARTY HERETO FOR ANY LOST OR PROSPECTIVE PROFITS OR ANY OTHER SPECIAL, PUNITIVE, EXEMPLARY, CONSEQUENTIAL, INCIDENTAL OR INDIRECT LOSSES OR DAMAGES (IN TORT, CONTRACT OR OTHERWISE) UNDER OR IN RESPECT OF THIS MASTER SERVICE AGREEMENT OR FOR ANY FAILURE OF PERFORMANCE RELATED HERETO HOWSOEVER CAUSED, WHETHER OR NOT ARISING FROM THE PARTY'S SOLE, JOINT OR CONCURRENT NEGLIGENCE. To the extent any payment required to be made under this Master Service Agreement is agreed by the parties to constitute liquidated damages, the parties acknowledge that the damages are difficult or impossible to determine and that such payment constitutes a reasonable approximation of such damages, and not a penalty.

14. **Governing Law**

This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Oregon.

15. **Waiver**

Any of the terms and conditions of this Agreement may be waived at any time and from time to time by the party entitled to the benefit thereof; but a waiver in one instance shall not be deemed to construe a waiver in any other instance. A failure to enforce any provision of this agreement shall not operate as a waiver of such provision or of any other provision hereof.

16. **Assignment**

This agreement shall be binding upon the parties and their representatives but shall not be subject to assignment.

17. **Termination**

PGE and ~~Enron~~ OEUC reserves the right at any time upon thirty (30) days' notice to the other to terminate this Master Service Agreement in whole or part. PGE, or any affiliate, reserves the right

at any time upon 30 days' notice to the other to terminate such affiliate's addendum to this Master Service Agreement. PGE shall notify the Commission upon any such termination taking effect.

18. **Integrated Agreement**

This Agreement embodies the entire agreement and understanding between the parties and supersedes all prior agreements between such parties, except for the January 1, 1993 PGE/WTCNW Service Agreement as amended. This Agreement may be executed by the parties in separate counterparts, each of which when executed and delivered shall be an original, but which together shall constitute but one and the same agreement.

Date as of _____.

by

by

~~Portland General Electric Company~~ ~~Enron Corp.~~

PORTLAND GENERAL ELECTRIC

OREGON ELECTRIC UTILITY

COMPANY

COMPANY, LLC

Exhibit A

Allocation Methods

No costs are currently being allocated from affiliates to PGE. The allocation of PGE indirect costs to affiliates is described in the Cost Allocation Manual provided annually with PGE's Affiliated Interest Report.

Exhibit B

List of PGE Affiliates

The following is a comprehensive list of affiliates with which PGE intends to transact business.

Each of these companies will provide services to and/or receive services from PGE in accordance

with of the Master Service Agreement or the Addenda thereof:

<u>Addendum</u>	<u>Affiliate</u>	<u>Status</u>
<u>1.</u>	<u>World Trade Center Northwest Corporation (WTCNW)</u>	<u>Active</u>
<u>2.</u>	<u>Salmon Springs Hospitality Group, Inc. (Salmon Springs)</u>	<u>Active</u>
<u>3.</u>	<u>Portland General Transport Corp. (PGT)</u>	<u>Inactive</u>
<u>4.</u>	<u>121 SW Salmon Corp. (121 Salmon)</u>	<u>Active</u>
<u>5.</u>	<u>Integrated Utility Solutions, Inc. (IUS)</u>	<u>Active</u>
<u>6.</u>	<u>Portland General Resource Development, Inc. (PGRD)</u>	<u>Active</u>
<u>7.</u>	<u>Oregon Electric Utility Company, LLC (OEUC)</u>	<u>Active</u>

Addendum 1

World Trade Center Northwest Corporation

(WTCNW is currently not providing any services to PGE)

A. PGE/WTCNW Services

(Included as part of the Master Services Agreement filed with the OPUC on 9-12-97, Docket No. UI-163)

B. PGE/WTCNW Service Agreement

(Filed, OPUC Docket UI-126; approved by Order No. 94-1954)

C. PGE/WTC Sublease Agreement

(Included as part of the Amendment to the Master Services Agreement filed with the OPUC on 6-9-98, Docket No. UI-163)

Addendum 2
Salmon Springs Hospitality Group, Inc.

A. PGE/Salmon Springs Services

(Included as part of the Amendment to the Master Services Agreement filed with the OPUC on 6-9-98, Docket No. UI-163)

B. PGE/Salmon Springs Agreement for Catering Services

(Included as part of the Amendment to the Master Services Agreement filed with the OPUC on 6-9-98, Docket No. UI-163)

Addendum 3
Portland General Transport Corp.
(PGT is currently inactive)

A. PGE/PGT Services

(No services between PGE and PGT)

B. PGE release (and potential repurchase) of interstate pipeline capacity to PGT

(Filed February 2, 1999; UI-175, UM-814, UP-156; Approved by the OPUC, Order No. 99-543)

Addendum 4
121 SW Salmon Corp.

A. PGE/121 Salmon Services

(No services between PGE and 121 Salmon)

B. PGE/121 Salmon sublease of World Trade Center

(Amended sublease application filed with the OPUC on 12-19-97, UI-169; approved by OPUC Order No. 98-193)

Addendum 5
Integrated Utility Solutions, Inc.

A. PGE/IUS

(Included as part of the Amendment to the Master Services Agreement filed with the OPUC on 3-24-00, Docket No. UI-181)

B. PGE purchase of computer hardware from IUS

(Filed with the OPUC 4-7-03, Waiver pursuant to OAR 860-027-0043 granted 4-9-03)

Addendum 6
Portland General Resource Development, Inc.

A. PGE/PGRD

(Included as part of the Amendment to the Master Services Agreement filed with the OPUC on 3-24-00, Docket No. UI-181)

Addendum 7
Oregon Electric Utility Company, LLC

A. PGE/OEUC
(included as part of the application)

Oregon Electric Utility Company, LLC

Page 1 of 1

Oregon Electric Utility Company, LLC (OEUC) agrees to become a party to the Master Service Agreement dated XXXXXXXXX and receive from PGE the Services described in Section 1 of the Master Service Agreement at the prices provided in Section 4 of the Master Service Agreement and abide by all the terms and conditions thereof.

Date as of _____

by

Oregon Electric Utility Company, LLC

by

Portland General Electric.

LIMITED LIABILITY COMPANY
OPERATING AGREEMENT
OF
OREGON ELECTRIC UTILITY COMPANY, LLC

This Limited Liability Company Operating Agreement of Oregon Electric Utility Company, LLC, an Oregon limited liability company (the "Company"), dated as of [•], 2004 (the "Agreement"), is entered into by and among the parties whose names and addresses are set forth on Schedule A hereto as members, and in the event any other parties are admitted to membership, such other parties who shall execute this Agreement by subscribing their names as members to the signature page hereof (each a "Member," and collectively, the "Members").

WITNESSETH:

WHEREAS, William J. Ohle, as the organizer of the Company formed the Company by executing and delivering Articles of Organization (such articles, as may be amended from time to time, the "Articles") with the office of the Secretary of State of the State of Oregon, on November 17, 2003 (the "Formation Date") pursuant to the Oregon Limited Liability Company Act, as amended (the "Act");

WHEREAS, the Company entered into a stock purchase agreement on November 18, 2003 (the "Stock Purchase Agreement"), pursuant to which the Company agreed to acquire (the "Acquisition") 100% of the issued and outstanding common stock of Portland General Electric Company, an Oregon Corporation ("PGE");

WHEREAS, the Members and the Company now desire to enter into this Agreement in order to, among other things, (i) admit new Members and permit withdrawal of certain existing Members; (ii) authorize and issue additional classes of membership interests in the Company, (iii) provide for the management of the Company and (iv) set forth the respective rights and obligations of the Members of the Company;

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Members and the Company hereby agree as follows:

ARTICLE I
DEFINITIONS

1.01. Certain Definitions. As used herein, the following terms shall have the following meanings:

"Acquisition" has the meaning set forth in the recitals to this Agreement.

"Act" has the meaning set forth in the recitals to this Agreement.

“Affiliate” means, with respect to any Person, any other Person that directly or indirectly controls, is controlled by, or is under common control with, such Person. For these purposes, “control” shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise.

“Agreement” has the meaning set forth in the preamble to this Agreement.

“Articles” has the meaning set forth in the recitals to this Agreement.

“Capital Contribution” has the meaning set forth in Section 3.03.

“Class A Interest” has the meaning set forth in Section 3.02(a) (which interests are described in Appendix A to the Subscription Agreements as the “Voting Interests”).

“Class B Interest” has the meaning set forth in Section 3.02(b) (which interests are described in Appendix A to the Subscription Agreements as the “Class A Interests”).

“Class C Interest” has the meaning set forth in Section 3.02(c) (which interests are described in Appendix A to the Subscription Agreements as the “Class B Interests”).

“Company” has the meaning set forth in the preamble to this Agreement.

“Company Board” has the meaning set forth in Section 4.04(a).

“Controllable Management Decision” means any action or omission by the Managing Member Committee or any member or Person acting on behalf of the Managing Member Committee other than as a result of (1) changes in law, or (2) actions of regulators, provided, that the exception described in clause (2) shall not apply if the Managing Member Committee shall have failed to manage the relations of the Company or PGE with any such regulators in accordance with good utility practices.

“Conversion Event” means (i) a reasonable determination by Members holding a majority of the Class B Interests 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 or (ii) the sale of all of the outstanding equity securities of PGE or an initial public offering of the equity securities of the Company or PGE in accordance with Section 6.04.

“Drag-Along Buyer” has the meaning set forth in Section 6.03(a).

“Drag-Along Member” has the meaning set forth in Section 6.03(a).

“Exit Notice” has the meaning set forth in Section 6.04(a).

“Formation Date” has the meaning set forth in the recitals to this Agreement.

“Gates” means Bill & Melinda Gates Foundation.

“Indemnified Person” has the meaning set forth in Section 10.02.

“Loss” and “Losses” have the meanings set forth in Section 10.02.

“Managing Member Committee” means the managing member committee of Managing Member LLC.

“Material Failure” means the actual or projected failure to achieve the results contemplated in the Company’s annual business plan or operating budget by 2% or more as of the end of an annual period.

“Managing Member” has the meaning set forth in Section 4.01(a).

“Member” and “Members” have the meanings set forth in the preamble to this Agreement.

“Membership Interests” has the meaning set forth in Section 3.03.

“Notices” has the meaning set forth in Section 11.03.

“OCM” means OCM Principal Opportunities Fund III, L.P.

“OPUC” has the meaning set forth in Section 6.02(d).

“Permitted Transferee” means (a) in the case of any Member that is a partnership or limited liability company, any general or limited partner, member or Affiliate of such Member, or (b) in the case of any Member that is a corporation, any Person that owns a majority of the voting stock of such Member, or any Person that is a direct or indirect wholly-owned subsidiary of such Member, (c) in the case of any Member that is an individual, any successor by death or divorce, or (d) in the case of any Member that is a trust whose sole beneficiaries are individuals, such individuals or their spouses or lineal descendants.

“Person” means an individual, corporation, association, limited liability company, partnership, estate, trust, unincorporated organization or a government or any agency or political subdivision thereof.

“PGE” has the meaning set forth in the recitals to this Agreement.

“PGE Board” has the meaning set forth in Section 4.04(f).

“Proposed Transfer” has the meaning set forth in Section 6.02(a).

“Proposed Transferee” has the meaning set forth in Section 6.02(a).

“Securities Act” means the U.S. Securities Act of 1933, as amended.

“Selling Members” has the meaning set forth in Section 6.03(a).

Draft August 15, 2004

“Stock Purchase Agreement” has the meaning set forth in the recitals to this Agreement.

“Subscription Agreements” means (i) the subscription agreement, dated March 7, 2004, between OCM and the Company, (ii) the subscription agreement, dated March 7, 2004, between Gates and the Company and (iii) such other subscription agreements that may be entered into from time to time.

“Tagging Member” has the meaning set forth in Section 6.02(a).

“TPG III” means, collectively, TPG Partners III, L.P., TPG Parallel III, L.P., TPG Investors III, L.P., FOF Partners III, L.P., FOF Partners III-B, L.P. and TPG Dutch Parallel III, C.V.

“TPG IV” means, collectively, TPG Partners IV, L.P. and TPG FOF IV, L.P.

“TPG Members” means collectively, TPG III and TPG IV.

“Transfer” means, with respect to any Membership Interest, a transfer, sale, exchange, assignment, pledge, hypothecation or other encumbrance or disposition, including the grant of an option or other right, whether directly or indirectly, whether voluntarily, involuntarily or by operation of law; and “Transferred”, “Transferee” and “Transferability” shall each have a correlative meaning.

“Transferring Member” has the meaning set forth in Section 6.02(a).

“U.S.” or “United States” means the United States of America.

“Withdrawing Managing Member” has the meaning set forth in Section 4.01(b).

1.02. Other Interpretive Provisions. The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(a) The words “hereof”, “herein”, “hereunder” and similar words refer to this Agreement as a whole and not to any particular provision of this Agreement; and any subsection, Section and Schedule references are to this Agreement unless otherwise specified.

(b) The term “including” is not limiting and means “including without limitation.”

(c) The captions and headings of this Agreement are for convenience of reference only and shall not affect the interpretation of this Agreement.

(d) Whenever the context requires, any pronouns used herein shall include the corresponding masculine, feminine or neuter forms.

ARTICLE II
ORGANIZATION

2.01. Formation of the Company. The members hereby:

(a) approve and ratify the filing of the Certificate with the Secretary of State of the State of Oregon on the Formation Date and all actions taken by or on behalf of the Company on or prior to the execution of this Agreement; and

(b) confirm and agree to their status as Members of the Company.

2.02. Name of the Company. The name of the Company is Oregon Electric Utility Company, LLC.

2.03. Term of the Company. The Company is hereby continued as a limited liability company under the Act, until dissolution thereof in accordance with the provisions of the Articles or this Agreement.

2.04. Office of the Company. The Company shall have its principal office at 222 SW Columbia Street, Suite 1850, Portland, Oregon 97201, and may establish such other offices or places of business for the Company as the Board may deem appropriate.

2.05. Registered Office and Registered Agent. The Company shall have its registered office in the State of Oregon at 222 SW Columbia Street, Suite 1850, Portland, Oregon 97201.

2.06. Purposes of the Company. The purposes of the Company shall be to (i) directly or indirectly invest in, hold and dispose of the equity interests of PGE (or any successor thereto), (ii) take any action that is necessary or appropriate in connection therewith and (iii) engage in any other lawful business the Company may undertake.

ARTICLE III
MEMBERSHIP INTERESTS; CAPITAL CONTRIBUTIONS; DISTRIBUTIONS

3.01. Membership Interests. From time to time, subject to Schedule B, the Company Board may issue membership interests in the Company in one or more classes or series, with such designations, preferences and rights as are fixed by the Company Board. Subject to Schedule B, the Company Board may increase the number of authorized membership interests in any then-existing class or series. Upon due authorization, the Company Board shall be authorized to take all actions that it reasonably deems necessary or appropriate in connection with the authorization, designation, creation and issuance of membership interests.

3.02. Initial Membership Interest Designations.

(a) A series of membership interests is hereby created and [•] membership interests are hereby designated as "Class A Interests". Subject to Section 3.02(b) below, the Class A Interests shall confer the voting rights set forth on Schedule B.

(b) A series of membership interests is hereby created and [•] membership interests are hereby designated as “Class B Interests”. The Class B Interests shall confer the voting rights set forth on Schedule B.

(c) A series of membership interests is hereby created and [•] membership interests are hereby designated as “Class C Interests”. The Class C Interests shall confer the voting rights set forth on Schedule B.

(d) Notwithstanding anything to the contrary contained in this Section 3.02 or Schedule B, upon the occurrence of a Conversion Event, then the 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.

3.03. Capital Contributions. Upon execution hereof, each Member shall make cash contributions (a “Capital Contribution”) to the Company, by wire transfer of immediately available funds in U.S. dollars in the amount described opposite such Member’s name on Schedule C hereto, in exchange for the number and class of membership interests set forth opposite such Member’s name on Schedule C hereto (the Members’ respective membership interests as set forth on Schedule C as may be amended from time to time, the “Membership Interests”); provided that in the event that the cash from equity contributions that the Company requires pursuant to the Stock Purchase Agreement for the Acquisition (i) is less than \$525 million, the commitments from each Member (other than the Managing Member) shall be reduced on a *pro rata* basis and (ii) is greater than \$525 million, each Member shall have the right, in its sole discretion, but not the obligation, to increase its commitment on a *pro rata* basis; provided further that, in any event, the TPG III Members and the TPG IV Members, in aggregate shall hold at least a 79.9% economic interest in the Company.

3.04. Additional Capital Contributions. Except with the approval of the Managing Member and Members holding a majority of the Class B Interests or as otherwise provided in this Section 3.04, no Member shall be obligated or permitted to make any additional contribution to the capital of the Company, except as provided in Section 3.03. In the event that any additional capital contributions are permitted pursuant to this Section 3.04, each Member shall have the right (but not the obligation) to make additional Capital Contributions *pro rata* based on their respective economic interest in the Company.

3.05. Return of Capital. Except upon the dissolution of the Company as provided in Section 8.03, no Member shall have the right to demand or to receive the return of all or any part of its Capital Contributions to the Company.

3.06. No Interest on Capital Contribution. No Member shall be paid interest on any of its Capital Contributions.

3.07. Distributions. Any distributions to the Members shall be made *pro rata* in accordance with their respective Membership Interest. Distributions may be made in cash or in-kind. The Managing Member may reserve amounts for anticipated expenses or contingent liabilities of the Company.

ARTICLE IV
MANAGEMENT OF COMPANY

4.01. Managing Member.

(a) The Members hereby designate Managing Member, LLC, an Oregon limited liability company, to act as the managing member of the Company (the "Managing Member"). All decisions of the Managing Member shall be made by the affirmative vote of at least three (3) of the five (5) members of the Managing Member Committee.

(b) The Managing Member may resign at any time. Such resignation shall be made in writing and shall take effect at the time specified therein or, if no time is specified therein, at the time of its receipt by the Members. The acceptance of a resignation shall not be necessary to make it effective, unless so expressly provided in the resignation. In the event that the Managing Member resigns, ceases to be a Member or otherwise becomes unable or ineligible to serve as Managing Member (a "Withdrawing Managing Member"), such Withdrawing Managing Member's replacement shall be designated by the Members. All references in this Agreement to a Member or the Members include any Member acting in the capacity of Managing Member.

4.02. Management by Managing Member. Except as otherwise expressly required by the Act or as otherwise provided in this Agreement, (a) the powers of the Company shall be exercised by or under the authority of, and the business and affairs of the Company shall be managed under the direction of, the Managing Member designated under Section 4.01 above and (b) the Managing Member may make all decisions and take all actions for the Company. Except as otherwise provided in this Agreement (including, without limitation, Sections 3.02(d), 4.03, 4.04, 6.01, 6.04 and 8.01(a)(i) and Schedule B), the Managing Member shall have the power and authority to take all actions on behalf of the Company acting in its capacity as the sole shareholder of PGE. The Managing Member shall have the same fiduciary duties to the Company and its Members, if any, as if (i) the Company were a corporation organized under the laws of Delaware and governed by Delaware law, (ii) the members of the Company were shareholders of the Company and (iii) the Managing Member and the members of the Managing Member Committee were members of the Company Board.

4.03. Removal of Members of the Managing Member. A member of the Managing Member may be removed by the consent of Members holding a majority of the Class B Interests upon the occurrence of any of the events set forth in Schedule D. In the event of the removal or resignation of any member of the Managing Member, Managing Member shall distribute to such member its pro rata share (based on capital contributions to Managing Member) of the Class A Interests of the Company held by the Managing Member. Upon any such distribution by the Managing Member, any such distributed Class A Interests shall automatically be converted into Class B Interests.

4.04. Board of Directors.

(a) The Members shall appoint a board of directors (the "Company Board") to oversee the Company's business, which shall consist of not less than five (5) directors.

(b) The Company Board shall be composed as follows: (i) eighty percent (80%) of the members of the Company Board shall be designated by the Managing Member and (ii) the remainder shall be designated by the Members holding a majority of the Class B Interests; provided that, upon the occurrence of a Conversion Event, this Section 4.04(b) shall terminate and be of no further force and effect.

(c) In addition, Members holding a majority of the Class B Interests may nominate and appoint additional non-voting observers to the Company Board.

(d) The initial Company Board at the Closing shall be as set forth on Schedule E.

(e) Decisions of the Company Board shall require the approval of a majority of the directors. The Company Board shall designate a chairman.

(f) The Company (in its capacity as the sole shareholder of PGE) shall take all actions necessary to cause the persons constituting the board of directors of PGE (the "PGE Board") to be appointed as described herein.

(g) The PGE Board shall consist of at least seven (7) and no more than fourteen (14) directors.

(h) The PGE Board shall be composed as follows: (i) eighty percent (80%) of the members of the PGE Board shall be designated by the Managing Member and (ii) the remainder shall be designated by Members holding a majority of the Class B Interests; provided that, upon the occurrence of a Conversion Event, this Section 4.04(f)(ii) shall terminate and be of no further force and effect.

(i) In addition, Members holding a majority of the Class B Interests may nominate and appoint additional non-voting observers to the PGE Board.

(j) The initial PGE Board at the Closing shall be as set forth on Schedule F.

4.05. Meetings; Notice; Written Consent.

(a) The Company Board shall meet at least quarterly. Meetings of the Company Board may be held at any time at any location specified in the notice thereof in such place within or outside of the State of Oregon, when called by the chairman of the Company Board or at least two (2) of the directors. At least three meetings of the Company Board per year shall be held in Oregon. Reasonable and sufficient notice of each meeting shall be given to each director. Directors may participate in a meeting of the Company Board by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other or by any other means permitted bylaw.

(b) It shall be reasonable and sufficient notice to a director to send notice at least seven (7) days before the meeting. Notice of a meeting need not be given to any director if a written waiver of notice, executed by such director before or after the meeting, is filed with the records of the meeting, or to any director who attends the meeting without protesting prior

thereto or at its commencement the lack of notice to such director. Neither notice of a meeting nor a waiver of a notice need specify the purposes of the meeting.

(c) Any action required or permitted to be taken at any meeting of the Company Board may be taken without a meeting pursuant to a written consent signed by a majority of the members of the Company Board, and such writing or writings shall be filed with the records of the meetings of the Company Board. Such consent shall be treated for all purposes as the act of the Company Board.

4.06. Directors' and Officers' Insurance. Each of the Company and PGE shall secure and maintain reasonable and customary directors' and officers' insurance policies.

ARTICLE V OFFICERS

5.01. Designation; Term; Qualifications. The Company Board may, from time to time, designate one (1) or more Persons to be officers of the Company. Any officer so designated shall have such authority and perform such duties as the Company Board may, from time to time, delegate to them. Each officer shall hold office for the term for which such officer is designated and until its successor shall be duly designated and shall qualify, or until his death, resignation or removal as provided in this Agreement. Any Person may hold any number of offices.

5.02. Removal and Resignation. Any officer of the Company may be removed as such, with or without cause, by the Company Board at any time. Any officer of the Company may resign as such at any time upon written notice to the Company. Such resignation shall be made in writing and shall take effect at the time specified therein or, if no time is specified therein, at the time of its receipt by the Company. The acceptance of a resignation shall not be necessary to make it effective, unless expressly so provided in the resignation.

5.03. Vacancies. Any vacancy occurring in any office of the Company may be filled by the Company Board in accordance with Section 5.01.

ARTICLE VI TRANSFER OF MEMBERSHIP INTERESTS

6.01. Limitations on Transfer of Class C Interests. The Class C Interests shall not be Transferred to any competitor of PGE or to any utility in the Pacific Northwest region of the United States without the consent of the Managing Member and Members holding a majority of the Class B Interests. In the event of a purported Transfer of Class C Interests in violation of this Section 6.01, such purported Transfer will be void and of no effect, and the Company will not give effect to such Transfer.

6.02. Tag-Along Rights

(a) In the case of a proposed Transfer by a TPG Member (a "Transferring Member") of all or any portion of its Membership Interest (including any Transfer during the Initial Holding Period), other than (i) to a Permitted Transferee or (ii) pursuant to or consequent

upon the exercise of the drag along rights set forth in Section 6.03, and the Membership Interest to be sold in such sale, when aggregated with all prior Transfers by the TPG Members (excluding any Transfer (i) a to Permitted Transferee or (ii) pursuant to the exercise of the drag along rights set forth in Section 6.03) represent more than twenty-five percent (25%) of the Membership Interest held by the TPG Members at the Closing (a "Proposed Transfer"), each other Member who exercises its rights under this Section 6.02(a) (a "Tagging Member") shall have the right to require the proposed transferee (a "Proposed Transferee") to purchase that portion of such Tagging Member's Membership Interest up to an amount equal to the product of (A) the Membership Interest of the Tagging Member, multiplied by (B) a fraction, the numerator of which is the aggregate Membership Interest of the Transferring Member or Members proposed to be sold and the denominator of which is the aggregate Membership Interest of the Transferring Member or Members; provided that if the Proposed Transferee elects not to purchase the entire Membership Interest offered by the Transferring Member and the Tagging Members, the amount of Membership Interest purchased by such Proposed Transferee will be allocated *pro rata* based on the respective Membership Interest such Members have elected to sell.

(b) The Transferring Member shall give notice to each other Member of a Proposed Transfer not later than ten (10) days prior to the closing of the Proposed Transfer, setting forth the amount of the Membership Interest proposed to be so Transferred, the name of the Proposed Transferee, the proposed amount, form of consideration and timing, and other material terms and conditions of the Proposed Transfer. The tag-along rights provided by this Section 6.02 must be exercised by a Member within ten (10) days following receipt of the notice required by the first sentence of this Section 6.02(b), by delivery of a written notice to the Transferring Member indicating its desire to exercise its rights and specifying the portion of its Membership Interest it desires to Transfer.

(c) Any Transfer of a Membership Interest by a Tagging Member to a Proposed Transferee pursuant to this Section 6.02 shall be the same price per dollar Membership Interest conveyed and on materially the same terms and conditions as the Transferring Member; provided that in order to be entitled to exercise its tag-along right pursuant to this Section 6.02, each Tagging Member must agree to make to the Proposed Transferee representations, warranties, covenants, indemnities and agreements comparable to those made by the Transferring Member in connection with the Proposed Transfer, and agree to the same conditions to the Proposed Transfer as the Transferring Member agrees. Each Tagging Member shall be responsible for its proportionate share of the costs of the Proposed Transfer to the extent not paid or reimbursed by the Proposed Transferee or the Company.

(d) Notwithstanding anything to the contrary contained in this Section 6.02, each Member acknowledges that any Proposed Transfer may be subject to approval by the Oregon Public Utility Commission ("OPUC").

6.03. Drag-Along Rights.

(a) If any TPG Members (collectively, the "Selling Members") receive and accept an offer to Transfer (excluding any Transfer to a Permitted Transferee) at least sixty-six and two-thirds percent (66 2/3%) of the Membership Interest owned by the TPG Members in

aggregate, the Selling Members shall have the right to require each other Member and their Permitted Transferees (each, a “Drag-Along Member”) to sell to the proposed transferee (the “Drag-Along Buyer”) that portion of such Tagging Member’s Membership Interest equal to the product of (A) the Membership Interest of the Drag-Along Member, multiplied by (B) a fraction, the numerator of which is the aggregate Membership Interest of the Selling Members to be sold, and the denominator of which is the aggregate Membership Interest of the Selling Members.

(b) The Selling Members shall give notice to each Drag-Along Member of the exercise of drag along rights pursuant to this Section 6.03 not later than ten (10) days prior to the closing of the proposed sale, setting forth the amount of the Membership Interest proposed to be so Transferred, the name of the Drag-Along Buyer, the proposed amount, form of consideration and timing, and other material terms and conditions of the proposed sale.

(c) Any Transfer of a Membership Interest by a Drag-Along Member to a Proposed Transferee pursuant to this Section 6.03 shall be the same price per dollar Membership Interest conveyed and on materially the same terms and conditions as the Selling Member. Each Drag-Along Member shall make to the Drag-Along Buyer representations, warranties, covenants, indemnities and agreements comparable to those made by the Selling Member in connection with the Transfer, and agree to the same conditions to the Transfer as the Selling Member agrees. Each Drag-Along Member shall be responsible for its proportionate share of the costs of the Transfer to the extent not paid or reimbursed by the Drag-Along Buyer or the Company.

(d) Notwithstanding anything to the contrary contained in this Section 6.03, each Member acknowledges that any Transfer pursuant to this Section 6.03 may be subject to approval by the OPUC.

6.04 Exit Rights.

(a) After consultation with the Company Board and the PGE Board, Members holding a majority of the Class B Interests 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 by delivery of notice to the Company Board and all Members not later than ten (10) days prior to the closing of the proposed sale (the “Exit Notice”).

(b) Upon the consummation of a Transfer contemplated by an Exit Notice under this Section 6.04, the proceeds of such Transfer received by the Company shall be applied first toward payment of costs, expenses, liabilities, losses or indebtedness of the Company, and thereafter shall be distributed on a *pro rata* basis to the Members based on their respective Membership Interests.

(c) Notwithstanding anything to the contrary contained in this Section 6.04, each Member acknowledges that any Transfer pursuant to this Section 6.04 may be subject to limitations under applicable law and regulation, including regulations imposed by the OPUC, if any.

6.05. Additional Limitations on Transfers. Any Transferee of Membership Interests (including Permitted Transferees) shall be required, at the time of and as a condition to

such Transfer, to become a party to this Agreement by executing and delivering such documents as may be necessary, in the reasonable opinion of the Company Board, to make such Person a party thereto, whereupon, subject to compliance with the provisions of this Article VI, such Transferee will be treated as a Member for all purposes of this Agreement. In the event of a purported Transfer of Membership Interests in violation of this Section 6.05, such purported Transfer will be void and of no effect, and the Company will not give effect to such Transfer. In addition, each Member acknowledges that a Transfer of Membership Interests may be subject to limitations under applicable law and regulation, including regulations imposed by the OPUC, if any.

ARTICLE VII
COMPANY EXPENSES, BOOKS AND RECORDS

7.01. Operating Expenses. The Company shall pay all expenses relating to its operation, including administrative expenses and fees, before any distributions may be made to the Members. Appropriate reserves for contingent liabilities may be withheld from distributions to Members; provided that any such reserves shall be withheld from the Members *pro rata* based on their respective Membership Interests.

7.02. Fiscal Year and Method of Accounting. The Company shall select the appropriate method of accounting and shall have a fiscal year that runs from January 1 through December 31 (except for the first fiscal year of the Company, which shall have begun on the Formation Date).

7.03. Records. The books and records of the Company shall be maintained at the principal office and place of business of the Company.

7.04. Financial Statements and Reports.

(a) The Managing Member shall oversee the accounting, tax and record keeping matters of the Company.

(b) The Company shall use reasonable efforts to cause each Member to receive, within a reasonable time after the close of each fiscal year and quarter, the financial statements for such fiscal year and quarter and such other information as may be reasonably requested by a Member or as is otherwise required by law.

(c) The Members shall have the right to receive audited annual consolidated financial statements of PGE and such other information as may be reasonably requested by a Member relating to PGE which the Company is permitted to disclose.

7.05. Certain Tax Matters. The Members hereby agree that the Company shall file an election to be treated as a corporation for U.S. federal income tax purposes. The Company shall file all necessary tax forms, and tax returns on a basis consistent therewith. Neither the Company nor any Member shall take any action so as to cause the Company to be treated as partnership for U.S. federal income tax purposes. The Members hereby acknowledge that the Company intends to file a consolidated U.S. federal tax return with PGE.

ARTICLE VIII
DISSOLUTION, LIQUIDATION, CONVERSION AND TERMINATION

8.01 Events Causing Dissolution.

(a) The Company shall be dissolved and its affairs shall be wound up upon the first to occur of the following:

(i) The consent of the Managing Member and Members holding a majority of the Class B Interests; or

(ii) Any dissolution required by operation of law.

(b) Dissolution of the Company shall be effective as of the day on which the event occurs giving rise to the dissolution, but the Company shall not terminate until there has been a winding up of the Company's business and affairs, and the Company's assets have been distributed as provided in Section 8.03 and in the Act; provided, however, that Articles X and XI shall survive the termination of this Agreement.

8.02. Winding Up. Upon dissolution of the Company, the Members shall proceed diligently to wind up the affairs of the Company and distribute its assets.

8.03 Liquidation and Termination. Upon dissolution of the Company, as expeditiously as is reasonable, the Members shall pay the liabilities of the Company and make distributions in the following manner and order:

(a) to creditors, including Members who are creditors, to the extent otherwise permitted by law, in satisfaction of liabilities of the Company (whether by payment or by establishment of reserves); and

(b) to the Members *pro rata* in accordance with their Membership Interests.

At such time as the distributions provided for in clauses (a) and (b) above have been made, the Company shall terminate.

8.04 Accounting on Liquidation. Upon liquidation, a proper accounting shall be made by the Company's accountants of the Company's assets, liabilities and results of operations through the last day of the month in which the Company is terminated.

ARTICLE IX
REPRESENTATIONS AND WARRANTIES

9.01. Representations and Warranties. Each Member hereby represents and warrants to the Company that on the date hereof:

(a) Such Member has the power and authority to enter into this Agreement and to carry out its obligations hereunder. Such Member is duly organized and validly existing under the laws of its jurisdiction of organization, and the execution of this Agreement, and the

consummation of the transactions contemplated herein, have been authorized by all necessary corporate or other action, and no other act or proceeding, corporate or otherwise, on its part is necessary to authorize the execution of this Agreement or the consummation of any of the transactions contemplated hereby. This Agreement has been duly executed by it and constitutes its legal, valid and binding obligations, enforceable against it in accordance with its terms.

(b) The execution and delivery by such Member of this Agreement and the performance of its obligations hereunder does not and will not (a) conflict with, or result in the breach of any provision of the constitutive documents of such Member; (b) result in any violation, breach, conflict, default or event of default (or an event which with notice, lapse of time, or both, would constitute a default or event of default), or give rise to any right of acceleration or termination or any additional payment obligation, under the terms of any material contract, agreement or permit to which such Member is a party or by which such Member's assets or operations are bound or affected; or (c) violate, in any material respect, any law applicable to such Member.

(c) Other than any consents which have already been obtained, no consent, waiver, approval, authorization, exemption, registration, license or declaration is required to be made or obtained by such Member in connection with (a) the execution, delivery or performance of this Agreement or (b) the consummation of any of the transactions contemplated herein.

(d) Each Member represents and warrants that (i) the Member's interest in the Company is intended to be and is being acquired solely for the Member's own account for the purpose of investment and not with a view to any sale or other disposition of all or any part thereof, (ii) the Member is aware that interests in the Company have not been registered under the Securities Act, that such interests cannot be sold or otherwise disposed of unless they are registered thereunder or unless an exemption from such registration is available, that the Company has no present intention of so registering such interests under the Securities Act, and that accordingly such Member is able and is prepared to bear the economic risk of making a Capital Contribution and to suffer a complete loss of investment, (iii) the Member's knowledge and experience in financial and business matters are such that the Member is capable of evaluating the risks of making a Capital Contribution, and (iv) the Member's determination to purchase the Member's interest in the Company, and make each Capital Contribution, has been, and in each case will be, made by such Member independent of and without reliance upon any other Member or Person other than such Member's investment advisor, if any, and independent of any statements or opinions as to the advisability of such purchase or Capital Contribution or as to the properties, business, prospects or condition (financial or otherwise) of any Person in which the Company may invest which may have been made or given by any such other Person. The foregoing representations and warranties may be relied upon by the Company, and by the other Members, in connection with each Member's investment in the Company.

ARTICLE X
LIABILITY AND INDEMNIFICATION

10.01. Liability.

(a) Subject to Section 4.02, if applicable, no Member of the Company (including the Managing Member), member of the Company Board, or any employee, director, officer, agent, shareholder, limited partner or general partner of a Member, shall be liable, responsible or accountable in damages or otherwise to the Company or the other Members by reason of acts, omissions or errors in judgment, except for acts, omissions or errors in judgment that are found by a court of competent jurisdiction to be the result of such person's fraud, gross negligence or willful misconduct. Notwithstanding any of the foregoing to the contrary, the provisions of this Section 10.01 shall not be construed so as to relieve (or attempt to relieve) a person of any liability, to the extent (but only to the extent) that such liability may not be waived, modified or limited under applicable law, but shall be construed so as to effectuate the provisions of this Section 10.01 to the fullest extent permitted by law.

(b) Subject to Section 4.02, if applicable, no Member (including the Managing Member) or member of the Company Board shall be subject in such capacity to any personal liability whatsoever to any person in connection with the Company assets or the acts, obligations or affairs of the Company. Members shall have the same limitation of personal liability as is extended under ORS § 63.165(2). The rights accruing to a Member under this Section 10.01 shall not exclude any other right to which such Member may be lawfully entitled, nor shall anything herein contained restrict the right of the Company to indemnify or reimburse a Member in any appropriate situation even though not specifically provided herein.

(c) Except as provided in Section 4.02 or this Section 10.01, no Member of the Company, or any employee, director, officer, agent, shareholder, limited partner or general partner of a Member in his or her capacity as such shall be liable under a judgment, decree, or order of a court, or in any other manner, for any debt, obligation or liability of the Company.

10.02. Indemnification. To the fullest extent permitted by law and subject to Section 4.02, if applicable, the Company shall indemnify, defend and hold harmless each Member of the Company (including the Managing Member), member of the Company Board and each employee, director, officer, agent, shareholder, limited partner and general partner of each Member (each, an "Indemnified Person") from and against any loss, liability, damages, cost or expense (including legal fees and expenses and any amounts paid in settlement) (each a "Loss" and collectively "Losses") resulting from a claim, demand, lawsuit, action or proceeding by reason of any act or omission performed or omitted by such Indemnified Person on behalf of the Company in a manner reasonably believed to be within the scope of the authority conferred on such Indemnified Person by this Agreement; provided that such acts or omissions of such Indemnified Person are not found by a court of competent jurisdiction to constitute fraud, gross negligence or willful misconduct. Expenses, including legal fees, incurred by an Indemnified Person and relating to any claim, demand, lawsuit, action or proceeding for which indemnification is sought under this Section 10.02 shall be paid by the Company upon demand by the Indemnified Person; provided that the Indemnified Person shall reimburse the Company

for such expenses if it is ultimately determined that such Indemnified Person is not entitled to indemnification hereunder.

ARTICLE XI
GENERAL PROVISIONS

11.01. Amendments to this Agreement. The terms and provisions of this Agreement may be modified or amended at any time and from time to time by the written consent of the Managing Member.

11.02. Entire Agreement. This Agreement supersedes all prior agreements with respect to the subject matter hereof. This instrument contains the entire agreement with respect to such subject matter. This instrument may not be amended, supplemented or discharged, and no provision hereof may be modified or waived, except expressly by an instrument in writing signed by the Managing Member. No waiver of any provision hereof shall be deemed a waiver of any other provision nor shall any such waiver by any party be deemed a continuing waiver of any matter. No amendment, modification, supplement, discharge, or waiver hereof or hereunder shall require the consent of any person not a party to this Agreement.

11.03. Notices. Unless otherwise specified herein, all notices, consents, approvals, reports, designations, requests, waivers, elections and other communications (collectively, "Notices") authorized or required to be given pursuant to this Agreement shall be given in writing, shall be either personally delivered to the Member to whom it is given or delivered by an established delivery service by which receipts are given or mailed by first-class mail, postage prepaid, or sent by facsimile or electronic mail, addressed to the Member at the following addresses (or at such other address for a Member as shall be specified by like notice):

if to the Managing Member, to:

222 SW Columbia Street
Suite 1850
Portland, Oregon 97201
Attn: [•]
Fax: [•]

if to any TPG Member, to:

301 Commerce Street, Suite 3300
Fort Worth, Texas 76102
Attention: Richard A. Ekleberry
Fax: 817.871.4088

with copies (which shall not constitute notice) to:

Texas Pacific Group
345 California Street
Suite 3300
San Francisco, CA 94104
Attn: Kelvin L. Davis
Fax: 415.741.1501

and

Cleary, Gottlieb, Steen & Hamilton
One Liberty Plaza
New York, NY 10006
Attention: Michael L. Ryan and David Leinwand
Fax: 212.225.3999

if to Gates, to:

2365 Carillon Point
Kirkland, Washington 98033
Attn: [•]
Fax: [•]

If to OCM, to:

333 South Grand Avenue,
28th Floor
Los Angeles, California 90071
Attn: B. James Ford and Jordon L. Kruse
Fax: [•]

All notices, other communications or documents shall be deemed to have been duly given: (i) at the time delivered by hand, if personally delivered; (ii) when receipt is acknowledged in writing by addressee, if by facsimile transmission or electronic mail; (iii) five (5) business days after having been deposited in the mail, postage prepaid, if mailed by first class mail; and (iv) on the first business day with respect to which a reputable air courier guarantees delivery; provided, however, that notices of a change of address shall be effective only upon receipt.

11.04. Registration Rights Agreement. Upon the request of any Member, at any time after the date hereof, all of the Members shall enter into a registration rights agreement with the Company and/or PGE or any of its subsidiaries, which shall provide the TPG Members with five (5) demand registration rights with respect to the Class A Interests and Class B Interests owned by it and which shall provide all Members with unlimited standard and proportional piggy

back registration rights, and shall contain such other terms and conditions as are customary for registration rights agreements.

11.05. Specific Performance. It is hereby agreed and acknowledged that it will be impossible to measure in money the damages that would be suffered if the parties fail to comply with any of the obligations herein imposed on them by this Agreement and that, in the event of any such failure, an aggrieved party will be irreparably damaged and will not have an adequate remedy at law. Any such party shall, therefore, be entitled (in addition to any other remedy to which such party may be entitled at law or in equity) to injunctive relief, including specific performance, to enforce such obligations, without the posting of any bond, and if any action should be brought in equity to enforce any of the provisions of this Agreement, none of the parties hereto shall raise the defense that there is an adequate remedy at law.

11.06. GOVERNING LAW; VENUE. THIS AGREEMENT SHALL BE GOVERNED AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF OREGON, WITHOUT REGARD TO THE CONFLICTS OF LAW PRINCIPLES THEREOF. ALL MATTERS LITIGATED THAT INVOLVE THIS AGREEMENT OR ANY RELATED DOCUMENTS OR MATTERS HEREUNDER SHALL BE BROUGHT ONLY IN FORT WORTH, TARRANT COUNTY, TEXAS.

11.07. Future Actions. The Company and the Members shall execute and deliver all such future instruments and take such other and further action as may be reasonably necessary or appropriate to carry out the provisions of this Agreement.

11.08. Limitation on Rights of Others. None of the provisions of this Agreement shall be for the benefit of or enforceable by any creditor of the Company. Furthermore, the Members shall not have any duty or obligation to any creditor of the Company to make any contribution to the Company or to issue any call for capital pursuant to this Agreement. Nothing in this Agreement shall be deemed to create any legal or equitable right, remedy or claim in any person not a party hereto (other than an Indemnified Person).

11.09. Successors and Assigns. No Member may assign or transfer any of its rights or obligations hereunder without the prior written consent of the Managing Member (which may be granted or withheld in the Managing Member's sole discretion). Any purported assignment or transfer in violation of the foregoing sentence shall be void *ab initio*. This Agreement shall be binding upon and inure to the benefit of the Members and their respective successors and permitted assigns.

IN WITNESS WHEREOF, the undersigned Members have executed this Limited Liability Company Operating Agreement as of the day and year first above written.

MANAGING MEMBER LLC

By: _____

Name:
Title:

TPG PARTNERS III, L.P.

By: TPG GenPar III, L.P.
Its General Partner

By: TPG Advisors III, Inc.
Its General Partner

By: _____

Name:
Title:

TPG PARALLEL III, L.P.

By: TPG GenPar III, L.P.
Its General Partner

By: TPG Advisors III, Inc.
Its General Partner

By: _____

Name:
Title:

TPG INVESTORS III, L.P.

By: TPG GenPar III, L.P.
Its General Partner

By: TPG Advisors III, Inc.
Its General Partner

By: _____

Name:

Title:

TPG FOF III, L.P.

By: TPG GenPar III, L.P.
Its General Partner

By: TPG Advisors III, Inc.
Its General Partner

By: _____

Name:

Title:

TPG FOF III-B, L.P.

By: TPG GenPar III, L.P.
Its General Partner

By: TPG Advisors III, Inc.
Its General Partner

By: _____

Name:
Title:

TPG DUTCH PARALLEL, C.V.

By: TPG GenPar III, L.P.
Its General Partner

By TPG Advisors III, Inc.
Its General Partner

By: _____

Name:
Title:

TPG PARTNERS IV, L.P.

By: TPG GenPar IV, L.P.
Its General Partner

By: TPG Advisors IV, Inc.
Its General Partner

By: _____

Name:
Title:

OCM PRINCIPAL OPPORTUNITIES FUND
III, L.P.

By: OCM Principal Opportunities Fund III
GP, LLC
Its: General Partner

By: Oaktree Capital Management, LLC
Its: General Partner

By: _____

Name:
Title:

By: _____

Name:
Title:

BILL & MELINDA GATES FOUNDATION

By: _____

Name:
Title:

SCHEDULE A

NAMES AND ADDRESSES OF MEMBERS

<u>Name</u>	<u>Address</u>
Managing Member, LLC	222 SW Columbia Street Suite 1850 Portland, Oregon 97201
TPG Partners III, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
TPG Parallel III, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
TPG Investors III, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
FOF Partners III, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
FOF Partners III-B, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
TPG Dutch Parallel III, C.V.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102
TPG Partners IV, L.P.	301 Commerce Street Suite 3300 Fort Worth, Texas 76102

OCM Principal Opportunities Fund III, L.P.

333 South Grand Avenue, 28th Floor
Los Angeles, California 90071

The Bill & Melinda Gates Foundation

2365 Carillon Point
Kirkland, Washington 98033

SCHEDULE B

VOTING RIGHTS SCHEDULE

I. General. The holders of Class A Interests shall vote on all matters on which the Members are entitled to vote. Except as expressly provided in this Agreement, holders of Class A Interests shall have one vote per Class A Interest held of record thereby. Except as otherwise expressly provided in the Agreement or this Voting Rights Schedule, all voting power ascribed to the Members shall be reserved for, and allocated to, the Class A Interests.

II. Class B Interest.

A. Except as set forth in Sections 3.02(d), 4.03, 4.04, 6.01, 6.04 or 8.01 of the Agreement, or as otherwise described in paragraph B below, Class B Interests shall not have any right to vote on matters submitted to the Members for a vote.

B. For so long as any Class B Interest is outstanding, neither the Company nor PGE shall undertake or consummate, without first obtaining the consent of the Persons holding a majority of the Class B Interests then outstanding, voting as a separate class:

1. any recapitalization, reorganization, reclassification, merger, consolidation, liquidation, dissolution or other winding up, spin-off, subdivision or other combination of the Company, PGE or any of their respective subsidiaries;

2. any declaration, setting aside or payment of any dividend or other similar distribution (including a redemption or repurchase of capital) in respect of any class of capital stock of the Company, PGE or any of their respective subsidiaries, other than payments of cash dividends on the Preferred Stock of PGE outstanding as of the date of the Acquisition in accordance with the terms of the Preferred Stock as in effect on the date of the Closing of the Acquisition;

3. any authorization, sale, issuance or redemption of equity securities (or any warrants, options or rights to acquire equity securities or any securities convertible into or exchangeable for equity securities) of the Company, PGE or any of their respective subsidiaries, other than in accordance with any then-current annual operating or capital budget and business plan approved in accordance with these consent rights;

4. any incurrence of indebtedness by the Company, PGE or any of their respective subsidiaries in the aggregate in excess of \$5,000,000 (a) for borrowed money, (b) evidenced by notes, bonds, debentures or other similar instruments, (c) under capital or financing leases or installment sale agreements or (d) in the nature of guarantees of the obligations described in clauses (a) through (c) of any other person or entity, other than in accordance with any then-current annual operating or capital budget and business plan approved in accordance with these consent rights;

5. any loan or advance (not specified in clause 4) to any person, other than trade credit in the ordinary course of business consistent with past practice;
6. any redemption, acquisition, cancellation or prepayment of a complete or partial discharge in advance of a scheduled payment date with respect to, any material modification or other material amendment of any terms of, or waiver of any material right under, any indebtedness of the Company, PGE or any of their respective subsidiaries (whether for borrowed money or otherwise), other than in accordance with any then-current annual operating or capital budget and business plan approved in accordance with these consent rights;
7. the entering into or amendment of any contract, agreement, arrangement or commitment with respect to the procurement of goods or services which creates or could reasonably be expected to create a financial obligation in an amount, whether payable at one time or in a series of payments, in excess of \$1,000,000, except as contemplated by any then-current annual operating or capital budget and business plan approved in accordance with these consent rights;
8. any capital expenditures in an amount greater than \$5,000,000 in any transaction or series of related transactions, except as contemplated by the then-current annual operating or capital budget approved in accordance with these consent rights;
9. any purchase, lease or other acquisition of any securities or assets of any other person, except for acquisitions of securities, products, supplies and equipment in the ordinary course of business consistent with past practice or acquisitions pursuant to the then-current annual operating or capital budget and business plan approved in accordance with these consent rights;
10. any sale, lease, exchange, transfer, or other disposition of the Company's, PGE's or their respective subsidiaries' assets or businesses on a consolidated basis (including, without limitation, the capital stock of any subsidiary), other than insignificant dispositions in the ordinary course of business consistent with past practice or dispositions pursuant to the then-current annual operating or capital budget and business plan approved in accordance with these consent rights;
11. any joint venture, partnership or other material operating alliance by the Company, PGE or any of their respective subsidiaries with any other person;
12. any material change in accounting policies, practices or principles, or voluntarily change in the Company's or PGE's outside independent auditor or accountants;
13. any voluntary proceeding or filing of any petition by or on behalf of the Company, PGE or any of their respective subsidiaries seeking relief under the Bankruptcy Code or the voluntary wind up, dissolution or liquidation of the Company, PGE or any of their respective subsidiaries;

14. any employment contract with the executive officers of the Company, PGE or any of their respective subsidiaries, including any material change in the compensation or terms of employment of such executive officers, or any employee stock option plan, equity incentive plan or any other material employee benefit plan;
15. the hiring or firing of a Chief Executive Officer, Chief Operating Officer or Chief Financial Officer of PGE;
16. any change in the principal line of business of the Company, PGE or any of their respective subsidiaries as in effect on the Closing of the Acquisition;
17. the adoption of, or amendment to, PGE's annual operating budget, capital budget and three-year financial plan, each of which will be updated annually;
18. any public offering or private sale of equity securities (other than financing activities in the ordinary course) or any change of control of the Company, PGE or any of their respective subsidiaries;
19. any transaction involving conflicts of interest between the Company and the Managing Member or any member or Affiliate thereof (including employees and directors of the Managing Member or any member or Affiliate thereof) or payment of any advisory or similar fees by the Company, PGE or any of their respective subsidiaries to the Managing Member or any member or Affiliate thereof;
20. any amendment or modification of the Company's, the Managing Member's, PGE's or any of PGE's subsidiaries' organizational documents (including limited liability company agreements);
21. any filing to obtain a material governmental permit or approval, any material filing in connection with a PGE rate proceeding or any material change to the rates or other charges under any PGE tariff, or any material amendment to any such filings;
22. initiation, settlement or compromise of any action, suit, claim, dispute, arbitration or proceeding by or against the Company, PGE or any of their respective subsidiaries (i) that would materially adversely affect such party, (ii) that results in aggregate value/cost of more than \$1,000,000, or (iii) would require the Company, PGE or any of their respective subsidiaries to be subject to any material equitable relief or to take or refrain from taking any material action in connection with the conduct of its business;
23. any action (or failure to act) by the Company, PGE or any of their respective subsidiaries that would result in any holder of a membership interest in the Company or any Affiliate thereof being subject to (a) regulation as a "holding company" or a "subsidiary company" or an "affiliate" of a "holding company" or a "public-utility company" under the 1935 Act or (b) any other federal or state regulation, in each case that is reasonably determined by such affected party to have an adverse effect;
24. any modification of the name of the Company or PGE; or

25. any contract, agreement, arrangement or commitment to do or engage in any of the foregoing.

III. Class C Interests. Class C Interests shall not have any right to vote on matters submitted to the Members for a vote.

SCHEDULE C

MEMBERSHIP INTERESTS OF MEMBERS¹

<u>Name</u>	<u>Aggregate Membership Interest</u>	<u>% of Class A Interests</u>	<u>% of Class B Interests</u>	<u>% of Class C Interests</u>
Managing Member, LLC	[\$3.5 m]	95%	0	0
TPG Funds*	[\$419.5 m]	5%	100%	0
OCM Principal Opportunities Fund, III	[\$50 m]			[50]%
Bill & Melinda Gates Foundation	[\$50 m]			[50]%

¹ Aggregate membership interests may be subject to change, upon the determination of the final purchase price.

* The TPG funds include TPG Partners III, L.P., TPG Parallel III, L.P., TPG Investors III, L.P., FOF Partners III, L.P., FOF Partners III-B, L.P., TPG Dutch Parallel III, C.V. and TPG Partners IV, L.P.

SCHEDULE D
REMOVAL OF MEMBERS OF THE MANAGER

A member of the Managing Member may be removed by Members holding a majority of the Class B Interests pursuant to Section 4.03 upon the following events:

1. the death or legal incapacity of the individual holding, directly or indirectly, any interest in such member of the Managing Member;
2. the commission of any felony by such member of the Managing Member or any Affiliate of such member of the Managing Member;
3. willful material misconduct committed by such member of the Managing Member or any Affiliate of such member of the Managing Member;
4. the breach of any fiduciary duty by such member of the Managing Member or any Affiliate of such member of the Managing Member;
5. self dealing by such member of the Managing Member or any Affiliate of such member of the Managing Member;
6. fraud or intentional material misrepresentation committed by such member of the Managing Member or any Affiliate of such member of the Managing Member;
7. intentional misappropriation by such member of the Managing Member or any Affiliate of such member of the Managing Member of Company funds or other Company property;
8. gross negligence of such member of the Managing Member or any Affiliate of such member of the Managing Member resulting in loss or damage to the Company or PGE;
9. a material breach of this Agreement by such member of the Managing Member or any Affiliate of such member of the Managing Member that results in a loss or damage to the Company or PGE;
10. the Transfer of any direct or indirect legal or beneficial interests in such member of the Managing Member (whether occurring voluntary or by operation of law, excluding however any Transfer occurring by reason of death or legal incapacity) without the prior written consent of Members holding a majority of the Class B Interests;
11. the bankruptcy, liquidation or insolvency of such member of the Managing Member or any Affiliate of such member of the Managing Member; or
12. Any or all members of the Managing Member Committee may be removed by Members holding a majority of the Class B Interests upon the Managing Member Committee or

any member thereof having taken any Controllable Management Decision that, in the reasonable judgment of the Members holding a majority of the Class B Interests, has resulted in or will result in a Material Failure to achieve the results contemplated by the Company's annual business plan or operating budget.

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SCHEDULE E
INITIAL COMPANY BOARD

Kelvin Davis
Gerald Grinstein
Peter O. Kohler, M.D.
Duane MacDougall
Robert Miller
Tom Walsh

SCHEDULE F
INITIAL PGE BOARD

Peter O. Kohler, M.D. (Chairman)
David Bonderman
Kelvin Davis
Kirby Dyess
Maria Eitel
Peggy Fowler
Gerald Grinstein
Jerry Jackson
Duane MacDougall
Robert Miller
M. Lee Pelton, Ph.D.
Tom Walsh

ACQUISITION CONDITIONS

A. Stipulated Conditions

1. PGE and Oregon Electric shall maintain separate books and records. All PGE and Oregon Electric financial books and records shall be kept in Portland, Oregon.
2. Oregon Electric and PGE shall exclude from PGE's utility accounts all goodwill resulting from this acquisition.
3. Oregon Electric and PGE shall exclude all costs and fees of the acquisition, including, but not limited to, all costs and fees associated with gaining regulatory approval before the Oregon Public Utility Commission, Nuclear Regulatory Commission, Federal Energy Regulatory Commission, Federal Trade Commission, Securities Exchange Commission, costs and fees associated with forming Oregon Electric, and any banking or financial institution fees associated with the creation of Oregon Electric and the financing and closing of the Acquisition from PGE's utility accounts. Within 90 days following the completion of the transaction, Oregon Electric will provide a preliminary accounting of these costs. Oregon Electric and PGE agree to provide the Commission a final accounting of these costs within 30 days following the completion of the final accounting related to the transaction.
4. Unless such a disclosure is unlawful, Oregon Electric shall notify the Commission of: (a) Its intention to transfer more than 5% of PGE's retained earnings to Oregon Electric over a six-month period, at least 60 days before such a transfer begins; (b) Its intention to declare a special dividend from PGE, at least 30 days before declaring each such dividend; and (c) Its most recent quarterly common stock cash dividend payment from PGE within 30 days after declaring each such dividend.
5. Subsequent to its purchase by Oregon Electric, PGE shall continue to perform under the Service Quality Measures ("SQM"), as set forth in Stipulations for PGE Service Quality Measures UM 814/UM 1121 dated July 13, 2004, for a period of ten full calendar years after the date the current SQM is scheduled to retire. Nothing in any provision of this Stipulation is intended to affect the Commission's authority to directly administer the stated terms of the SQM. Notwithstanding the provisions described in this paragraph, the parties have agreed to replace the current R4 measurement with a CAIDI-related measurement, and further that PGE will maintain records of outages longer than three hours. In addition, PGE agrees to work with ICNU to evaluate and, if necessary, develop additional service quality standards related to service to industrial customers.
6. PGE and Oregon Electric shall maintain separate debt ratings and, if more than \$5 million of preferred stock is outstanding, then PGE and Oregon Electric shall maintain separate preferred stock ratings.

B. Conditions Ready for Stipulation

7. The Commission or its agents may audit the accounts of Oregon Electric, its affiliates, and any subsidiaries that are the bases for charges to PGE to determine the reasonableness of allocation factors used by Oregon Electric to assign costs to PGE and amounts subject to allocation or direct charges. Oregon Electric agrees to cooperate fully with such Commission audits.
8. Oregon Electric and its affiliates shall not allocate to or directly charge to PGE expenses not authorized by the Commission to be so allocated or directly charged.
9. PGE shall maintain its own accounting system. PGE and Oregon Electric shall maintain separate books and records, both of which shall be kept in Portland, Oregon.
10. If the Commission believes that Oregon Electric and/or PGE have violated any of the conditions set forth herein, any conditions contained in other stipulations signed by Oregon Electric and PGE, or any conditions imposed by the Commission in its final order approving the Application (collectively, the "Conditions"), then the Commission shall give Oregon Electric and PGE written notice of the violation.
 - a. If the violation is for failure to file any notice or report required by the Conditions, and if Oregon Electric and/or PGE provide the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the ten-day period. For any other violation of the Conditions, the Commission must give Oregon Electric and PGE written notice of the violation. If such failure is corrected within five business days of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the five-day period.
 - b. If Oregon Electric and/or PGE fail to file a notice or written report within the time permitted in subparagraph a. above, or if Oregon Electric and/or PGE fail to cure, within the time permitted above, a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation, with an opportunity for Oregon Electric and/or PGE to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that Oregon Electric and/or PGE violated one or more of the Conditions, then the Commission shall issue an Order stating the level of penalty it will seek. Oregon Electric and/or PGE, as appropriate, may appeal such an order under ORS 756.580. If the Commission's order is upheld on appeal, and the order imposes penalties under a statute that further requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalties specified in the order, and Oregon Electric and/or PGE shall file a responsive pleading agreeing to pay the penalties. The Commission shall seek a penalty on only one of Oregon Electric or PGE for the same violation.

- c. The Commission shall not be bound by subsection (a) in the event the Commission determines PGE has violated any of the material conditions, contained herein, more than two times within a rolling 24-month period.
- d. PGE and/or Oregon Electric shall have the opportunity to demonstrate to the Commission that subsection (c) should not apply on a case-by-case basis.

C. Proposed Conditions

11. Oregon Electric shall maintain and provide the Commission unrestricted access to a record of each instance in which TPG Applicants withhold their consent to a decision of the PGE Board of Directors. The record shall detail the basis for the decision, including any governing report or document that memorializes the exercising of the consent rights and shall identify the persons involved in making the TPG Applicant Consent Rights decision. Oregon Electric shall provide the records to the Commission upon request. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information.
12. Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all books and records of Oregon Electric and PGE that are reasonably calculated to lead to information relating to PGE, including but not limited to, Board of Directors' Minutes, Board Subcommittee Minutes, and other Board Documents. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information.
13. PGE and Oregon Electric shall notify the Commission within 30 days of the formation of a subsidiary of either of them. For any subsidiaries created, such notice shall include a copy of the business plan (including a description of any goods or services to be sold) and capitalization strategy.
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 laws or the MSA.
15. In the event of a dispute between Commission Staff and Oregon Electric or PGE regarding a Commission Staff request made pursuant to the Acquisition Conditions, the parties agree that an Administrative Law Judge (ALJ) shall resolve the dispute as follows: (i) Oregon Electric or PGE shall deliver to the ALJ the books and records responsive to Staff's request and shall indicate the basis for the objection; (ii) Staff may respond in writing and Oregon Electric and/or PGE may reply; (iii) the ALJ shall review the documents in camera; and (iv) the ALJ shall issue a ruling determining whether the documents (a) are reasonably calculated to lead to the discovery of admissible evidence, and, if so, (b) whether the documents should receive the protection requested. The ALJ shall use this standard whether or not Staff is making the request in connection with an open docket. Nothing in this provision shall affect the right of Oregon Electric and/or PGE to request that the Commission treat the documents as exempt from disclosure to third parties under applicable law.
16. Provided the Commission continues to treat PGE on a stand alone basis for purposes of determining PGE's revenue requirement, PGE shall not make any distribution to Oregon Electric that would cause PGE's equity capital to fall below 48 percent of the total PGE capital without Commission approval. PGE's total capital is defined as common equity, preferred equity, and long-term debt. Long-term debt is defined as debt with duration of more than one year. Hybrid securities (e.g., convertible debt) will be assigned to equity and long-term debt

based on the characteristics of the hybrid security. For these hybrid securities, the Commission, prior to issuance, will determine the assignment of equity and/or debt characteristics. The Commission Staff and PGE may re-examine this minimum common equity percentage as financial conditions change and may request that it be adjusted.

17. Provided the Commission continues to treat PGE on a stand-alone basis for purposes of determining PGE's revenue requirement, the allowed return on common equity and other costs of capital will not rise as a result of Oregon Electric's acquisition of PGE. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.
18. Provided the Commission continues to treat PGE on a stand-alone basis for purposes of determining PGE's revenue requirement, Oregon Electric guarantees that the customers of PGE shall be held harmless if Oregon Electric's acquisition of PGE directly results in a higher revenue requirement.
19. Oregon Electric and PGE shall provide the Commission unrestricted access to all written information provided to stock or bond rating analysts, which directly or indirectly pertains to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided to, and presentations made to, stock and bond rating analysts. For purposes of this condition, "written" information includes but is not limited to any written and printed material, audio and video tapes, computer disks and electronically-stored information. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information.
20. Oregon Electric agrees to provide for the benefit of PGE customers, a rate credit in the amount of \$15 million. This credit will be paid at \$3 million per year for five years beginning in 2007. This rate credit will remain in place even if there is an intervening general rate case or in the event Oregon Electric sells its interest in PGE.
21. Oregon Electric will assure that PGE receives the benefit of the Stock Purchase Agreement indemnification for (1) certain tax liabilities relating to the period when PGE was a member of the Enron consolidated tax group and (2) certain liabilities relating to Enron's benefits plans (together, "control group liabilities").
22. Oregon Electric will prepare and make available to the Commission and the public, on a quarterly and annual basis, financial and operating disclosure reports that are equivalent in scope to that of Form 10-Q and Form 10-K reports filed with the U.S. Securities and Exchange Commission.
23. Provided the Commission continues to treat PGE on a stand-alone basis for purposes of determining PGE's revenue requirement, Oregon Electric agrees that for a period of three years following the completion of the closing of its acquisition of PGE, it will apply the proceeds of dividends from PGE solely to pay interest, reduce debt and cover Oregon Electric's operating and other expenses.

EXHIBIT OREGON ELECTRIC/108
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REQUEST OEUC 20:

Please provide listing and description of the securities laws and rules that are expected to apply to OEUC or MM? Are the ownership interests in the LLC expected to be considered securities and/or regulated by the SEC? Please provide details.

APPLICANTS' RESPONSE TO REQUEST OEUC 20:

The membership interests in Oregon Electric, and the common shares of PGE that are held by Oregon Electric, will be "securities" within the meaning of Section 2(a)(16) of PUHCA, Section 2(a)(1) of the Securities Act of 1933 (the "33 Act"), Section 3(a)(10) of the Securities Exchange Act of 1934 (the "34 Act") and for purposes of the federal securities laws generally. As a result, any transfers thereof will be governed by federal securities laws.

The membership interests in Oregon Electric and Managing Member and the common shares of PGE that are held by Oregon Electric will be securities within the meaning of Oregon Revised Statutes (ORS) 59.015, part of the Oregon Securities Law, ORS 59.005 to 59.451, 59.991, and 59.995.

The membership interests in Oregon Electric and Managing Member will not be, and are not required to be, registered with the SEC under the 33 Act or the 34 Act, or registered with the Oregon Department of Consumer and Business Services under the Oregon Securities Law.

EXHIBIT A
APPLICANTS' SUPPLEMENTAL
RESPONSE TO REQUEST OEUC 47

Summary of Indemnification Provisions
Stock Purchase Agreement relating to Portland General Electric Company

Under the Stock Purchase Agreement, dated as of November 18, 2004, between Oregon Electric Utility Company, LLC ("Purchaser") and Enron Corp. (the "Stock Purchase Agreement"), there are four general categories of indemnification provisions (i) shared indemnity items that are recoverable only from the escrow ("Shared Special Matters"), (ii) non-shared indemnity items, also recoverable only from the escrow ("Non-Shared Special Matters"), (iii) breaches of post-Closing covenants, which are uncapped and (iv) the indemnity items for which recovery is capped at the Purchase Price ("Tax and Benefit Matters"). The following summary of the indemnification provisions contained in the Stock Purchase Agreement is qualified in its entirety by reference to the Stock Purchase Agreement.

1. Shared Special Matters.

a. Generally. The Stock Purchase Agreement provides that from and after the Closing Date, Enron Corp. ("Enron") will indemnify and hold harmless Purchaser, Portland General Electric Company (the "Company") and their respective affiliates, and their respective officers, directors, employees, agents, partners, successors and assigns (collectively, the "Indemnified Parties") from all liabilities, losses, damages, claims, reasonable and documented costs and expenses (including reasonable attorney's fees) actually suffered or incurred by them (including by way of set-off against assets or otherwise) (collectively, "Losses") arising out of the Shared Special Matters.

- Purchaser is not entitled to be indemnified for any exemplary or punitive damages due to any breach of this Agreement.
- Purchaser is not entitled to be indemnified to the extent that Losses resulted from fraud, gross negligence, bad faith or willful misconduct of Purchaser.
- Purchaser is entitled to indemnification for the effect of a loss by the Company of its market-based rate authority as a result of a Shared Special Matter if market based rate authority is lost for a period of more than 24 months, in an amount equal to the lesser of (x) the agreed sale price of wholesale power to a buyer, minus the adjusted price to that buyer after application of cost-based caps required by the loss of market based rate authority and (y) \$1,000,000, for any periods in excess of the 24 months and occurring prior to the 3rd anniversary of the Closing.
- Purchaser is not entitled to be indemnified for Losses that are reserved for on the Company's 2002 balance sheet or that result in a reduction in the Purchase Price under the purchase price adjustment mechanism.

b. Shared Special Matters. Under the Stock Purchase Agreement, Shared Special Matters include the following matters, and all proceedings or matters arising from the same or related facts and/or circumstances (to the extent that they relate to pre-Closing acts or events):

- Existing FERC docket relating to alleged illegal power trades and failure to post transactions with affiliates in violation of codes of conduct and market based rate authority;
- Existing FERC dockets relating to show cause orders and 100 day discovery period for trading practices alleged to be in violation of Cal PX and CAISO tariffs prohibiting gaming and market manipulation.
- Existing FERC docket relating to alleged anomalous bidding.
- Existing FERC docket relating to alleged illegal trading practices in the California markets.
- Existing FERC docket relating to alleged illegal power sales in the Pacific Northwest markets.
- Two wholesale electric antitrust cases pending in USDC for the Southern District of California and the 9th circuit.
- Two lawsuits in California brought by the California Attorney General.
- Claims asserted by the US Commodities Futures Trading Commission ("CFTC") arising from the CFTC's subpoena of documents from the Company (6/17/02) relating to alleged market manipulation.
- Claims or liabilities arising out of, or related to the matters that are the subject of Civil Investigative Demands by Oregon Attorney General (7/8/02, 1/2/03, 3/5/03, 11/6/03).
- Class action in Washington claiming violations of the Federal Power Act.
- Claim by Coleville Indian Tribe regarding tribal claims to lands used to generate power.
- Port of Seattle lawsuit against 12 energy firms alleging antitrust and RICO violations.

c. Pre-Closing Sharing Mechanism.

- If any Shared Special Matters are settled or resolved, or reserves are taken with respect to a Shared Special Matter, following execution but prior to Closing, Purchaser will increase its Purchase Price by an amount equal to:

- Aggregate Amounts to be paid by the Company and/or its subsidiaries under all settled and resolved Shared Special Matters, plus reasonable and documented fees and expenses of external counsel and other third-party consultants relating to work performed for the Company or its subsidiaries following execution and prior to Closing for settled or resolved Shared Special Matters, plus reserves taken with respect to Shared Special Matters between 12/31/02 and the Closing (to the extent that such reserves (i) reduce purchase price through the purchase price adjustment mechanism and (ii) relate to matters other than those that have been settled or resolved as described above) ("Pre-Closing Settlement Amount"); multiplied by
 - 62.5%, unless with respect to any item included in Pre-Closing Settlement Amount, (i) no tax deduction is claimed by Enron and (ii) Enron delivers a "more likely than not" legal opinion that deductions would not be allowable; multiplied by
 - 10%.
 - Purchase Price Adjustment relates only to the initial \$104.4 million of Pre-Closing Settlement Amounts (i.e., the maximum increase in purchase price, assuming no tax deductions claimed, is \$10.44 million).
 - For any increase in Purchase Price for pre-Closing settlements or reserves, the size of the escrow and the indemnification cap for Shared and Non-Shared Special Matters is decreased by an amount equal to (i) the Pre-Closing Settlement Amount, less (ii) the size of the Purchase Price adjustment for pre-Closing settlements and reserves, except as described under Pre-Closing Settlement and Reserve Objection Rights.
- d. Post-Closing Sharing Mechanism. Purchaser's right to indemnification for Losses relating to Shared Special Matters is limited to 90% of such Losses, subject to reduction as described under Pre-Closing Settlement and Reserve Objection Rights.
- e. Pre-Closing Settlement and Reserve Objection Rights.
- If Enron proposes to enter into any settlement or to post any reserve with respect to a Shared Special Matter in excess of \$20 million, Purchaser is entitled to object to such settlement or reserve, in which case, Purchaser must provide a recommended amount of settlement or reserve that it believes to be reasonable. Following an objection, Enron may:
 - Elect not to effect the settlement, in which case, the amount of Losses for which Purchaser would be indemnified is capped at the average of the amount proposed by Enron and the amount proposed by Purchaser;
 - Elect not to post the reserve;

- Elect to effect the settlement or post the reserve in a matter not in excess of that proposed by Purchaser;
- Elect to effect the settlement or post the reserve as proposed by Enron, but only increase purchase price and decrease the size of the escrow account and indemnification cap by the amount proposed by Purchaser; or
- Elect to effect the settlement or post the reserve as proposed by Enron, and increase the purchase price and decrease the size of the escrow account and indemnification cap by the full amount, in which case, Purchaser would have a right to terminate the Agreement.

e. Indemnification Cap. Indemnification for the Shared Special Matters and the Non-Shared Special Matters is recoverable only from the escrow, which equals an amount (not less than zero) equal to (i) \$94 million, less, (ii) Pre-Closing Settlement Amount, plus (iii) the size of the Purchase Price adjustment for pre-Closing settlements and reserves.

2. Non-Shared Special Matters.

a. Generally. The Stock Purchase Agreement provides that from and after the Closing Date, Enron will indemnify and hold harmless the Indemnified Parties from all Losses arising out of the Non-Shared Special Matters.

- Purchaser is not entitled to be indemnified for any exemplary or punitive damages due to any breach of this Agreement.
- Purchaser is not entitled to be indemnified to the extent that Losses resulted from fraud, gross negligence, bad faith or willful misconduct of Purchaser.
- Purchaser is not entitled to be indemnified for Losses that are reserved for on the Company's 2002 balance sheet or that result in a reduction in the Purchase Price under the purchase price adjustment mechanism.

b. Non-Shared Special Matters. Under the Stock Purchase Agreement, Non-Shared Special Matters include the following matters:

- Breaches of representations and warranties of Enron.
 - In general, Enron's representations and warranties survive for 15 months following the Closing.
 - Representations and warranties relating to the ownership and transfer of the shares of the Company and the capitalization of the Company and its subsidiaries survive until the earlier of the (i) escrow being exhausted and (ii) 3rd anniversary of the Closing.
 - Representations and warranties relating to employee benefits matters survive until the earlier of the (i) expiration of the applicable statute of

limitations, (ii) escrow being exhausted and (iii) 3rd anniversary of the Closing.

- o Representations and warranties relating to tax matters do not survive the Closing (there is a separate tax indemnity).
- Breach of a pre-closing covenant (which survive for 15 months following the Closing).
- Liability solely as a result of Enron's direct or indirect ownership or control of the Company or its subsidiaries (not as a result of an act, omission or agreement of such entity, regardless of whether it's alleged that Enron caused such action or omission).
- Liability resulting from, relating to or based on alleged market manipulation and/or illegal trading activities (or any improper pre-closing action or omission related thereto) in the power markets located in the western U.S.

c. Basket. There is a "tipping basket" of \$12.5 million for breaches of representations, warranties and pre-closing covenants.

d. Indemnification Cap; Escrow. Indemnification for the Shared Special Matters and the Non-Shared Special Matters is recoverable only from the escrow, which equals an amount (not less than zero) equal to (i) \$94 million, less (ii) Pre-Closing Settlement Amount, plus (iii) the size of the Purchase Price adjustment for pre-Closing settlements and reserves.

3. Breaches of Post-Closing Covenants. The Stock Purchase Agreement provides that from and after the Closing Date, Enron will indemnify and hold harmless the Indemnified Parties from all Losses arising out of the breach of any covenant or agreement of Enron contained in the Agreement that by its terms requires performance after the Closing.

a. Survival. Post-Closing covenants survive until such covenant or agreement is performed.

b. Limitations.

- Purchaser is not entitled to be indemnified for any exemplary or punitive damages due to any breach of this Agreement.
- Purchaser is not entitled to be indemnified to the extent that Losses resulted from fraud, gross negligence, bad faith or willful misconduct of Purchaser.

c. Indemnification. Claims for indemnification are treated as an allowed administrative expense under the Bankruptcy Code.

4. Tax and Benefit Matters.

a. Tax Indemnification. Enron will indemnify and hold the Indemnified Parties harmless from and against all taxes (including interest and penalties) that are imposed upon or assessed against the Company or its subsidiaries or their assets or properties (as well as any costs of enforcement):

- As a result of the Company or its subsidiaries being severally liable for taxes of Enron or an affiliate thereof under Section 1.1502-6(a) or any analogous provisions of state, local or foreign law;
- For tax periods ending on or prior to the Closing (including taxes imposed as a result of the Company or its subsidiaries being severally liable for taxes of any other person under Section 1.1502-6(a) or any analogous provisions of state, local or foreign law);
- Taxes throughout the straddle period to the extent that they relate to the period up to and including the Closing Date.
- 50% of transfer and similar taxes incurred in connection with the Agreement.
- Taxes imposed on the Company or its subsidiaries for any taxable periods ending on or prior to the Closing by reason of being a successor-in-interest or transferee of another entity.

Enron is liable for the taxes described above only to the extent the total claims for such taxes exceed the amount of taxes (i) reflected in the net reserve for taxes (excluding reserves attributable to differences between tax basis and carrying value of assets over liabilities) and (ii) reduce the purchase price under the purchase price mechanism.

b. Exceptions to Tax Indemnification. Purchaser is not entitled to indemnification for:

- Taxes that that are barred from recovery under the applicable statute of limitations;
- Liability for taxes relating to non-ordinary course transactions taken by Purchaser or affiliates on or after the Closing;
- Interest or penalties attributable to tax returns required to be filed by Purchaser;
- Any taxes resulting from an actual or deemed Section 338 election and any similar election under state or foreign law; and
- Taxes to the extent they (i) are reflected in the net reserve for taxes (excluding reserves attributable to differences between tax basis and carrying value of assets over liabilities) and (ii) reduce the purchase price under the purchase price mechanism.

c. **Benefits Indemnity.** Enron will indemnify and hold the Indemnified Parties harmless from and against all Losses arising out of any employee benefit plan that are imposed against the Company or any of its subsidiaries or any of their assets:

- Related to defined benefit pension plan liabilities maintained by Enron that arise under Title IV of ERISA due to its being considered an ERISA affiliate of Enron;
- Due to the Company's status as a participating employer under (or due to the participation of Company employees in) the Enron Corp. Savings Plan;
- Arising out of or in connection with claims by any person other than a current or former employee or non-employee director of the Company against the assets set aside in the Company Umbrella Trust for Management and/or the Company Umbrella Trust for Outside Directors or any predecessor or successor trusts or subtrusts holding assets intended to be available to fund claims by current or former employees and non-employee directors of the Company under Company benefit arrangements;
- Arising out of or in connection with claims for deferred compensation or nonqualified retirement benefits by current or former employees or directors of Portland General Corporation or Portland General Holdings, Inc. that were intended to be paid out of assets set aside in the Portland General Holdings, Inc. Umbrella Trust for Management or the Portland General Holdings, Inc. Umbrella Trust for Outside Directors or any predecessor or successor trusts or subtrusts thereto; and
- Relating to group health insurance plans sponsored or maintained by Enron or its ERISA affiliates with respect to a termination of such health plans arising under 4980B of the Internal Revenue Code for plan participants and beneficiaries other than current or former employees of the Company, and their beneficiaries.

d. **Administrative Expense.** Claims for indemnification are treated as an allowed administrative expense under the Bankruptcy Code.

e. **Limitations.**

- Aggregate indemnification payments (when combined with all other indemnification payments) may not exceed the purchase price.
- Right to indemnification limited to an amount equal to 62.5% of a Loss, unless with respect to such Loss, (i) no tax deduction is claimed by the Indemnified Party and (ii) the Indemnified Party delivers a "more likely than not" legal opinion that deductions would not be allowable.

REQUEST OEUC 88:

Regarding Application, page 24, lines 13-15, and Exhibit 3, page 8, line 8: Provide specific examples of "possible decisions regarding long-term planning" and "critical decisions that will impact rates" that will be made during the next five years. Explain what criteria the board will use to make these decisions and how these criteria are different than criteria PGE's board has been using to make long-term planning decisions.

APPLICANTS' RESPONSE TO REQUEST OEUC 88:

One of the more significant and immediate long-term planning decisions that the PGE Board will face in the next five years will be the implementation of the 2002 Integrated Resource Plan (IRP), if acknowledged by the Commission, or, if not acknowledged, revision of that plan with the objective of obtaining acknowledgement. The mere acknowledgement of an IRP is never the final step in the continuous long-term resource planning process. The Board will need to ensure that the acknowledged plan is properly executed. It also will continually monitor the impact of changes in a dynamic electric marketplace – for example, changes in generation capacity and operation of the transmission grid – and take action that adapts to such issues by amending the plan, if warranted. In addition, the 2002 IRP itself provides – and the Commission rules require – that a new IRP will be filed in 2005. Therefore during the next year the Board will consider major long-term resource planning decisions that will be the subject of the 2005 IRP filing, relating to additional resource actions to be initiated in 2006 and 2007. In addition, the 2002 IRP, if acknowledged and implemented, would require yet further long-term resource planning in about 2008-2009, given the projected difference between PGE owned or contracted resources and demand. Thoughtful decisions regarding PGE's generation resources are critical to addressing the company's short position over time and in so doing, to improving rate stability.

Other long-term planning decisions and other critical decisions that will impact rates and that will be made in the next five years include whether, when and on what terms (a) to propose resource rate plans for mid- and long-term supply contracts with risk-adjustment compensation for the company, (b) to refinance debt if warranted by market conditions, (c) to address the impact of changes to Bonneville Power Administration's energy and capacity obligations, (d) to finance the building or acquisition of new generation resources and other major capital investment initiatives, (e) to initiate a general rate case, particularly if the proposed Port Westward generation plant is acknowledged, (f) to address changes in deregulation of the industry, (g) to define the Company's priorities and objectives as ones that are consistent with PGE's core business, (h) to review the performance of each sector of the business and take actions necessary to assure efficient performance is achieved in a manner consistent with the long-term interests of the customers, and (i) to consider proposed methodologies for net variable power cost adjustments related to hydro power variability risks.

The constitution of the new Board will be different from the current Board and this is likely to impact how the Board addresses these decisions. PGE's Board has been made up entirely of directors or executives of Enron and PGE. By contrast, the new Board will have several

independent directors (*i.e.*, not shareholders or employees), its directors will have diverse skill sets from a range of different industries, a number of its directors will have a depth of experience from serving on boards of a substantial number of other companies, and at least five of its directors will be from Oregon and bring local understanding and sensitivity to the Board. These attributes will create a Board with a fresh perspective, diverse expertise, local accountability and deep experience. It also will be a Board with members who have experience in helping companies develop innovative approaches to challenges rather than merely preserving the status quo.

As to specific criteria, the new Board will make decisions based on PGE's over-arching business mission of providing electric service in a safe and reliable manner with excellent customer service at a cost-effective price. In order to do this, it will apply its financial, operational, and management skills and resources to develop the appropriate specific criteria.

REQUEST OEUC 95:

Does OEUC envision the possibility that it may need to push cash downstream to PGE? If yes, how would OEUC access necessary capital, if needed, to support the on-going operations of PGE? Please identify the specific source of funds, segmented between equity and debt.

APPLICANTS' RESPONSE TO REQUEST OEUC 95:

Please see Response to Request OEUC 30, which discusses PGE's access to additional equity, and Response to Request OEUC 37, which analyzes PGE's liquidity. Please also see Confidential Exhibit A to Response to Request OEUC 65, a memorandum analyzing certain capital structure considerations.

PGE will continue to have independent access to capital to support its operations. Therefore, Oregon Electric believes that PGE is extremely unlikely to require cash, or otherwise seek additional capital, from Oregon Electric. However, in the event that Oregon Electric requires additional capital to support PGE's operations, such capital could be raised in private or public transactions involving the issuance of equity securities or debt instruments. The specific possible sources of such capital would need to be evaluated under the circumstances that then exist.

REQUEST OEUC 112:

Referring to Oregon Electric/Exhibit 3, Davis/11, lines 14-16: Please list and provide examples of TPG resources available to OEUC?

APPLICANTS' RESPONSE TO REQUEST OEUC 112:

Please see Applicants' Response to Request Staff/OEUC 77 (describing services to be provided by TPG to PGE).

Please see Applicants' Response to Request Staff/OEUC 78 (describing financial and organizational tools to be provided by TPG to PGE).

Please see Applicants' Response to Request CUB/OEUC 14 (describing experience TPG has in assisting companies in industries in the midst of change) (excerpted below for ease of reference).

Relevant Experience. While TPG has not previously invested in electric utilities, it does have particular experience assisting companies in industries in the midst of change. In the 1980s and early 1990s, the airline industry underwent similar restructuring that resulted in partial deregulation and the need for airlines to modify management structures to reflect a more competitive market. In that time period, TPG invested in Continental Airlines and America West, and under TPG's ownership, new management teams were put in place that led both companies to a dramatic turnaround.

Similarly, TPG invested in MEMC in the middle of the worst downturn in the history of the semiconductor industry, just two months after September 11, 2001. TPG led the effort to recruit a new CEO and board that included former semiconductor industry executives, spearheaded a series of initiatives to contain costs, rationalized order fulfillment processes, and reinvigorated core customer relationships through direct sales visits. As a result of TPG's leadership and the new management's efforts, MEMC avoided bankruptcy, recapitalized its balance sheet, and was able to maintain its headquarters and jobs in St. Louis.

TPG believes that this experience has some relevance to PGE's business and, as complimented by additional Board members and existing PGE expertise, will position Applicants with the necessary collective experience to meet the challenges ahead.

To amplify on the information above, the following lists some recent examples of the types of resources that TPG is providing to its portfolio companies. The list is not intended to be exhaustive, but rather to provide a flavor of the types of services that TPG provides to its companies.

In April 2004, TPG organized a CEO/Executive Conference for executives of its portfolio companies. The theme of the conference was how to initiate and accelerate change in an organization. In addition, a session on human resources best practices was

held. Attendees included TPG portfolio company executives, senior GE executives, and speakers from companies such as eBay, PepsiCo, and Continental Airlines, among others. The purpose of the conference was to impart the tools and processes used by GE and several other businesses around the world that have excelled at transformation, adaptation, and speed of change. The conference also provided a valuable forum for executives of companies in which TPG Funds have invested to share ideas and learn from one another.

In May 2004, TPG organized and hosted a conference for executives of its portfolio companies to learn about GE's Lean Six Sigma practices and how those practices might be applied to certain of the businesses in which TPG Funds have invested in order to improve efficiency and productivity. Lean Six Sigma practices are tools companies use to improve quality and efficiency and increase value to shareholders.

Finally, TPG partners have served on the boards of directors of more than 50 companies, and many have significant experience as former senior operating executives. These individuals serve as an ongoing resource for companies in which TPG Funds invest.

REQUEST OEUC 146:

Referring to Oregon Electric/Exhibit 4, McDermott/Page 4 of 17, line 22, please explain specifically how this transaction creates a greater alignment of owner and customer interests? Please provide an example of an interest that will become more aligned due to this transaction.

APPLICANTS' RESPONSE TO REQUEST OEUC 146:

Please see Applicants' Response to Request Portland/OEUC 16 (excerpted below for ease of reference):

a. As an investor in TPG, the interests of OPERS are aligned with the interests of PGE's customers in the same manner as those of Applicants. As stated in the Application, page 25, lines 20-23, "Applicants' investment ultimately will be successful only if PGE is successful. PGE's success is dependent on providing safe, reliable and cost-effective energy to its customers. Thus the Applicants' interests are aligned with those of PGE's customers."

Investors in regulated utilities understand that the potential return on their investment may be limited, which is in the customers' interest. In return, investors are given the opportunity to earn a reasonable rate of return. This regulatory framework ensures that the interests of private owners and the customers they serve are aligned.

For a specific example of how those interests are aligned in the matter of investments in utility assets with a useful life of over ten years, please see Applicants' Response to Request CUB/OEUC 21 (provided under separate cover dated May 7, 2004). The investors' interests are similarly aligned with the interests of PGE customers with respect to allowed rate of return, retained earning, dividend payments, and investments in utility assets with a useful life over ten years because the rules, processes, and oversight of the Commission assures alignment.

b. Although in theory there may be differences between the objectives of shareholders and customers, as a practical matter, given the regulatory oversight and the rules and measures the Commission has put in place, investors are precluded from acting outside the bounds of Commission rules and determinations in a manner that would be detrimental to customers. Of course, OPERS, as a limited partner in TPG III and TPG IV, would have no ability itself to assert control over PGE.

Please also see Applicants' Response to Request CUB/OEUC 21 (excerpted below for ease of reference).

First, Oregon Electric intends to own an interest in PGE for significantly longer than a few years. Furthermore, Applicants, whose ownership of

the utility is not indefinite, believe that long-term capital investments do make sense for an owner that may sell the utility in the shorter-term. Indeed, the interests of the ratepayers and Applicants are closely aligned in this matter. PGE's investors will only be able to realize a profit on their investment if PGE's value as a utility can be improved, a key driver of which will be increased stability. Critical to increasing the stability of this company is effectively addressing its energy "short" position, a critical component of which will come from long-term investments in generation resources. PGE cannot grow and thrive as a utility and service provider unless it has this necessary long-term capital investment, including that which targets the maintenance and enhancement of its existing assets. Applicants and investors would not benefit from allowing PGE to become resource or infrastructure deficient, or by delaying necessary capital improvements. Instead, such actions would undermine PGE's ability to serve its customers, and at the same time, its value to investors. Thus it is in the best interest of PGE ratepayers and Applicants to ensure that adequate long-term capital investments are made.

REQUEST CUB/OEUC 4:

At 3/Davis/12, Mr. Davis states that “[w]e expect to hold PGE longer than most of the companies in which we invest.” What is the average time TPG holds its companies? On what basis does Mr. Davis believe that TPG will hold PGE longer than this average?

APPLICANTS’ RESPONSE TO REQUEST CUB/OEUC 4:

TPG’s primary focus is not on the duration of its investments, but on the responsible stewardship of the companies in which it invests. Since TPG has only been in existence for 11 years, averages are not particularly helpful when it comes to measuring the length of TPG’s investments. However, as a matter of context, TPG still owns interests in many of the companies in which it has been invested longer than five years ago. Examples of how long TPG has held some of its investments, and how those investments were ultimately realized, include:

- TPG acquired Del Monte Foods Company in 1997 and continues to have a Board seat and an interest in the company.
- TPG invested in Denbury in 1995 and again in 1999. Denbury was a small, publicly-traded company with a limited following at that time. TPG held its investment in Denbury until earlier this year, when it sold its remaining shares through a public market equity offering nine years after its initial investment.
- TPG acquired Ducati Motors in 1995 and continues to hold a controlling interest in the company. Ducati is publicly traded today.
- TPG acquired J. Crew in 1997 and continues to hold a controlling interest in the company.

TPG’s investment goals for PGE, which include stabilizing the company and its earnings, building a more efficient and effective utility, addressing the company’s energy short position, and realizing profitable, long-term growth, will take significant time and attention. The regulatory process ensures that key decisions, such as rate setting and long-range planning, occur with a high degree of oversight and time for public review and inquiry. While careful investment in the utility industry may result in steady, long-term growth, it is unlikely to result in a quick return or profit. TPG knows this, and would not have chosen to invest in the industry if they were interested in a quick turnaround. Ultimately, TPG does not intend to sell its investment in PGE until it realizes its investment goals.

REQUEST CUB/OEUC 8:

Beyond any benchmarking analysis, please describe the analysis of PGE's operations that was conducted as part of TPG's due diligence.

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 8:

In the context of a corporate acquisition, the term "due diligence" generally refers to the investigation undertaken by the potential buyer of the business to be acquired. The purpose of due diligence in this context is provide the potential buyer with sufficient information to determine whether to pursue a transaction, and if so, the appropriate terms and purchase price for negotiations. Due diligence work is not intended to result in operational plans for the company, should it be acquired.

Due diligence seeks to identify a company's strengths, weaknesses, and liabilities by examining the company's competitive positioning, operations, financial condition, material legal and regulatory actions/issues, the condition of major physical assets, labor and employee issues, and organizational structure, among other things. As part of financial due diligence, prospective buyers will perform financial modeling in order to predict a broad range of possible scenarios with respect to financial performance. These scenarios are informed by the buyer's due diligence findings, which are typically limited by the level and quality of information to which the buyer has access. In order to establish a universe of potential assumptions for financial modeling, buyers sometimes use benchmarking. Benchmarking involves the comparison of certain of the target company's financial and operating metrics to publicly available information for comparable companies in order to help identify relative strengths and weaknesses, as well as potential areas of improvement.

TPG worked with two consultants to perform due diligence analyses of PGE's operations: the Boston Consulting Group ("BCG") and an industry executive, Jack Fusco, and his team ("Team Fusco"). BCG reviewed PGE's operations and structure, including PGE's load forecasts, operational and administrative costs, and rates. BCG also examined electric market and regional macro-economic matters. Team Fusco looked at PGE's physical assets, including generating resources and transmission infrastructure, power marketing operations, energy supply positions, and support systems and functions. The due diligence performed by BCG and Team Fusco was based on limited access to PGE's records, information, and personnel.

As part of the due diligence review, BCG undertook benchmarking of certain of PGE's operations and costs by comparing PGE to other utilities. The information on other companies was taken from data retrieved from various public sources. It is not necessarily truly "comparable" data and the specific circumstances of PGE (e.g., the inherent characteristics of its service territory, applicable weather patterns, generation resources, work force profile) render conclusions from such comparisons of limited applicability and usefulness.

Some of the due diligence by TPG and these consultants, including BCG's benchmarking analysis, produced preliminary findings that suggested that certain operating efficiencies

might be achieved. The benchmarking findings were limited by the factors discussed above. In addition, all of the analyses were necessarily limited by the fact that they were conducted from an external vantage point and with only the limited information afforded TPG and its consultants in the due diligence process. None of the due diligence findings were vetted with PGE to test their validity. The analyses on which the findings were based did not take into account a number of factors that would have to be considered before any plan to realize certain efficiencies could be drawn and implemented, such as potential impacts on customer service and reliability.

Oregon Electric and the identified Board members do not plan to take any actions with respect to PGE's operations based upon these preliminary, outside-in analyses. Rather, it is anticipated that PGE's Board will initiate more extensive internal benchmarking and other analyses upon closing as part of an initial review of PGE's operations. Applicants understand that they can conduct a full review and analysis of PGE's operations only after closing, when they have unlimited access to PGE's records and personnel and a complete understanding of all of the relevant considerations. Final decisions on what measures, if any, may be appropriate to achieve greater efficiencies can only be made after a thorough analysis of the impact of such measures on reliability, service quality metrics, and other similar considerations. Thus, the preliminary, rough-cut benchmarking analysis performed as part of due diligence cannot be regarded as an indication of what ultimately may be achieved. Rather, benchmarking results provided guidance as to Applicants' thinking on the various possible scenarios reflected in the model runs, not on a plan of operation for the company.

The following Extremely Confidential documents related to the work done by Team Fusco and BCG may be reviewed upon request at Ater Wynne's offices in accordance with the terms described in Applicants' Motion for Additional Protection filed April 19, 2004, with the OPUC:

- Revised Extremely Confidential Exhibit XX in Response to Staff Request OEUC 68, Boston Consulting Group – PGE Very Preliminary Cost Benchmarking, dated May 2003. This presentation discusses a first-pass preliminary cost benchmarking based on a few days analysis.
- Revised Extremely Confidential Exhibit YY in Response to Staff Request OEUC 68, Boston Consulting Group – Project Tahoe Update, dated August 25, 2003. This presentation provides an update on the analysis of PGE performed by the Boston Consulting Group.
- Revised Extremely Confidential Exhibit ZZ in Response to Staff Request OEUC 68, Boston Consulting Group – Project Tahoe Interim Discussion, dated August 28, 2003. This presentation provides an update on the analysis of PGE performed by the Boston Consulting Group.

- Revised Extremely Confidential Exhibit AAA in Response to Staff Request OEUC 68, Boston Consulting Group – Project Tahoe: Interim Assessment, dated August 21, 2003. This presentation provides an interim assessment of PGE's operations performed by the Boston Consulting Group.
- Revised Extremely Confidential Exhibit CCC in Response to Staff Request OEUC 68, August 20, 2003 Draft Memorandum from Tom Webb regarding Project Tahoe – Generating Facilities Due Diligence Summary. This memorandum discusses the results of a limited due diligence review of PGE's generating facilities.
- Revised Extremely Confidential Exhibit DDD in Response to Staff Request OEUC 68, August 20, 2003 Draft Memorandum from Tyler Reeder regarding Project Tahoe – Energy Markets and Market Position Due Diligence Summary. This memorandum reviews the Pacific Northwest power energy market, PGE's position in that market, and PGE's power trading operations.
- Revised Extremely Confidential Exhibit EEE in Response to Staff Request OEUC 68, August 20, 2003 Draft Memorandum from Jack Fusco regarding Project Tahoe – Corporate Due Diligence Summary. This memorandum discusses PGE's corporate support functions.
- Revised Extremely Confidential Exhibit FFF in Response to Staff Request OEUC 68, August 20, 2003 Draft Memorandum from Tom Bullis regarding Project Tahoe – T&D and Support Services Due Diligence Summary. This memorandum includes a summary of high-level due diligence of PGE's Distribution, Transmission, Substations, and Support functions and systems.

Additional analyses and observations made by TPG can be found in the following additional Extremely Confidential documents, which may also be reviewed upon request at Ater Wynne's offices in accordance with the terms described in Applicants' Motion for Additional Protection filed April 19, 2004, with the OPUC. These memoranda and presentations were made to TPG's Investment Review Committee ("IRC"), which is comprised of the partners of TPG who make final investment decisions for the firm. The materials were prepared by the TPG team working on the PGE transaction over the course of many months as the due diligence investigation of PGE and negotiations with Enron evolved. The IRC was briefed on the team's findings and issues that arose from time to time, and the accompanying materials represent iterative work product developed during most of 2003. Please see Applicants' Responses to Staff Requests OEUC 22 and 24.

- Revised Extremely Confidential Exhibit A to Response to Staff Request OEUC 24, Memorandum to IRC re: Portland General Electric – Update, dated April 21, 2003. This memorandum presents an update regarding negotiations with Enron, PGE's business, and certain investment issues.

- Revised Extremely Confidential Exhibit B to Response to Staff Request OEUC 24, TPG's Project Tahoe Investment Review, dated May 19, 2003. This presentation gives an update on negotiations, investment issues, PGE's business, and financial data.
- Revised Extremely Confidential Exhibit C to Response to Staff Request OEUC 24, TPG's Project Tahoe Interim Report on Due Diligence, dated August 25, 2003. This presentation gives an update on the due diligence process, key issues, PGE's business, and a proposed structure of the transaction.
- Revised Extremely Confidential Exhibit D to Response to Staff Request OEUC 24, Memorandum to IRC re: Update on Project Tahoe, dated August 31, 2003. This memorandum presents an update regarding business due diligence issues, negotiations, risks, and other investment issues.
- Revised Extremely Confidential Exhibit E to Response to Staff Request OEUC 24, Memorandum re: Update on Project Tahoe, dated September 2, 2003. This memorandum presents an update regarding business due diligence issues, negotiations, risks, and other investment issues.
- Revised Extremely Confidential Exhibit F to Response to Staff Request OEUC 24, Project Tahoe IRC Update, dated September 2, 2003. This presentation gives an update on the status of the transaction, a review of financial performance, an overview of the transaction, and certain financial and other information.
- Revised Extremely Confidential Exhibit G to Response to Staff Request OEUC 24, TPG's Project Tahoe IRC Update (Draft Form), dated September 10, 2003. This draft presentation gives an update regarding the status of the transaction, information on the proposed Port Westward facility, financing issues, and certain financial and other information.
- Revised Extremely Confidential Exhibit H to Response to Staff Request OEUC 24, TPG's Project Tahoe IRC Update (Draft Form), dated September 15, 2003. This draft presentation gives an update regarding the status of the transaction, information on the proposed Port Westward facility, financing issues, and certain financial and other information.
- Extremely Confidential Exhibit I to Fourth Supplemental Response to Staff Request OEUC 24, Memorandum regarding Update on Project Tahoe, dated August 25, 2003. This memorandum presents an update regarding business due diligence issues.

REQUEST CUB/OEUC 11:

Page 18 of the Application states that based “upon forecasts completed by the Applicants, PGE will be able to pay approximately \$80 to \$100 million of annual dividends to Oregon Electric. These forecasts incorporate budgeted capital expenditures to support reinvestment in PGE infrastructure as well as budgeted operations and maintenance expenses. This will translate into over \$250 million of pay down of debt principle over the first five years.”

- a. Provide a copy of the forecasts completed by the Applicants that are referred to above.
- b. Provide work papers that identify the details of these forecasts including the budgeted capital expenditures and operations and maintenance expenses.
- c. Do these forecasts include any changes in rates/revenue requirement? If so, when are these changes forecast, what are the amounts of the changes and what are the causes of the rate/revenue requirement changes?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 11:

- a. CUB has been provided with 48 scenarios that were generated from the electronic model TPG used to evaluate this transaction. These scenarios present an extremely wide array of different outcomes regarding the projected financial performance of PGE. For instance, in certain scenarios TPG assumed that PGE experienced limited load growth and continued to under-earn its allowed return on equity, while other scenarios assumed that PGE experienced robust load growth and/or achieved certain operating efficiencies in order to earn its allowed return on equity. Scenario 3 (which includes the building of new generation, such as Port Westward) and Scenario 23 (which does not include new generation), have been referenced for illustrative purposes in answering certain questions from CUB and the OPUC. In each scenario, PGE is expected to dividend excess cash flow to Oregon Electric after paying PGE's capital expenditures and meeting PGE's debt service requirements.

The average annual amount of cash flow that PGE would dividend to Oregon Electric over the first five years of the forecast period, as indicated in the tables below, is approximately \$90 million. Under Scenario 3, which includes \$265 million of incremental capital expenditures associated with Port Westward, the dividends in the early years are smaller but ramp up in the later years once Port Westward is completed and incorporated into the rate base.

Oregon Electric will use dividends from PGE to pay Oregon Electric's minimal operating expenses, interest on its debt, and to voluntarily pay down debt principal. On a consolidated basis, Scenario 3 implies that approximately \$255 million in debt principal is paid down over the first five years of the forecast period. In Scenario 23, debt pay down increases to approximately \$375 million

because PGE does not incur the capital expenditures associated with Port Westward. The capitalization at PGE under both scenarios meets the current 48% minimum equity ratio under the current ring-fencing provisions in all years.

To assist in an understanding of the various possible outcomes, Oregon Electric produced to CUB summary model printouts for all 48 scenarios, as well as full model printouts for Scenarios 3 and 23, under separate cover dated April 13, 2004.

- b. For details of the projected capital expenditures and operation and maintenance expenses, please refer to the model runs referenced above. In addition, please refer to Applicants' Response to Staff Request OEUC 97 for further discussion of projected capital expenditures.
- c. As a general matter across all 48 scenarios, there is no assumption for changes to base rates except for those scenarios in which Port Westward is assumed to be built. Operational efficiencies are assumed in some of these hypothetical scenarios, but no change was made in revenue requirements because the model was not intended to be used to predict rates (*i.e.*, the model assumes no changes in base rates except as noted in the prior sentence) and Applicants viewed any hypothetical operational efficiencies as contributing to PGE achieving its authorized rate of return rather than reducing revenue requirements. Lastly, it is important to note that rates will vary year to year due to changes in power costs—these power costs are incorporated into rates through the annual RVM process. Because the model does not forecast power costs (other than for illustrative purposes), it does not capture these annual changes in rates due to power costs. Power costs in the future will be driven by PGE's specific mix of resources, as well as the Pacific Northwest power markets more broadly.

In Scenario 3, which contemplates \$265 million of capital expenditures to construct Port Westward, the TPG model assumed that a rate case would be undertaken in mid-2006 to incorporate Port Westward at cost into the rate base and to adjust rates further to allow PGE to earn its allowed return on equity. This assumption is consistent with PGE's model contained in Enron's Plan of Reorganization, which assumed that Port Westward is constructed during 2004 and 2005, and that a rate case takes place in 2006 to incorporate Port Westward into the rate base and to allow PGE to earn a reasonable rate of return on equity. Given that TPG's model was designed to understand PGE's cash flow characteristics and not to properly project customer rates, the exact impact of a rate case on customer rates was not specifically contemplated and would require additional work with PGE management. Specifically, the model would have to be modified to reflect the cost and timing of constructing Port Westward, to develop a forecast of power costs over time (which represent the largest component of customer rates), and to quantify the potential reduction in rates that Port Westward would provide in the form of lower power costs.

Scenario 23 assumes that PGE does not build new generation, but rather addresses its short position with a combination of short-term power purchases and long-term

contracts. Scenario 23 does not contemplate a rate case or any changes to base rates during the forecast period.

BT PAYDOWN SUMMARY - SCENARIO 3 (\$MM)

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5	Average
Dividend from PGE to Oregon Electric		\$44	\$52	\$122	\$117	\$103	\$67
Debt Balances							
Oregon Electric Debt	\$707	\$690	\$667	\$574	\$484	\$405	
Annual Debt Paydown		\$18	\$23	\$93	\$90	\$79	
Cumulative Debt Paydown		\$18	\$40	\$133	\$224	\$303	
Consolidated Debt	\$1,774	\$1,805	\$1,770	\$1,686	\$1,596	\$1,517	
Annual Debt Paydown		(\$31)	\$35	\$84	\$90	\$79	
Cumulative Debt Paydown		(\$31)	\$4	\$88	\$178	\$257	
PGE Debt / Total Capitalization	51%	51%	49%	50%	50%		

DEBT PAYDOWN SUMMARY - SCENARIO 23 (\$MM)

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5	Average
Dividend from PGE to Oregon Electric		\$103	\$96	\$99	\$89	\$75	\$93
Debt Balances							
Oregon Electric Debt	\$709	\$631	\$560	\$486	\$420	\$366	
Annual Debt Paydown		\$78	\$70	\$74	\$66	\$54	
Cumulative Debt Paydown		\$78	\$149	\$223	\$289	\$343	
Consolidated Debt	\$1,695	\$1,586	\$1,504	\$1,439	\$1,372	\$1,319	
Annual Debt Paydown		\$109	\$82	\$65	\$66	\$54	
Cumulative Debt Paydown		\$109	\$192	\$257	\$323	\$377	
PGE Debt / Total Capitalization	49%	48%	48%	48%	48%		

REQUEST CUB/OEUC 14:

At page 24, the Application states “[TPG] will provide invaluable experience and expertise to help PGE management navigate the present industry turmoil.” What does TPG/OEUC foresee PGE having to navigate? What strategies does TPG have for addressing these potential pitfalls? What experience does TPG have in managing electric utilities?

APPLICANTS’ RESPONSE TO REQUEST CUB/OEUC 14:

The Challenges. The electric industry and PGE are undergoing a period of significant change:

- Efforts to partially de-regulate the electric industry at federal and state levels have altered the industry from one exclusively dominated by vertically integrated, cost-based, rate-regulated monopolies to one in which independent power producers compete in a real-time market and may be expected over time to play a larger role, customer choice may play a larger role, and there is potential for a shift to independent operation of transmission systems.
- The future role of BPA in the marketplace, both as an energy provider and as a transmission operator, is uncertain.
- Natural gas price volatility is increasingly playing a key role in setting electric rates.
- Reduced liquidity in the electric trading markets.

As PGE states in its Final Action Plan, filed on March 26, 2004, as part of its 2002 Integrated Resource Plan: “It is unclear whether public policy in the West will settle on a gradual movement to full electric wholesale and retail competition, or embrace a model of vertical integration in which short-term purchases and sales play only a balancing role.”

In addition to these general challenges, PGE is an “energy short” utility and is expected to be so over the next five to ten years. Key decisions on how to best serve and protect customers – through building of its own generation resources or continued dependency on the competitive market or some combination – will have to be made over the next several years and beyond.

The Strategy. Oregon Electric’s central strategy is to allow PGE to devote its sole focus to providing safe, reliable and efficient electric service to its customers. The distractions of the past several years have challenged management. This acquisition will not only eliminate many of those distractions, but management will also have clear Board direction to focus on its core business and not have its efforts diverted to managing other types of businesses.

This focus will be assured by a new, experienced Board, led by Neil Goldschmidt and populated with prominent Oregonians and national business leaders who will be instrumental in providing the guidance PGE will need to address the local and regional character of some of these challenges, as well as the broader aspects of these challenges.

Oregon Electric intends to implement this strategy by drawing on experience in regulated industries and in the competitive marketplace. In a period of a paradigm shift in the electric marketplace, having traditional utility skills and experience as well as a breadth of experience in a competitive marketplace will be critical. PGE has a depth of regulatory experience that the Board will use as a resource to inform its decision making. In addition, the Board will draw on the experience of the TPG Applicants in other regulated industries (see answer to (b) below), as well as the experience of industry leaders who will join the Board. This experience of operating in regulated environments will be combined with the substantial experience of TPG and other Board members in helping to operate companies in a competitive, dynamic marketplace. One important tool Oregon Electric expects the new Board will introduce is the use of fundamental market analysis as an important input into decision-making. The successful execution of the Applicants' strategy will depend on using information developed through fundamental analysis and other experience and techniques to achieve PGE's obligation to provide reliable, safe, and efficient energy to its customers. The Applicants believe they are particularly well equipped to do so.

Relevant Experience. While TPG has not previously invested in electric utilities, it does have particular experience assisting companies in industries in the midst of change. In the 1980s and early 1990s, the airline industry underwent similar restructuring that resulted in partial deregulation and the need for airlines to modify management structures to reflect a more competitive market. In that time period, TPG invested in Continental Airlines and America West, and under TPG's ownership, new management teams were put in place that led both companies to a dramatic turnaround.

Similarly, TPG invested in MEMC in the middle of the worst downturn in the history of the semiconductor industry, just two months after September 11, 2001. TPG led the effort to recruit a new CEO and board that included former semiconductor industry executives, spearheaded a series of initiatives to contain costs, rationalized order fulfillment processes, and reinvigorated core customer relationships through direct sales visits. As a result of TPG's leadership and the new management's efforts, MEMC avoided bankruptcy, recapitalized its balance sheet, and was able to maintain its headquarters and jobs in St. Louis.

TPG believes that this experience has some relevance to PGE's business and, as complimented by additional Board members and existing PGE expertise, will position Applicants with the necessary collective experience to meet the challenges ahead.

REQUEST CUB/OEUC 19:

Where are TPG's investors, the Local Applicant's, and the passive investors' profits going to come from? Do you foresee dividends or capital gains as the major component of the investors' profit? If you foresee capital gains as a portion of the profit, why will PGE be worth more in a decade? Have you given thought to future potential buyers of PGE? If so, who have you considered and why?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 19:

Any future return on a member's investment in Oregon Electric will come from either a sale of the member's interest or from a sale or initial public offering of PGE by Oregon Electric. In these instances, capital gains are expected to be the primary driver of a return to Oregon Electric's investors. Oregon Electric does not expect to pay regular dividends to its members.

The Applicants believe that PGE will be more valuable in the future under Oregon Electric's responsible ownership because the following is expected to occur in the years to come:

- PGE will free itself from the distractions, uncertainty, and potential legal liabilities arising from its current owner.
- PGE's new Board of Directors will apply its fresh perspective, diverse expertise, local accountability, and deep experience to focus PGE on its business mission of providing electric service in a safe and reliable manner with excellent customer service at a cost-effective price.
- PGE's new Board of Directors, with access to TPG's resources and personnel, can draw on this expertise when needed to create effective financing plans and execute those plans successfully.
- PGE will maintain and enhance its generation, transmission, and distribution assets to meet its service quality measures, which in turn will ensure that these assets will represent ongoing value to PGE's shareholders.
- PGE will make long-term commitments and investments to address its short energy position, which will in turn provide increased rate stability.
- Oregon's economy should enjoy a period of renewed growth and expansion after the last few years of economic recession, and PGE will be a partner with the Oregon business community in harnessing these renewed growth opportunities.
- PGE's earnings will stabilize and improve as many "one-time" charges that have negatively impacted the company's results for the last few years cease to continue in the future (e.g., write-offs and charges for the settlement of certain liabilities related to the 2000/2001 energy crisis; OPUC disallowment of certain power contracts entered into during 2001).

As a matter of course in evaluating any prospective investment, TPG assesses the range of possible exit alternatives, which often includes the potential for a public offering or a strategic sale. With respect to a public offering, TPG typically analyzes the potential range of trading multiples of comparable companies to the particular company in which it is considering investing. With respect to a sale, a review of potential strategic buyers is typically made. As it generally does in evaluating all potential investments, TPG evaluated the range of potential trading multiples in a prospective public exit of PGE. In addition, CSFB provided a brief review of potential strategic buyers that was based primarily on arraying those utilities that are geographically contiguous or proximate to PGE. While the eventual realization of TPG's investment in PGE could come by means of a sale or initial public offering of PGE stock, it is far too early to speculate as to what path will be best for PGE.

REQUEST CUB/OEUC 21:

Long-term capital investments make sense for an owner who intends to be around for a long time, but does not make sense for an owner who intends to sell the utility in a few years. Please explain why customers should feel confident that the proposed ownership will make the appropriate long-term capital investments, especially given the consent rights listed in Exhibit 7.

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 21:

First, Oregon Electric intends to own an interest in PGE for significantly longer than a few years. Furthermore, Applicants, whose ownership of the utility is not indefinite, believe that long-term capital investments do make sense for an owner that may sell the utility in the shorter-term. Indeed, the interests of the ratepayers and Applicants are closely aligned in this matter. PGE's investors will only be able to realize a profit on their investment if PGE's value as a utility can be improved, a key driver of which will be increased stability. Critical to increasing the stability of this company is effectively addressing its energy "short" position, a critical component of which will come from long-term investments in generation resources. PGE cannot grow and thrive as a utility and service provider unless it has this necessary long-term capital investment, including that which targets the maintenance and enhancement of its existing assets. Applicants and investors would not benefit from allowing PGE to become resource or infrastructure deficient, or by delaying necessary capital improvements. Instead, such actions would undermine PGE's ability to serve its customers, and at the same time, its value to investors. Thus it is in the best interest of PGE ratepayers and Applicants to ensure that adequate long-term capital investments are made.

REQUEST CUB/OEUC 26:

Kelvin Davis' testimony (3/Davis/11&12) and Exhibit 13 list summaries of select TPG investments. Please list all companies that have been purchased by any of the TPG partnerships (TPG Partners I, II, III or IV) and provide the following information about each purchased company:

- a. When did TPG purchase it?
- b. What was the purchase price?
- c. What was TPG's ownership stake in percentage terms?
- d. Of the total purchase price, how much was funded by debt and how much was funded by equity?
- e. Does TPG retain ownership of the company?
- f. If not, when did TPG sell it?
- g. Which of these were spun off into independent companies and which were sold to other companies?
- h. What was the sales price?
- i. How much had TPG reduced the debt associated with the purchase (d, above) when it was sold?
- j. How much of the sales price was equity and how much was debt?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 26:

Applicants object to the question on the grounds that it is overly broad and unduly burdensome and not reasonably calculated to lead to relevant evidence. In addition, the request calls for Extremely Confidential Information.

TPG does not maintain information about its investments in the form in which it has been requested; gathering the information requested would require a special study and hours of work by numerous TPG employees. In addition, much of the information requested is not relevant to this transaction. Subject to and without waiving the foregoing objections, Applicants provide the response below. In addition, Applicants are willing to work with CUB to provide additional specific information relevant to this request.

The table below provides summary information for the non-technology/telecom companies that TPG I, TPG II, TPG III, and TPG IV have invested in to date. The majority of these investments have not yet been fully exited. Of the investments that have been fully or partially realized, certain of the companies were taken public or TPG sold its shares in the public markets over time (9 transactions), while others were sold to strategic buyers (6 transactions). TPG's portfolio is segmented between

technology/telecom investments and non-technology/telecom investments. TPG's investments in the technology sector have tended to involve earlier stage and/or higher growth companies than the non-technology companies TPG tends to invest in, which inherently makes such technology sector companies higher risk and/or more volatile than the larger more established operating businesses typically invested in part of TPG's non-technology portfolio. While diverse in nature, TPG's non-technology portfolio has typically included companies characterized by significant size, long operating histories, strongly established franchises and brand names, and proven product and service offerings. By comparison, TPG's technology portfolio has typically included companies characterized by shorter operating histories, less established brand awareness, and risks associated with unproven or emerging technologies. These different characteristics have created portfolios with distinctly different risk-reward profiles. TPG's non-technology investments have seen more consistent results, as one would expect from a well-executed and diverse portfolio of non-technology investments, in comparison to the much higher levels of volatility, incidence of loss, and extraordinary profits that one would anticipate resulting from a technology-dependent portfolio. Accordingly, Applicants have provided CUB with information regarding TPG's non-technology portfolio as being more applicable to TPG's prospective investment in PGE.

TPG Non-Technology / Telecom Investments

Company	Approximate Investment Date	Final Exit Date ⁽¹⁾	Type of Exit ⁽²⁾		
			IPO / Public Offering	Strategic Sale	Other
TPG I					
PPOM, L.P.	04/15/94	01/15/97		X	
Banco Alianza	04/15/94	06/15/97		X	
Allied Waste Industries	12/15/94	05/15/97	X		
America West Airlines	05/15/94	Still Holding	X		
Beringer Wine ⁽³⁾	12/15/95	08/15/00		X	
Denbury - TPG I	12/15/95	03/22/04	X		
Virgin Entertainment	07/15/95	12/15/99		X	
Favorite Brands	09/15/95	04/15/00			X
Ducati	08/15/96	Still Holding			
Virgin Rail	03/15/97	10/15/98		X	
Del Monte	04/15/97	Still Holding	X		
TPG II					
Belden & Blake	07/15/97	Still Holding			
Vivra	06/15/97	Still Holding			
Genesis Health Ventures	10/15/97	09/15/99			X
J Crew	10/15/97	Still Holding			
Café Valley	02/15/98	Still Holding			
Diamond Brands	04/15/98	05/15/00			X
Oxford Health	05/15/98	02/15/02	X		
Aerfi ⁽⁴⁾	11/15/98	10/15/00		X	
Denbury - TPG II	04/15/99	03/22/04	X		
Punch Taverns	08/15/99	12/15/03	X		
Spirit Group	08/15/99	Still Holding			
Bally	10/15/99	Still Holding			
Piaggio	12/15/99	Still Holding			
Magellan Health	12/15/99	Still Holding			
TPG III					
GMP	03/15/00	Still Holding			
Petco	10/15/00	Still Holding	X		
Findexa	12/15/01	Still Holding			
Endurance Specialty Insurance	12/15/01	Still Holding	X		
Burger King	12/15/02	Still Holding			
Gate Gourmet	12/15/02	Still Holding			
Quintiles Transnational	09/15/03	Still Holding			
Scottish & Newcastle	11/15/03	Still Holding			
TPG III and TPG IV					
Debenhams	12/15/03	Still Holding			
KRATON Polymers	12/15/03	Still Holding			

Notes

- "Final Exit Date" represents time at which TPG's investment was completely realized. Investments identified as "Still Holding" represent investments in which TPG still has an interest.
- Exits characterized as "IPO / Public Offering" represent transactions in which the company went public (or, in certain cases, such as Denbury or Oxford Health Plans, was already public), and TPG subsequently exited its holdings through secondary sales in the public markets.
- Beringer was taken public through an IPO, and then was subsequently sold in a strategic sale.
- Aerfi paid a dividend to its shareholders, and then was subsequently sold in a strategic sale.

REQUEST CUB/OEUC 68:

At page 3, line 15 of Kelvin Davis' supplemental testimony the following is stated: "We also support PGE's ongoing capital expenditure program for transmission and distribution improvements." Please reconcile this statement with the last bullet on page OE 105344 of OEUC 24, Exhibit F.

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 68:

As part of its due diligence investigation, TPG and its consultants conducted a preliminary review of PGE's operations, including its capital expenditure budget. The consultants' initial impression was that PGE's capital expenditures could be reduced from the projected numbers, as reflected in the statement on page OE 105344. As described in more detail in Applicants' Response to Request CUB/OEUC 8, this due diligence review was significantly limited in a number of respects. Importantly, while the review was intended to provide guidance to TPG during the due diligence phase, it was never intended to serve as the basis for any operational changes, budget cuts, or other actions on Oregon Electric's part.

In fact, Oregon Electric's current intention is to continue to support PGE's ongoing capital expenditure program for transmission and distribution improvements. Oregon Electric notes that in all of TPG's financial modeling, TPG assumed that PGE continued to expend maintenance-oriented capital on a recurring basis consistent with past practice and management's projections, although in some scenarios, the level of expected capital expenditures was varied modestly to reflect the possibility of achieving capital efficiencies. See Model Description provided to CUB under separate cover dated April 14, 2004. Please also see Applicants' Confidential Response to Request Staff/OEUC 97, regarding projected levels of capital expenditures.

Please also see Applicants' Response to Request CUB/OEUC 8.

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

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

**REBUTTAL TESTIMONY
OF
CARRIE WHEELER
ON BEHALF OF OREGON ELECTRIC
(REDACTED VERSION)**

August 16, 2004

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I. INTRODUCTION

Q. Please state your name, occupation, and employer.

A. My name is Carrie Wheeler. I am a principal with Texas Pacific Group (“TPG”). My job is to identify, evaluate, and execute prospective investment opportunities, as well as to monitor and advise those companies in which we have existing investments. I often take lead responsibility for structuring and arranging the debt financing for the investments in which I am involved.

Q. Please describe your professional experience and education.

A. I have been with TPG since 1996. From 1993 to 1996, I worked as an analyst in the Mergers and Acquisitions Department and the Principal Investment Area of Goldman, Sachs & Co. I served on the Board of Directors of Denbury Resources, Inc., from 2000 to June 2004. I have a Bachelors of Commerce Honors degree from Queen’s University in Ontario, Canada.

Q. Have you ever testified before this Commission?

A. No.

Q. On whose behalf is this testimony presented?

A. This testimony is presented on behalf of Oregon Electric Utility Company, LLC (“Oregon Electric”).¹

II. PURPOSE

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to concerns raised by Staff and intervenors as to the sufficiency and prudence of the capital structure that Oregon Electric has chosen for its acquisition of PGE. In Section III of my testimony, I will briefly describe

¹ Throughout this testimony, I will use “Oregon Electric” to refer to Oregon Electric Utility Company, LLC, or to all Applicants, as the context may imply.

1 the model that TPG constructed in order to analyze the financial aspects of the Proposed
2 Transaction. In Section IV, I will explain the capital structure designed for the
3 Proposed Transaction, and how customers are protected from any risks that Oregon
4 Electric's capital structure may present. In Section V, I will discuss the expected terms
5 of the financing package for Oregon Electric and certain constraints to finalizing all the
6 terms of the financing package that exist at this stage in the regulatory approval process.

7 **III. TPG'S FINANCIAL MODEL**

8 **Q. What role did you play in Oregon Electric's acquisition of PGE?**

9 A. TPG assigns a "transaction team" to each of its potential investments. As a member of
10 the PGE transaction team, I worked with David Bonderman, Kelvin Davis, Rick
11 Schifter, and several other TPG employees on our due diligence investigation of PGE
12 and our negotiations with Enron.

13 In addition to my general involvement in the transaction, I was primarily
14 responsible for overseeing the financial analysis of the transaction, which included,
15 among other things, building and running a detailed financial model. During the course
16 of 2003, we worked with our banking advisors from Credit Suisse First Boston
17 ("CSFB") and our accounting advisors from Deloitte & Touche in order to construct a
18 detailed financial model of both PGE and Oregon Electric. Our goal in building the
19 model was to gain a thorough understanding of the financial characteristics of PGE
20 today and its prospects for future financial performance, which are suggestive of a range
21 of possible outcomes of the investment. This information was critical in allowing us to
22 determine, with a high degree of confidence, whether we wished to invest in PGE, and
23 if so, the purchase price, contract terms, and capital structure appropriate in these
24 particular circumstances.
25

1 **Q. Please briefly describe the process you used to build the model.**

2 A. The model is built upon information and assumptions sourced directly from PGE's
3 financial plans, including the PGE financial forecast that was disclosed publicly in
4 Enron's Plan of Reorganization, and input we received from PGE's finance team
5 regarding the basis for the underlying assumptions in their projections and how best to
6 construct the model.² This information included assumptions regarding PGE's load,
7 operations and maintenance ("O&M") expense, and capital expenditures.

8 The model allowed us to vary key assumptions and thus attempt to predict
9 PGE's future financial performance under a variety of different circumstances.
10 Accordingly, we modeled a multitude of different scenarios in order to gain an
11 understanding of a broad range of financial outcomes. Based upon our model runs, we
12 were able to design a capital structure for Oregon Electric that would provide for the
13 necessary ongoing investment in PGE's infrastructure and generation resources, as well
14 as withstand the potential for periods of depressed financial performance.

15 **Q. Has Staff commented on the quality of TPG's financial modeling?**

16 A. Yes. In his Direct Testimony, Staff witness Thomas Morgan stated the following:

17 In Staff's assessment, the myriad of models that TPG developed to
18 "stress test" the potential performance of PGE, and the residual
19 impact on the finances at OEUC, indicate a high level of
20 sophistication. The model and the runs that were created appear to be
21 high quality and detailed and the model instills confidence in the
22 overall results.³

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25 ² See Confidential Exhibit Staff/202, Morgan/226-228 (describing financial model); Confidential Exhibit
Staff/202, Morgan/229.

³ Staff/200, Morgan/34-35.

IV. CAPITAL STRUCTURE

1
2 **Q. Staff and a number of intervenors have suggested that the “double-leveraged”**
3 **capital structure subjects PGE to an unacceptable degree of risk. What is your**
4 **response?**

5 A. In their testimony, Staff and intervenors identify essentially three risks that they believe
6 are associated with Oregon Electric’s capital structure. First, they are concerned that
7 the debt at Oregon Electric will place undue pressure on PGE to cut costs or borrow in
8 order to fund dividends to Oregon Electric. Second, they are worried that the structure
9 will put PGE at risk of bankruptcy. And third, they are concerned that an expected
10 downgrade in PGE’s credit rating resulting from the leverage at Oregon Electric will
11 increase PGE’s cost of debt. In my view, each of these concerns is unfounded.

12 *A. Undue Pressure to Cut Costs*

13 **Q. Do you agree that the amount of debt at the holding company will place undue**
14 **pressure on PGE to cut costs?**

15 A. No, I do not. It appears that Staff’s and intervenors’ concerns (including their concerns
16 regarding bankruptcy) stem from their belief that the proposed level of debt at Oregon
17 Electric will result in large debt service requirements that will exceed PGE’s ability to
18 fund dividends to Oregon Electric. This concern is without basis.

19 During the due diligence phase, TPG took great care to analyze the amount of
20 dividends PGE could be expected to pay Oregon Electric (as well as historical dividend
21 levels prior to the Enron bankruptcy) within the 48% equity ratio below which PGE
22 cannot make distributions. This analysis allowed us to determine the amount of debt
23 that could prudently be placed at Oregon Electric. As described above, the extensive
24 financial modeling we performed gives us a high degree of confidence that PGE’s
25 dividends will be more than sufficient to service Oregon Electric’s debt. This

1 determination was made only after assessing various sensitivities that illustrated the
2 financial implication of highly unlikely, persistent financial underperformance by the
3 company.⁴

4 Moreover, a \$100 million revolving credit facility will be put in place at Oregon
5 Electric to ensure sufficient liquidity to service Oregon Electric debt obligations even in
6 the highly unlikely event that PGE's dividends are less than anticipated. The revolver
7 will provide additional protection that PGE will not be unduly pressured to fund
8 dividends if it ever becomes imprudent to do so.

9 To provide some illustrative numbers on this point, one of our baseline scenarios
10 illustrated that Oregon Electric would have average fixed charges during the forecast
11 period (which are expected to consist of after-tax interest expense, mandatory debt
12 amortization payments, and operating expenses) of approximately \$33 million per year.⁵
13 After the payment of these charges, Oregon Electric is forecasted to have excess
14 liquidity (comprised of dividends from PGE and undrawn revolver capacity at Oregon
15 Electric) of approximately \$155 million per year on average over the forecast period.
16 While these numbers are based on one scenario, the results are generally indicative of
17 the ample liquidity that will exist at Oregon Electric, which we further tested at length
18 by running various model sensitivities. It is important to note that this scenario assumes
19 substantial expenditures for the construction of new generation.

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24 ⁴ A "sensitivity" represents a scenario run through the model where one or more assumptions are modified (such
as load growth or the potential for operating efficiencies) to determine their potential impact on projected
financial performance.

25 ⁵ Based on Scenario 3 of the financial model previously provided to Staff, which assumed that PGE builds
significant new owned generation during the forecast period. See Staff/202, Morgan/230-305.

1 **Q. Please further describe the sensitivities TPG performed in order to test the**
2 **prudence of Oregon Electric's financial structure.**

3 A. TPG ran a number of different model scenarios that varied key assumptions to
4 understand their impact on the overall financial forecast and the robustness of Oregon
5 Electric's capital structure. Because PGE's Action Plan pertaining to its Integrated
6 Resource Plan had not been approved at that time, TPG modeled certain of its
7 projections assuming that new generation (based on Port Westward or other significant
8 new owned generation) would be built, and other scenarios assuming that new
9 generation would not be built.

10 Four basic scenarios were developed, each with and without new generation:
11 (1) a scenario assuming 2% load growth over the projection period; (2) a scenario
12 assuming 2.5% load growth; (3) a scenario assuming a faster than anticipated economic
13 recovery and slightly higher load growth over the projection period than in the first two
14 scenarios; and (4) a scenario assuming a slower than anticipated economic recovery and
15 slightly lower load growth than in the first two scenarios. Additional sensitivities were
16 performed to evaluate potential operating and capital efficiencies.

17 At Staff's request, and in order to "stress test" the capital structure, we ran
18 additional downside sensitivities that assumed 10%, 20%, and 30% declines in "EBIT"
19 from baseline scenarios for the entire 5-year projection period.⁶ EBIT means earnings
20 before interest and taxes. It is an important measure of the "core profitability" of a
21 company, prior to the payment of interest and taxes, both of which are impacted by the
22 capital structure of a company. For reference, PGE has generated average EBIT of \$244
23 million over the last ten years. This compares to projected EBIT levels of \$235 million

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25 ⁶ See Confidential Exhibit Staff/202, Morgan/169-178 (Applicants' Response to Request Staff/OEUC 37 and
Supplements thereto, outlining the financial ratios and parameters generally used by S&P in providing their
ratings advisory opinion for PGE and Oregon Electric).

1 in the 10% decline scenario, \$209 million of EBIT in the 20% decline scenario, and
2 \$183 million of EBIT in the 30% decline scenario.

3 Such sustained periods of meaningful declines implied by these “stress-testing”
4 analyses produces earnings that are much lower than PGE’s long-term, historical
5 average performance and, in particular, are unprecedented in terms of the 5-year
6 duration of the downturn in earnings. EBIT has been lower than the 30% decline
7 projections only twice in the past 15 years (12 years apart), and there has been no
8 instance of a persistent downturn at the earnings level implied by the 10%, 20%, or 30%
9 decline projections at any time in PGE’s past 15-year history.

10 Furthermore, the downturn in earnings posited by these analyses is so severe and
11 persistent that it could occur only if PGE were unable to recover its costs in rates. Such
12 an occurrence would imply a complete departure from the regulatory compact under
13 which PGE currently exists, and is very difficult to imagine. That being said, the results
14 of these “stress-testing” runs demonstrated that even during a period of unprecedented
15 difficulty, the capital structure would allow for ample liquidity and debt service
16 requirements to be met. Moreover, these sensitivities showed that even if EBIT were to
17 decline 10% and 20% from the baseline projections throughout the 5-year forecast
18 period (ending in 2009), PGE’s and Oregon Electric’s core credit statistics (such as
19 funds from operations to total debt, interest coverage, and total debt to capitalization)
20 would remain strong and indicative of S&P senior secured credit ratings of BBB+ for
21 PGE and ratings of BB for Oregon Electric. Even if EBIT were to decline by 30% from
22 the baseline projections for the entire forecast period upon which the analysis was
23 based, Oregon Electric would have sufficient liquidity to cover its financial obligations.
24 Under this scenario, PGE would maintain S&P senior secured credit ratings of BBB and
25

1 Oregon Electric would maintain ratings of BB. These characteristics speak to the
2 resilience of Oregon Electric's proposed capital structure.

3 Thus, while these sensitivities tested extremely remote scenarios, they are
4 helpful in demonstrating that the proposed capital structure for Oregon Electric and
5 PGE is prudent, even in the event of a downturn in financial performance of
6 unprecedented severity and duration.⁷

7 **Q. Do Oregon Electric's projections depend on the assumption that PGE will achieve**
8 **savings with respect to PGE's budgeted O&M and capital expenditures?**

9 **A.** No. As discussed in more detail in Kelvin Davis' testimony, TPG's due diligence work
10 suggested that it was possible, based on a preliminary "outside-in" analysis, that certain
11 savings with respect to PGE's budgeted O&M expense and capital expenditures might
12 be achievable under Oregon Electric's ownership. For that reason, the model runs
13 assume O&M savings ranging from *****BEGIN CONFIDENTIAL***** [REDACTED]
14 *****END CONFIDENTIAL***** annually, relative to a total projected non-fuel
15 O&M level of \$279 million in 2004.

16 In addition, as outlined in Kelvin Davis' testimony, the models also assumed
17 between *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
18 **CONFIDENTIAL***** in capital expenditure efficiencies. Importantly, all scenarios
19 assumed that projected capital investment remained consistent with, or in excess of,
20 historical investment levels.⁸

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22
23 ⁷ See Oregon Electric/201, Wheeler/7-8 (Applicants' Response to Staff/OEUC 42, testing scenarios where LIBOR
is one to three percentage points above projections).

24 ⁸ Staff witness Mr. Durrenberger states in his testimony that TPG consultants estimated between *****BEGIN**
25 **CONFIDENTIAL***** [REDACTED] *****END CONFIDENTIAL***** in annual O&M and capital
expenditures savings. However, none of our model scenarios contemplate this level of savings. As described
above, the model scenarios assume between *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
CONFIDENTIAL*** in savings.

1 Significantly, model runs that do not contemplate any savings still demonstrate
2 that there is sufficient liquidity to meet all debt service obligations. Therefore, there
3 would be no undue pressure to reduce costs at PGE. On the contrary, PGE will face
4 only the healthy desire of its owners, customers, and regulators to see the company
5 operate as efficiently as possible, providing customers with safe, highly reliable
6 electricity on a cost-effective basis.

7 **Q. Does that mean Oregon Electric will not seek savings in O&M expenses or capital**
8 **expenditures?**

9 A. Not at all. As explained by Mr. Davis, while Oregon Electric does hope to help PGE
10 gain efficiencies that may result in savings, it has no formal plan to do so unless and
11 until its own investigation, led by the new Board of Directors in conjunction with
12 management, confirms that such savings can be achieved without compromising the
13 safety, reliability, or service that PGE's customers currently enjoy. If any savings can
14 be achieved under such circumstances, this would have the effect of improving PGE's
15 return on equity ("ROE"), which is significantly below authorized levels, partially
16 mitigating the need for a rate case.

17 **Q. Staff is concerned that, in the unlikely event that profits at PGE were insufficient**
18 **to service debt at Oregon Electric, PGE might be harmed by drawing on its**
19 **revolver to send cash to Oregon Electric. Is this concern valid?**

20 A. No, it is not. I would again point out that our modeling demonstrates that the possibility
21 that PGE's earnings would be so depressed as to prevent the sufficient payment of
22 dividends to Oregon Electric is quite remote. But if such an unlikely event were to
23 occur, Oregon Electric's proposed ring-fencing⁹ commitments would assure that there
24 would be no adverse impact on PGE.

25 ⁹ By ring-fencing, I am referring to the following merger conditions imposed by the Commission in UM 814:
• PGE shall maintain separate debt and, if outstanding, preferred stock ratings.

B. Bankruptcy

1
2 **Q. Some intervenors suggest that the capital structure poses a risk that either Oregon**
3 **Electric or PGE might be required to file bankruptcy. How do you respond?**

4 A. First, I note that there is a distinct lack of evidence to back these concerns; indeed these
5 fears appear to be without relevant analytical or experiential support. Second, all of our
6 extensive modeling, which is rigorous and highly analytical, and our vast experience in
7 using prudent amounts of leverage to help finance investments, indicate that the capital
8 structure that will be in place at Oregon Electric can be supported, even in the unlikely
9 event of a significant and sustained downturn in PGE's earnings. We have no reason
10 whatsoever to anticipate bankruptcy. Moreover, even if there were to be a bankruptcy
11 at Oregon Electric, the ring-fencing conditions that we anticipate will be in place would
12 protect PGE and its customers—just as they have been so effectively protected during
13 the Enron bankruptcy.¹⁰

14 **Q. ICNU witnesses Antonuk and Vickroy point to the situations of NUI Corporation**
15 **and Northwestern as illustrating some of the dangers posed by this transaction.**
16 **Can you respond?**

17 A. The situations of these two companies are not applicable to Oregon Electric.
18 Northwestern and NUI Corporation—both holding companies for utilities—suffered
19 financial distress after they pursued aggressive growth strategies by investing in risky
20 unregulated businesses. There is no evidence to suggest that the holding company

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- 21 • PGE shall not make any distribution to Enron that would cause PGE's equity capital to fall below 48
22 percent of the total PGE capital without Commission approval. The Commission Staff, PGE, and Enron
23 may re-examine this minimum common equity percentage as financial conditions change, and may
24 request that it be adjusted.
 - 25 • Enron, PGE, and the Commission Staff agree that the allowed return on common equity and other costs
of capital will not rise as a result of the merger. These capital costs refer to the cost of capital used for
purposes of rate setting, avoided cost calculations, affiliated interest transactions, Least Cost Planning,
and other regulatory purposes.

OPUC Order No. 97-196 (Jan. 4, 1997), Appendix A (Stipulation).

¹⁰ See PGE/100, Piro/*.

1 structures themselves, or the levels of leverage *per se*, caused NUI's and
2 Northwestern's financial troubles. Rather, it was the lack of financial support from
3 their underperforming unregulated businesses that led to their woes. Oregon Electric
4 does not contemplate entering into new unregulated businesses and will exist solely to
5 hold PGE. Antonuk and Vickroy's citation of these troubled companies is an
6 inappropriate comparison to the basis upon which the capital structure has been
7 established for Oregon Electric.

8 **Q. Antonuk and Vickroy recommend that Oregon Electric agree to a "golden share"**
9 **arrangement to ensure that in the event of a bankruptcy at Oregon Electric, PGE**
10 **will not unnecessarily be "consolidated"¹¹ into bankruptcy as well.¹² What is your**
11 **response?**

12 A. As I have explained, I believe that the risk of Oregon Electric filing bankruptcy is
13 remote given the strength of our financial structure. Moreover, in the event Oregon
14 Electric were to file bankruptcy, I do not see that a "golden share" arrangement would
15 provide PGE with any substantial protection. However, we have consulted our legal
16 advisors and we are confident there is no real risk of consolidation.

17 **Q. The testimony of CUB and ICNU suggest that any risk associated with Oregon**
18 **Electric's capital structure will be borne by PGE's customers. Do you agree?**

19 A. No, I do not. First, TPG and the other shareholders of Oregon Electric are investing
20 approximately half a billion dollars to purchase PGE's equity stock. This equity capital
21 is at risk if our projections are meaningfully incorrect. Accordingly, we have every
22 incentive to ensure that our projections are based on the highest quality analyses
23 possible, and that our capital structure is sound. On the other hand, with anticipated

24 ¹¹ Consolidation describes the situation where the assets and liabilities of two or more separate legal entities are
25 combined and treated as the assets and liabilities of a single legal entity in a bankruptcy proceeding.

¹² ICNU/200, Antonuk-Vickroy/14.

1 ring-fencing and all of the Commission's protections in place, PGE and its customers
2 will be highly insulated from the effects of any distress that could possibly occur at
3 Oregon Electric. More specifically, Oregon Electric has agreed to conditions that (a)
4 guarantee customers will be held harmless against higher revenue requirements as a
5 result of the acquisition, and (b) there will be no increase in the cost of capital at PGE as
6 a result of the acquisition.¹³ It is Oregon Electric and the investors who bear any risk
7 that might exist, not PGE's customers nor PGE as a corporate entity.

8 **Q. ICNU witnesses Antonuk and Vickroy propose a number of conditions that they**
9 **believe should be included in the final financing agreements of Oregon Electric in**
10 **order to protect PGE's customers in the event of bankruptcy. Could you please**
11 **comment on these?**

12 A. ICNU witnesses Antonuk and Vickroy propose four representations or covenants that
13 they believe should "apply to existing and future indebtedness."¹⁴ The first is: "*That*
14 *the utility is being operated as a corporate and legal entity separate from all affiliates.*"
15 This representation is already clearly provided for under the affiliated interest and other
16 statutes, rules, and policies. There is no reason to include this verbiage in financing
17 agreements.

18 The second suggested representation is: "*That lenders to the parent and*
19 *affiliates in agreeing to make loans have relied solely on the creditworthiness of the*
20 *parent and affiliates, based on the assets and equity interests owned by the parent and*
21 *affiliates.*" We anticipate that Oregon Electric's potential lenders will rely solely on
22 Oregon Electric's assets, including its equity interest in PGE, to make their loans to the
23 holding company. Thus, this condition comports with our plans.

24
25 ¹³ See Oregon Electric/100, Davis/*.

¹⁴ ICNU/200, Antonuk-Vickroy/25-26.

1 The third suggested representation is: *“That the repayment of parent and*
2 *affiliate indebtedness will be made solely from assets of the parent and affiliate, and not*
3 *from any assets or pledge of assets of the utility.”* The assets of PGE will not be
4 pledged to Oregon Electric’s lenders, and Oregon Electric’s lenders will not have
5 recourse to PGE’s assets. Accordingly, we do not believe that potential lenders to the
6 parent will rely on PGE’s assets for repayment of their loans. However, we expect
7 Oregon Electric’s potential lenders will rely on Oregon Electric’s assets, which include
8 the shares of PGE representing an equity interest in PGE and related dividends,
9 provided that such dividends may not be paid to Oregon Electric unless PGE is at or
10 above the 48% equity ratio. Therefore, this condition is acceptable, with the
11 modification that the parent’s assets include dividends received by virtue of its equity
12 interest in PGE.

13 The fourth suggested representation is: *“That no lenders will take any steps to*
14 *procure the appointment of a receiver or to institute any bankruptcy, reorganization,*
15 *insolvency, wind up, liquidation, or like proceeding that includes the utility or any of*
16 *these assets.”* We do not believe that this condition provides any substantive protection
17 to PGE or its customers and notably, we could not find this provision in the credit
18 documents of other holding companies that own regulated utilities. Oregon Electric
19 creditors would not be creditors of PGE and would not have a claim against PGE’s
20 assets because PGE would neither guarantee nor pledge its assets for the benefit of the
21 parent’s obligations. Oregon Electric creditors would only have a claim to the parent’s
22 (Oregon Electric’s) assets.

C. *PGE's Credit Ratings*

1
2 **Q. Both Staff and other intervenors noted Standard & Poor's proposed credit**
3 **downgrade of PGE and voiced concerns that it would result in a higher cost of**
4 **debt for the utility.¹⁵ Can you respond?**

5 A. Standard & Poor's Rating Evaluation Service ("Standard & Poor's") has provided
6 guidance suggesting that PGE's corporate credit rating may be downgraded "one notch"
7 from BBB+ to BBB upon closing of the transaction. Based upon our advisors'
8 evaluation, we do not believe that such a downgrade would materially affect PGE's
9 total borrowing costs. And in any event if it does, Oregon Electric has already agreed to
10 a condition that prevents customers from bearing this cost to the extent it arises as a
11 result of Oregon Electric's acquisition.

12 First, Standard & Poor's has advised that PGE will maintain its investment
13 grade rating, and PGE's senior secured debt rating is expected to remain at its current
14 rating of BBB+. Therefore, there should be no impact on the cost of PGE's secured
15 debt, which represents almost 80% of PGE's total debt, as a result of this transaction.
16 Standard & Poor's does expect PGE's senior unsecured rating to fall by only one notch
17 from BBB to BBB- following the closing of the transaction. However, substantially all
18 of PGE's senior unsecured debt has fixed rate coupons and does not begin maturing
19 until 2010. Therefore, there will be no near to medium-term impact on the cost of
20 PGE's senior unsecured debt from a potential downgrade. Moreover, by the time any of
21 this debt comes due in 2010, Oregon Electric expects that it will have meaningfully
22 improved its credit ratings due to the amount of debt that will have been paid down in
23 the intervening period. In this context, it is important to note that Oregon Electric's
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25

¹⁵ Staff/200, Morgan/29-31; ICNU/200, Antonuk-Vickroy/16-18.

1 plan is to use free cash flow to pay down debt at Oregon Electric, which will have the
2 benefit of improving the consolidated credit profile over time.¹⁶

3 Significantly, we have consulted our financial advisors at CSFB on the projected
4 financial impact of the expected one notch downgrade at PGE. We have been advised
5 that, even if PGE needed to issue unsecured notes at the BBB- rating, rather than the
6 current BBB rating, the basis point spread, or the difference in interest rate, between
7 what it would be able to raise unsecured debt at would be a maximum of 25 points. To
8 frame the potential magnitude of this difference, if PGE theoretically raised \$100
9 million of new unsecured debt, this would have a maximum incremental cost of
10 \$250,000 per year.

11 **Q. Staff has pointed out that the overall credit profile will be improved by the**
12 **expected pay down of debt at Oregon Electric, which is based on the cash flow**
13 **sweep provisions envisioned in the Highly Confident Letter. Is Oregon Electric**
14 **willing to commit to specific terms of the cash flow sweep, separate and apart from**
15 **the financing documents?**

16 A. Yes. Oregon Electric will agree to a cash sweep provision as particularly defined in Mr.
17 Davis' testimony.¹⁷ Oregon Electric is committed to paying down debt at the holding
18 company and thereby improving its overall credit profile. Specifically, Oregon Electric
19 accepts the following condition: For a period of three years following the completion of
20 the closing of its acquisition of PGE, Oregon Electric will apply the proceeds of
21 dividends from PGE solely to pay interest, reduce debt, and cover the Oregon Electric
22 operating and other expenses. This "cash sweep" condition complements the ring-
23 fencing conditions Oregon Electric has committed to and, to be clear, is acceptable only
24 in conjunction with those other conditions.

25 ¹⁶ See Confidential Exhibit Staff/202, Morgan/169-178.

¹⁷ See Oregon Electric/100, Davis/*.

D. *Ring-Fencing*

1
2 **Q. Do you believe that the “ring-fencing” provisions currently in place provide**
3 **sufficient protection to PGE?**

4 A. Yes. The Enron ring-fencing merger conditions that are currently in place provide
5 sufficient protection for PGE, and Oregon Electric has previously agreed to adopt these
6 conditions. These conditions played an important role in helping insulate PGE’s credit
7 quality from that of Enron during its bankruptcy. Standard & Poor’s has affirmed the
8 effectiveness of these ring-fencing measures, citing their implementation as the reason
9 why PGE has maintained credit ratings that are indicative of its stand-alone credit
10 quality and the reason for which PGE is the sole Enron subsidiary that enjoys this
11 treatment.¹⁸ The strength of the current ring-fencing is also highlighted by Fitch
12 Ratings, Ltd., who has praised the current structure as being the “poster child for
13 effective regulatory ring-fencing.”¹⁹

14 In fact, PGE’s ring-fencing merger conditions are more robust than those of
15 other regulated utilities in the region, some of which lack ring-fencing altogether. For
16 example, such regional utilities as Avista Utilities (division of Avista Corp.), Idaho
17 Power (a subsidiary of IDACORP), and Puget Sound Energy (a subsidiary of Puget
18 Energy, Inc.) lack any such provisions, and Sierra Pacific Power Company and Nevada
19 Power Company (subsidiaries of Sierra Pacific Resources) only started operating under
20 dividend restrictions mandated by the Public Utility Commission of Nevada in
21 December 2003.

22 As I stated above in Section B, ICNU witness Antonuk and Vickroy cited NUI
23 and Northwestern in an attempt to illustrate the supposed danger posed by this
24 transaction; however, unlike Oregon Electric, NUI Corporation and Northwestern did

25 ¹⁸ See Oregon Electric/201, Wheeler/1-2.

¹⁹ See Oregon Electric/202, Wheeler/3.

1 not operate under any ring-fencing conditions. Northwestern's corporate structure
2 allowed the utility to take on the equity risk of subsidiaries and the utility's finances
3 were intertwined with non-utility businesses. Similarly, NUI co-mingled cash between
4 utility and non-utility operations, loaned money from the utility to the parent, and was
5 accused of over-allocating shared services to the utility. NUI has recently put in place a
6 ring-fencing structure to curtail such practices and stabilize the utility's financial
7 situation. The combination of Oregon Electric's commitment to ring-fencing, and the
8 fact that Oregon Electric's only holding will be PGE, will provide substantial protection
9 to PGE.

10 FINAL FINANCING DOCUMENTS

11 **Q. Staff has stated that it cannot judge the Proposed Transaction until it knows all of**
12 **the terms that will be incorporated in the final financing documents. Why have**
13 **you not provided Staff with copies of the final financing terms?**

14 A. We have had extensive and ongoing conversations with CSFB about the expected
15 financing and believe that Oregon Electric will secure financing on substantially the
16 same terms as those outlined in the Highly Confident Letters that were provided
17 November 18, 2003, recognizing that such letters embody the expected material terms
18 and conditions of the financing. However, it is standard market practice that the full
19 financing documents are not finalized until the financing is ready to be consummated
20 and the transaction is ready to close. It is a "cart before the horse" issue.

21 Given the lengthy and involved nature of the regulatory approval process, it is
22 premature to complete financing documents because they must take into account the
23 conditions, constraints, and commitments resulting from this approval process.
24 However, we expect to work with our financing sources over the coming months to
25 begin to secure near-final financing commitments and prepare financing documentation

1 that will be ready with sufficient time for review by Staff and intervenors before final
2 Commission action.

3 We recommend Staff and intervenors rely on the Term Sheet terms. If there are
4 any material deviations, we will advise immediately. TPG has raised tens of billions of
5 dollars of debt financing over the last decade and we are highly confident of our ability
6 to secure financing on attractive and market terms in this situation as well.

7 **Q. Can you predict what terms will be incorporated with a reasonable degree of**
8 **confidence?**

9 A. As I have noted, CSFB has provided us with a Highly Confident Letter that outlines the
10 key terms and conditions that CSFB was highly confident it would underwrite at the
11 time it provided that letter. Market conditions can change, but at this point, CSFB's
12 updated guidance has affirmed that they remain "highly confident" that they can arrange
13 financing as to the expected spreads on the Senior Secured Credit Facilities and the
14 expected rate on the Senior Notes, and that the other terms and conditions will be
15 substantially similar to those contained in the Highly Confident Letter. Additional
16 terms and conditions that are more typically left to final documentation will be added,
17 which would include customary provisions for facilities of this type such as the role of
18 the administrative agent, loan assignments among the lenders, and the precise levels of
19 financial maintenance covenants, among others.

20 **Q. A number of intervenors have noted concerns about the variable rate nature of the**
21 **financing.²⁰ Please comment.**

22 A. Oregon Electric's proposed debt financing structure, which is based on both Senior
23 Secured Credit Facilities and Senior Notes, can mitigate against potential increases in
24 interest rates post closing. The Senior Notes will be at a fixed rate for the entirety of
25

²⁰ Staff/200, Morgan/30; ICNU/200, Antonuk-Vickroy/22-24.

1 their 10-year life. The rates on the Senior Secured Credit Facilities are based on fixed
2 spreads over a LIBOR rate, where the underlying LIBOR rate has the ability to float or
3 move over time. However, these floating rates can be swapped to fixed rates, thereby
4 removing any variability in the interest expense on these securities. We actually
5 anticipate that the lenders will require Oregon Electric to swap up to 50% of the Senior
6 Secured Credit Facilities to fixed rates, depending on market conditions. There is
7 obviously a cost to having the certainty of a fixed rate, and the benefit of that certainty
8 must be weighed against the ability to enjoy lower overall interest costs by floating for
9 some period of time.

10 It is also worth noting that the vast majority of debt at *both* PGE and Oregon
11 Electric will be at fixed rates, so that any exposure to variable rate interest is actually
12 quite manageable. With substantially all of the debt at PGE today and the Senior Notes
13 at Oregon Electric at fixed rates, only about 15% of the combined debt will be floating
14 on average over the first five years of the forecast period²¹, assuming approximately
15 50% of the Senior Secured Credit Facilities will continue to have floating rate debt with
16 the remainder “swapped” from floating to fixed interest. We believe that the existence
17 of some floating rate debt is imminently manageable, and does not pose any material
18 risk in Oregon Electric’s capital structure. Indeed, Thomas Morgan of Commission
19 Staff characterized TPG’s assumptions regarding interest rates as reasonable and
20 appropriately conservative: “It appears that the financial models have used reasonable
21 interest rates that may be expected to cushion the current movements in the market.”²²

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25 ²¹ Based on Scenarios 3 and 23 of the financial model previously provided to Staff. *See* Staff/202, Morgan/230-382.

²² Staff/200, Morgan/30.

1 **Q. Are you providing additional information to Staff and intervenors regarding**
2 **TPG's financial modeling and the financing and capital structure for Oregon**
3 **Electric and PGE under the Proposed Transaction?**

4 A. Yes. I have attached to my testimony some of the many data responses Oregon Electric
5 prepared for Staff and intervenors regarding these issues, which I believe may also be
6 helpful in addressing some of the concerns raised by these parties in their testimony.²³

7 **Q. Does this conclude your testimony?**

8 A. Yes.

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²³ See Oregon Electric/201, Wheeler/1-29.

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An Enron Subsidiary is "Ring-Fenced"

Publication date: 16-Jan-2003

Credit Analyst: Swami Venkataraman, San Francisco (1) 415-371-5071; James Penrose, Esq., New York (1) 212-438-6604

On Nov. 25, 2002, Standard & Poor's affirmed Portland General Electric Co.'s (PGE) 'BBB+' corporate credit rating following the implementation of ring-fencing structures designed to insulate the credit quality of PGE from that of its parent Enron Corp. (D/--/--). As a result, PGE is the only Enron subsidiary to be rated on its own credit merits.

In October 2001, Northwest Natural Gas Co. (Northwest; A/Stable/A-1) had agreed to buy PGE from Enron. Subsequently, Standard & Poor's lowered its ratings on Enron following that company's bankruptcy. PGE's ratings were not lowered, reflecting Standard & Poor's expectation that PGE would be sold to Northwest under the above-mentioned contract of sale that had been executed prior to Enron's bankruptcy. Following the mutual termination of the sale agreement between Enron and Northwest, Enron's management committed to establish, and subsequently implemented, mechanisms to isolate, or "ring-fence," the credit quality of PGE from that of Enron. This ring-fencing enabled PGE to maintain ratings that were more indicative of its stand-alone credit quality.

■ The PGE Ring-Fencing

In the days following the termination of the sale agreement with Northwest, Enron's management assured Standard & Poor's in writing that it had no intention of bringing PGE into its bankruptcy, a fact that was key to the maintenance of PGE's rating. In addition, Enron commenced an auction for 12 of its operating businesses, including PGE, indicating management's intent to keep PGE out of the Enron bankruptcy and further bolstering the case for rating PGE on a stand-alone basis.

However, these developments were not, by themselves, sufficient to enable PGE to maintain investment-grade ratings. Transwestern Gas Pipeline Co., another 100%-owned subsidiary of Enron involved in the auction process, is rated BB/Watch Pos/-. These ratings are not based on the stand-alone credit quality of Transwestern because Transwestern could still remain a part of a reorganized holding company, of uncertain credit quality, that emerges from bankruptcy.

■ Ring-Fencing and Economic Disincentives

In general, the rating of a weaker parent constrains the rating of an otherwise financially healthy, wholly owned subsidiary. A weak parent has the ability and may have the incentive to siphon assets out of its financially healthy subsidiary and to burden it with liabilities during times of financial stress. The weak parent might also have an economic incentive to file the subsidiary into bankruptcy if the parent itself were forced into bankruptcy, regardless of the subsidiary's stand-alone strength.

Ring-fencing may allow for an exception to this rule. In appropriate circumstances, a package of enhancements, including legal and structural inhibitors to a filing of the subsidiary by the parent and provision of so-called "nonpetition" language by the parent, along with other considerations such as regulatory insulation, may allow a subsidiary's rating to be elevated over the credit quality of the consolidated entity (assuming the stand-alone rating of the subsidiary merits the same). Typically, Standard & Poor's will not rate even ring-fenced subsidiaries more than three "notches" above the credit quality of the consolidated entity. However, in the case of Enron and PGE, the establishment of powerful financial disincentives for Enron and its creditors to file PGE into bankruptcy enabled a much greater ratings separation.

■ Legal and Structural Mechanisms

In addition to providing a "nonconsolidation" legal opinion (to the effect that a bankruptcy court would not consolidate PGE with Enron), PGE has established a special class of junior preferred stock (or "golden share") that requires the vote of the junior preferred holder before PGE could voluntarily file for bankruptcy. The stock is held by an entity that is independent of PGE and its affiliates. On Sept. 30, 2002, the junior preferred stock was issued to Global Securitization Services LLC, a limited liability company specializing in the ownership and administration of special-purpose vehicles established in connection with structured finance transactions.

In Standard & Poor's judgment, the issuance of the junior preferred stock is a useful mitigant to the risk of a voluntary bankruptcy filing. The requirement that the holder of the golden share consider the interest of creditors may also weigh in favor of the conclusion that PGE should not easily be voluntarily filed into bankruptcy for the benefit of Enron's creditors and in a manner detrimental to PGE's bondholders.

[16-Jan-2003] An Enron Subsidiary is "Ring-Fenced"

■ Regulatory Insulation

Further supporting the ratings separation is the fact that Standard & Poor's views the Oregon Public Utilities Commission (OPUC) as being among the most supportive of utility credit quality in the country. Indicative of this support are the several restrictive conditions imposed on Enron when it acquired PGE in 1997 that served to largely insulate PGE from Enron's subsequent woes. Among the important restrictions were the maintenance of a 48% equity level at PGE and advance notification of special or large dividends to Enron. In addition, PGE is required to maintain its own accounting system, separate from Enron's.

The effectiveness of OPUC's rules can be gauged from the fact that Transwestern Pipeline and Northern Natural Gas, FERC-regulated gas pipelines that are both Enron subsidiaries, pledged their assets as collateral for loans in November 2001, and then passed the funds to Enron through promissory notes just weeks before Enron's collapse. Transwestern's \$550 million worth of loans to Enron has been written off by the pipeline and Northern Natural is still liable for \$450 million. Although the merits of these transactions are currently under litigation, Enron was unable to similarly borrow money from PGE, illustrating the effectiveness of regulatory insulation.

■ Economic Disincentives

PGE's corporate credit rating is significantly higher than would be expected from the ring-fencing criteria because of the perceived economic disincentives for Enron or its creditors to file PGE into bankruptcy. In Standard & Poor's view, PGE's value as a going concern is greater than if it were part of a consolidated bankruptcy filing. Standard & Poor's has concluded that if an otherwise healthy PGE were filed into bankruptcy, the adverse financial and contractual consequences of such a filing would outweigh any advantages. A bankruptcy filing by PGE would likely result in defaults under PGE's portfolio of power purchase and sale agreements. Standard & Poor's has been advised that the nature of these agreements is such that a default would trigger termination payments by the company for net out-of-the-money positions. A downgrade of ratings to below investment-grade status could require the company to post additional collateral. Standard & Poor's further understands that these contracts constitute "safe-harbor" contracts for purposes of sections 556 and 560 of the bankruptcy code and that the defaults would not be affected by the "automatic stay" provision of the federal bankruptcy code. Standard & Poor's believes that the financial penalty that would be suffered by PGE in the event of a downgrade to noninvestment-grade status, or, a priori, a PGE bankruptcy, is a material disincentive for Enron's creditors to file PGE.

Currently, if Standard & Poor's cut PGE's ratings to below investment grade, counterparties have the right to demand about \$117 million in collateral. In addition, counterparties could demand upfront cash payments for all purchases by PGE of its gas and power requirements. These requirements are substantial because PGE is short on generation capacity.

■ Where Does PGE Go From Here?

PGE is currently rated 'BBB+' with a developing outlook. The ring-fencing mechanisms implemented thus far are sufficient, in Standard & Poor's opinion, to insulate PGE's credit quality from that of Enron. Still, as the developing outlook indicates, there is uncertainty about where PGE's rating will ultimately go. This will depend on PGE's prospective buyer or on the nature of the company that eventually emerges from the Enron bankruptcy if PGE is not sold to a third party.

Electric Power Daily

Friday, February 27, 2004

Calif. ISO chairman calls FERC order 'unacceptable'

The Federal Energy Regulatory Commission's Feb. 20 order barring the California Independent System Operator from enforcing new market rules until it seats an independent board is "unacceptable" and should be withdrawn, ISO Chairman Michael Kahn said Thursday.

Speaking at board meeting, Kahn said the board, whose members are appointed by the governor, is still determining how it will respond to the commission's order approving the ISO's rules governing market behavior, but prohibiting the grid operator from enforcing them until a new board is installed (ER03-1102).

The ISO has appealed to the U.S. Court of Appeals for the District of Columbia a 2002 FERC order requiring the ISO to seat an independent board. A ruling from the court is expected later this year. "What am I supposed to do about [the order]? The [state Attorney General] has said let it be litigated.... We are willing to work with FERC," but we are awaiting a ruling from the court.

(continued on page 7)

Retail marketer executives see industry consolidation

The retail energy marketing industry is likely to undergo greater consolidation as companies seek to acquire expertise they lack and attain the critical customer mass necessary to succeed, executives with several marketers predicted Thursday.

In remarks to a retail energy conference sponsored by the Center for Business Intelligence in Orlando, Fla., Reliant Energy Services President James Ajello said that to be successful in competitive retail markets, companies must have a load of at least 1,000 MW. "We feel there will be some shakeout in the industry," Ajello said, adding "I believe you'll see some consolidation."

Although he declined to predict when such consolidation would occur, Ajello said more marketers are likely to realize that they will not achieve a significant customer load or an optimal business plan without combining their strengths.

Ajello, however, said that because the industry has seen little consolidation thus far, there is no established basis for determining a marketer's value and that may serve to discourage some mergers.

J.D. Burrows, vice president of marketing for Tractebel Energy Services,

(continued on page 6)

Nevada's senators want to FERC rule on Enron payment

Nevada Sens. Harry Reid (D) and John Ensign (R) have urged the Federal Energy Regulatory Commission to consider a motion by the state's two utilities asking for authority to reject a \$336-million payment to Enron Power Marketing for terminated supply contracts.

The Nevada Public Utilities Commission and Bureau of Consumer Protection, part of the state attorney general's office, Wednesday said FERC should require Enron to demonstrate that it did not violate provisions in supply contracts with Nevada Power and Sierra Pacific Power, utility subsidiaries of Reno, Nev.-based Sierra Pacific Resources.

The dispute centers on contracts that bankrupt Enron terminated in May 2002 after the utilities were downgraded to junk status. Enron claimed that it could terminate the contracts because of the downgrade and that it was owed about \$300-million, reflecting the difference between the value of the contracts and the

Reliability

Michigan utilities appeal PSC reliability rules to state court

Michigan's electric industry, claiming that the Public Service Commission overstepped its authority in some areas, has asked the state Court of Appeals to set aside the commission's Jan. 29 electric reliability standards order that provides for both financial incentives and penalties.

In particular, the industry objected to a provision in the standards that would give customers a \$25 credit if they experience repeated power disruptions.

"By adding a penalty provision, [the PSC] effectively legislated on that issue," James Ault, attorney for the Michigan Electric and Gas Assn. (MEGA), said Thursday. Only the state Legislature can make that determination and it has not done so, he said.

MEGA includes Alpena Power, Indiana Michigan Power, Edison Sault Electric, Upper Peninsula Power, We Energies, Wisconsin Public Service and Xcel Energy. Joining MEGA

(continued on page 7)

Wholesale

More companies resume price reporting to index publishers

Several energy trading companies have told the Federal Energy Regulatory Commission they again have begun reporting natural gas or electricity trade prices to index publishers. Another, PPL Corp., Thursday said it, too, had notified FERC that it would resume reporting Monday after having discontinued the practice in November 2002.

A PPL spokesman said the company believes resumed reporting will "help promote competitive wholesale energy markets by increasing price transparency and liquidity."

In response to a November FERC order requiring companies to report to the agency any change in its price-reporting practices, at least four other companies have sent letters to the commission recently saying they have begun reporting natural gas transaction data to publishers of natural gas indexes.

(continued on page 7)

then-current market prices.

In August, Judge Arthur Gonzalez, U.S. Bankruptcy Court for the Southern District of New York, ruled in Enron's favor. The utilities appealed the decision and also asked FERC to assert jurisdiction over the issue (EL04-1).

Earlier this month, the utilities asked FERC to take note of two recent court rulings in Nevada and Texas, which the utilities argued showed the courts are deferring to the FERC on issue.

In the filing, the utilities submitted a copy of an e-mail from an Enron employee to utility employees the utilities say shows Enron was seeking to terminate the contracts well before the utilities were downgraded. The Nov. 30, 2001, e-mail, sent two days before Enron filed for bankruptcy, was titled "arguments for termination now," the filing said.

According to the utilities, Christian Yoder, formerly an Enron senior counsel, wrote: "Hey Guys, here are the legal arguments for trying to get reluctant counterparties to settle with us pre-bankruptcy. After the bankruptcy, we have a number of options that all favor us and all potentially hurt [the other parties]."

According to the Wednesday letter to FERC from Sens. Reid and Ensign, the Enron e-mail shows that the utilities should not be required to pay the company for the terminated contracts. "The issues raised by the complaint, and by the e-mails from Enron that are already before you, appear to demonstrate that Enron was abusing termination provisions of the tariffs on file with your Commission as a way to generate cash for their creditors," the letter said. "Such abuse would mean that Enron is not entitled to this monetary award."

The senators offered possible actions FERC could take against Enron. "The Commission could make the revocation [to sell power at market-based rates] applicable to the entire period of time that Enron was in violation of their tariffs. The

Commission could also reform Enron's contracts with Nevada's utilities to conform with just and reasonable rates."

The senators lamented FERC's inaction on the issue. "Even here, where the Commission has significant evidence that Enron has manipulated the termination provisions of the tariffs as much as it manipulated the market previously, [it] has refused to act."

Mo. strikes SJLP 'premium' from Aquila rates

The Missouri Public Service Commission Thursday tried to unscramble the chaotic situation involving Aquila's buyout more than three years ago of St. Joseph Light & Power by eliminating any chance the Kansas City, Mo.-based utility will recover the acquisition premium it paid in the deal.

Under yesterday's order, the PSC said the acquisition premium becomes a non-issue because it will not be recognized for regulatory purposes. Aquila now carries it as a goodwill asset valued at about \$111-million.

The PSC approved the merger Dec. 14, 2000, and Aquila and SJLP closed the deal two weeks later. But AG Processing, an SJLP customer, filed an appeal, arguing the PSC had failed to determine how it would treat the acquisition premium, then calculated at \$92-million. On Oct. 28, the Missouri Supreme Court sided with AG, which then contended that the court decision meant the merger had never legally occurred.

That wreaked havoc with Aquila, which by then had merged the St. Joseph utility into its operation, eliminating it as a separate entity, and had filed for a 15.5% rate hike for the SJLP territory and 19% for its other Missouri operations. Combined, those operations represent half of Aquila's regulated assets in the seven states where it operates.

AG and the Missouri Public Counsel won a court order Tuesday suspending the rate hearings because of the Supreme

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Court ruling. As today's order was issued, Aquila and the PSC had asked an appeals court in Kansas City to lift the suspension on the hearings.

Aquila filed a formal motion with the court yesterday morning and the PSC said it planned to do so by the end of the day.

Regulators focus on 'ring fencing' utilities

Regulators are increasingly focused on "ring fencing" utilities from the credit risks of holding companies and their non-utility units, Fitch Ratings said Thursday in a new report, "U.S. Utilities—Survey of State Public Service Commissions."

A utility's financial condition often is greatly affected by the condition of its holding company and affiliates, with group rating linkage accounting for about half of Fitch's rating changes for electric and gas utilities over the past few years, the ratings agency added. Twenty-nine utilities would have higher ratings, but for links to weak parents or affiliates, Fitch said.

Before the industry's recent financial upheaval, state regulatory commissions "employed a relatively *laissez-faire* approach to regulating financing and affiliate activities," taking action to insulate utilities from affiliates only after severe deterioration in the group's credit quality. And even now, they are likely to act only after a utility's unsecured debt has already been cut to speculative grade, Fitch said.

Direct legal authority to order ring-fencing varies widely, but where it is weak, commissions can act through rate orders, where "the ability to exact retribution on a wayward utility through punitive orders is omnipresent," often based on the authority to deny recovery of the cost of "imprudent" transactions with affiliates, Fitch declared.

The Oregon Public Utility Commission's approval of Enron's 1997 acquisition of Portland General Electric is often cited as the "poster child for effective regulatory ring fencing," Fitch said. The PUC used its broad statutory authority over acquisitions to require that PGE have minimum 48% equity ratio, limited Enron's access to PGE assets, and limited the utility's ability to pay upstream dividends.

Because PGE assets were not pledged to Enron lenders, and the utility's financial integrity remained intact, Fitch added. PGE was cut to BB- due to "group contagion" but that was far above Enron's D rating and the utility has been upgraded to BB with a positive outlook.

On the other hand, "NorthWestern exemplifies a company that lacks ring-fencing of the utility," Fitch said. "Its corporate structure has often been cited by Fitch as entailing higher risk for the utility because the utility takes on the equity risk of subsidiaries and the utility's finances are intertwined with non-utility businesses." The Montana PSC told Fitch it has no statutory authority over affiliate transactions.

The survey includes a state-by-state rundown of commissions' legal authority to regulate utility securities issues, affiliate transactions, acquisitions, and ownership, and compares the new answers with those in Fitch's last such survey, in 1995. Fitch received responses from commissions in 47 states and the District of Columbia.

Calif. muni, FERC staff settle gaming charge

Federal Energy Regulatory Commission staff Thursday said it had reached a settlement agreement with Modesto, Calif., Irrigation District over the municipal utility's activities during the state's 2000-2001 energy crisis.

Under the deal, Modesto, which did not admit to any wrongdoing, agreed to pay \$60,000 to settle allegations it conspired to manipulate the market. In a statement explaining the agreement, staff said the deal "shall not be deemed or construed as an admission of, or as evidence of, wrongdoing or a violation of any tariff, regulation or statute by MID or of any potential claim of civil liability, or that the allegations...have any merit."

The accusations date back to a series of show-cause orders FERC issued in June, alleging that nearly all market participants either willfully violated tariff rules imposed by the California Independent System Operator or engaged in unethical partnerships to drive up prices.

Modesto was accused of participating in an alliance or partnership to perform so-called "ricochet" trading with Enron to manipulate the California market from Jan. 1, 2000, through June 20, 2001.

The muni, however, said that while some of its trading activities "may have caused confusion to, and may have given rise for concern," it did nothing illegal. "The agreement states that MID regrets any such confusion and concern that MID's transactions may have caused," the explanatory statement said.

The \$60,000 will be placed into a deposit account at the U.S. Treasury established by FERC to pay claims related to the energy crisis.

Court won't reconsider Duke Energy NSR order

In what the electric power industry is hailing as an important Clean Air Act ruling, a federal judge has rejected the government's request that he reconsider his August 2003 decision allowing Duke Energy to employ a less-stringent industry-wide definition of routine maintenance in defending its position that work it carried out at its coal-fired plants did not trigger the Act's new source review requirements.

The Dept. of Justice Thursday said the agency was reviewing the Feb. 23 ruling by U.S. District Court Judge Frank Bullock of the Middle District of North Carolina and had not determined what its next step would be.

The judge has set a July 6 trial for the case which began in December 2000 when DOJ sued Charlotte, N.C.-based Duke for alleged NSR violations, saying the company made major modifications to seven coal-fired plants without obtaining necessary permits or installing technology to limit emissions.

In asking the judge to reconsider his opinion or allow it to appeal the finding, DOJ argued that Duke knew that the Environmental Protection Agency defined routine maintenance on a plant-by-plant basis and understood that the agency considered increases in total annual emissions to be potential violations of the Act. DOJ said it had recently received

documents showing that the Utility Air Regulatory Group, a Washington trade association that represents utilities, had long told Duke Energy that EPA "intended its test for routine maintenance to be a narrow exception."

In denying the reconsideration request, Bullock, however, said the court "undertook a painstaking review of the statutory and regulatory framework" and relied on "the statutes and the legislative intent" in making its decision. "Thus, even assuming that the EPA may have spoken out of both sides of its mouth on these issues, the primary basis for the court's holding was plain statutory language and congressional intent," Bullock wrote. "The question of fair notice, the basis for the plaintiff's relevance argument, is no longer an issue for trial."

The utility trade organization Electric Reliability Coordinating Council said Bullock's latest ruling reaffirmed a broader interpretation of routine maintenance and, as a result, the case could be resolved quickly.

"The court noted that the language and intent of the NSR program was to consider actions 'routine' at a facility if such actions were routinely undertaken in the industrial sector as a whole," said Scott Segal, ERCC director. "Now that important point of law has been reaffirmed, the factual basis for the government's case is clearly diminished."

Lawyers for other parties in the suit against Duke Energy, Environmental Defense and the North Carolina Sierra Club, were unavailable for comment at press time.

SoCal Ed optimistic it can close plant deal

Edison International CEO John Bryson Thursday said that although the Federal Energy Regulatory Commission's Wednesday order approving subsidiary Southern California Edison's proposal to purchase the uncompleted 1,054-MW Mountainview plant "sets the stage" to complete the deal, the company has further work to do on the conditions FERC imposed on the plan.

While FERC approved the company proposal to create a wholly owned subsidiary to purchase, complete and operate the plant and sell its output to the utility at cost-based rates under a 30-year contract, the agency's order prohibited the subsidiary from selling any of the plant's output into the market at market-based rates. FERC also changed the company's cost-recovery provisions on some fixed and variable operational and maintenance issues.

Although Bryson said the company does not intend "to let some ratemaking issues stand in the way" of the purchase, he declined to say whether the utility would exercise its option to purchase Mountainview by the Feb. 29 deadline. "We are optimistic, but we can't go into further detail," he said in a conference call with analysts.

Bryson said the company will "likely need to take some additional steps, including regulatory ones, before we can proceed. It does appear that the FERC ruling with the California Public Utilities Commission decision [approving the proposal in December] sets the stage for SoCal Ed to move forward on the facility.... We will probably get the items worked out."

Edison reported fourth-quarter net income of \$197-million, or 60 cents/share, compared with a loss of \$24-million, or 7 cents/share, for the same period in 2002, and attributed the improvement to positive regulatory decisions, lower operating and maintenance costs, improved power plant performance, and the absence of losses from EME's discontinued operations.

SoCal Ed's earnings from operations in Q4 2003 were \$222-million, up \$69-million from the same period last year. EME broke even in Q4 2003, compared with a loss from operations of \$13-million in 2002. Edison Capital had earnings from operations of \$16-million in Q4 2003, compared with a loss of \$25-million in Q4 2002.

The company said its 2003 yearly earnings were \$821-million, or \$2.52/share, down from \$1.1-billion, or \$3.31/share, for 2002. Its 2002 earnings included a gain of \$480-million related to a regulatory decision on SoCal Ed's utility-retained generation.

Vt. bill would expand definition of grid upgrades

The Vermont Senate has approved an amendment to a state energy bill that would expand on a recent decision by federal regulators to encourage transmission reliability improvements by including alternatives to new lines such as distributed generation and energy efficiency projects.

The state's utilities, Central Vermont Public Service and Green Mountain Power, are opposed to the amendment to the bill (S 261).

The ISO New England in December won approval from the Federal Energy Regulatory Commission for a plan that would require region-wide financial support for new transmission projects that improve reliability.

The Vermont bill would direct state officials and utilities to "negotiate" with the ISO and FERC to expand the New England cost-sharing system to cover non-transmission alternatives that are shown to be less costly. It would also prevent Vermont ratepayers from supporting transmission projects elsewhere in the region unless a least-cost planning process is used to approve the project.

According to a spokesman for CVPS, the attempt to impose Vermont policy on all of New England is not tenable and would only lead to litigation and extra expense.

In a statement, the two utilities said they supported the state's least-cost planning policy, but they had been unsuccessful last year in getting the rest of New England to agree to it. They said the new bill would force them to fight again on issues on which they had ready fought and lost, and could force them into "expensive litigation" with the ISO. The final result, they said, might be that Vermont would lose the benefits of the current ISO cost-sharing system for local transmission projects.

The utilities said they would welcome "an ideal world where all states played by the same rules," but were concerned the new law would not bring change and "leave Vermont much worse for the battle."

The pending bill also would require Vermont to adopt a

renewable-energy portfolio standard by 2012 and efficiency standards for certain appliances by Jan. 1, 2006. The Senate approved the bill with the regional policy language Wednesday in a 22-6 vote. The bill, sponsored by Sen. Peter Welch, must still pass the Senate on third reading and then go to the state House for consideration.

Ind. regulators move to adopt net metering

Indiana regulators have taken the first step toward adopting a rule for net metering, under which small utility customers that generate some of their own power can sell it back to the utility at market prices.

A spokeswoman for the Utility Regulatory Commission said the net-metering initiative grew out of the commission's desire to promote distributed generation resources across Indiana.

"The proposed rulemaking is designed to make it easier for residential customers and schools that own and operate a solar, wind or hydro electrical generating facilities to operate in parallel with their electric company," the commission said in a statement. The proposed rule, issued Wednesday, would establish a credit for self-generation, set limits on the size of the net-metering facility and standardize the interconnection agreements between the entities.

Net-metering facilities would be limited to a maximum of 10 kW under the proposed rule. The URCom plans to begin exploring a rule for larger distributed generation projects this summer.

Calpine says Q4 earnings up sharply to \$120M

Independent power producer Calpine Corp. Thursday reported fourth-quarter 2003 net income of \$119.6-million, or 29 cents per share, up sharply from the \$25.2-million, or 7 cents per share, loss it recorded in fourth quarter 2002 and told analysts that even if the U.S. wholesale power market remains soft, it expects to do no worse than break even this year.

Calpine officials said they believe liquidity questions that dogged the company last year are largely behind it and that it can focus on growing the business in 2004. Calpine now has slightly more than 22,000 MW of generating capacity in the U.S. and U.K. and expects to bring eight projects on-line this year that will increase the total by 3,800 MW and bring it closer to its goal of having a 30,000-MW portfolio in operation by 2006.

President and CEO Peter Cartwright told analysts that the company expects to achieve about \$11-billion in revenues in 2004, up from the nearly \$9-billion it recorded in 2003. Earnings before interest, taxes, depreciation and amortization, Cartwright added, are expected to come in this year at about \$1.7-billion. At this level of earnings, the company said it could survive a continued market downturn at no worse than break even.

The third-quarter results include a gain of roughly 38 cents/share from the cumulative effect of a change in accounting principles (primarily the adoption of Derivatives Implementation Group Issue No. C20 relating to derivative

contracts) that was partially offset by "certain mark-to-market" activity, the gain of roughly 10 cents/share on the sale of oil and gas assets to Calpine Natural Gas Trust and a gain of roughly 9 cents/share from the purchases of outstanding debt. Partially offsetting these gains, the company said, were a 14-cent/share loss for charges related primarily to equipment and natural gas impairment costs, office space write-downs and cost associated with the termination of long-term service contracts.

For the year, the company reported \$282-million in net income, or 71 cents/share, compared with \$118.6-million or 33 cents/share reported in 2002.

Cartwright said Calpine was able to refinance \$4.2-billion in debt, raise \$2.7-billion through "liquidity transfers" and reduce debt by \$461-million last year. In addition, the company expanded its generating capacity by 3,500 MW and signed more than 7,000 MW of power-supply contracts with major load-serving entities. In 2004, Calpine hopes to double the number of bilateral supply contracts it signed in 2003, he added. At the end of the year, the company was "actively pursuing" numerous supply opportunities that represent more than 22,000 MW of capacity, it said.

Although Cartwright said the company's earnings continued to be depressed by low spark spreads in certain markets, he said he is encouraged by continued overall growth in U.S. power demand, which increased 1.8% last year.

Calpine said the additional generating capacity contributed to a 13% increase in generation for 2003. Power generation and marketing revenue, however, fell 3% in Q4 compared to the same period in 2002 because of a decline in sales of purchased power for hedging and optimization of \$184-million. That was offset by a \$129-million increase in steam and power revenue from increased production and higher electricity prices.

Power generation and marketing revenue for 2003 was up 16% over 2002 results as electricity and steam revenue rose by nearly \$1.5-billion, or 46%. This increase, however, was offset by a decline in sales of purchased power of \$432-million. Overall, Calpine said it achieved roughly \$8.9-billion of revenue for 2003, compared with \$7.4-billion reported in 2002.

NRC puts conditions on Davis-Besse restart

The Nuclear Regulatory Commission Thursday added two new conditions that FirstEnergy Nuclear Operating Company (FENOC) agreed to meet as part of its effort to restart its Davis-Besse nuclear plant in Ohio.

The agency directed that FENOC, during its first cycle after restarting, conduct mid-cycle visual inspections to insure there is no boric acid leakage. Davis-Besse was shut down two years ago after operators discovered severe corrosion of the reactor head. The second condition is that FENOC "contract with independent outside organizations to conduct comprehensive assessments" of the plant's operations, safety culture, and other issues. The assessments are to be conducted by the end of 2004 and "annually thereafter for 5 years," NRC said.

An agency official said it was up to FENOC to propose the assessment, but the NRC believes "independent" means that the

assessment will be conducted by entities outside the company. NRC said that although FENOC accepted the conditions, that action does not mean restart approval is "forthcoming."

Alberta utility posts 22% rise in Q4 earnings

ENMAX Corp., a utility owned by the city of Calgary, Alberta, Thursday said higher prices received on the provincial power pool pushed fourth-quarter net earnings up nearly 22% to US\$35-million, compared with \$28.8-million for the same period in 2002.

The increase was partially offset by higher electricity supply costs. Revenues were \$225.7-million vs. \$241.3-million in fourth-quarter 2002.

For the year, ENMAX net earnings were up slightly to \$126-million, compared with \$124.9-million in 2002. Revenues were \$907.5-million, compared with \$862.5-million a year earlier.

In 2003, ENMAX's unregulated retail business sold 9,552 GWh of electricity to 420,000 customers across Alberta, a 4% increase in volume. Its regulated transmission and distribution business increased volumes by 2% in 2003, distributing 7,928 GWh of electricity to customers in and around Calgary. For 2003, power pool prices averaged \$47.25/MWh, compared with \$33/MWh in 2002.

During 2003, ENMAX invested \$126.4-million in capital projects, with 40% of that money used to expand distribution and transmission to meet customer growth. This included \$32.5-million invested in a joint venture to build Canada's largest single site wind farm.

The utility continued to pay down debt with a debt-to-capitalization ratio of 12.5% at year-end. Its strategic plan is to invest in both unregulated and regulated businesses both in and outside of Alberta.

In 2003, the city of Calgary received dividend payments of \$37.5-million, compared with \$26.5-million for 2002.

FirstEnergy alters 'rate stabilization' plan

FirstEnergy has proposed revisions to a controversial electric rate plan that would determine how much customers pay for power in its northern Ohio service area through 2008, but opponents to the plan say the changes aren't enough.

The Akron, Ohio-based company's decision to alter the proposal comes near the end of a two-week Public Utilities Commission hearing on its "rate stabilization plan." Reply briefs and rebuttal testimony are scheduled for the next several weeks, with a commission ruling expected in April.

A FirstEnergy spokeswoman Wednesday said the company opted to make the changes after hearing testimony from PUC staff members and others who questioned various elements of the plan. "We believe the changes will enhance the plan for customers," she said.

Among other changes, FirstEnergy would increase by 10% the shopping credits customers receive for switching to a competitive retail electric service provider through 2008. The company would retain a rate stabilization charge through 2008,

but give a 100% credit—up from 65% as initially proposed—to customers who leave the FirstEnergy system. However, the credit is subject to a cap.

Consumer advocates said the changes do not go far enough.

"There are still many elements in the plan that would harm consumers," said a spokesman for the Ohio Consumers' Counsel. The changes "really don't drive to the heart of the OCC's concerns, such as raising generation rates by as much as 50% over three years."

MDU Resources buys Trinidad and Tobago unit

A unit of Bismarck, N.D.-based MDU Resources Thursday said it had purchased a 49.9% share of Carib Power Management, indirect owner of the InnCOGEN 225-MW gas-fired power plant located in the Republic of Trinidad and Tobago. Financial terms were not disclosed, but MDU said the deal was expected to increase earnings in 2004.

MDU, through its Centennial Resources independent power production unit, will own the minority interest in the simple-cycle turbine plant, which began commercial operation in September 1999 and is considered the island's lowest cost and newest power producing facility. A third-party contractor will continue to operate and maintain the plant.

MDU Chairman Martin White said the purchase underwent a "stringent review process" and is in keeping with MDU's strategic plans to diversify and expand its international operations, which it began in 2001.

InnCOGEN has 26 years remaining on its purchased-power agreement with the Trinidad and Tobago Electric Commission. Carib Power Management is an affiliate of New York-based Power Management.

Barton takes over helm of energy panel

Rep. Joe Barton (R-Texas) Thursday officially took the helm of the House Energy and Commerce Committee. Barton succeeds Rep. Billy Tauzin (R-La.) who has said he will not run for re-election.

Barton is expected to announce a new committee structure next week. Earlier this month Barton told reporters he would work for passage of the comprehensive energy bill, President Bush's "Clear Skies" legislation to regulate power plant emissions and step-up oversight of federal agencies, including the Environmental Protection Agency and the Federal Energy Regulatory Commission.

Last week, acknowledging that the House-passed energy bill has stalled in the Senate, Barton said he would work with the Senate to find the votes needed there to clear the bill and send it to the president.

Marketers to match strengths ... from page 1

agreed that the industry is likely to consolidate. The thin margins in retail markets will narrow the number of companies which are able to compete, Burrows said, adding

that if a company has a particularly good customer-support or risk-management operation, it may look to merge with another that could use those assets, he said. Other mergers may occur solely for a company to acquire market share, he said.

Nick Fulford, senior vice president for Centrica North America, said that with so many marketers chasing customers, he believes "it's definitely time for a shakeout."

FERC order shows lack of 'trust' ... from page 1

"It is not acceptable for [FERC] to say they are mad about the governance issue when we are trying to do the right thing. It says to the state—you can't trust us." Kahn said that because the ISO has no control over the issue now that it is before the court, the ISO will do "absolutely nothing." If FERC wants "a working relationship, it will rescind" the order, he said.

PSC stands by ruling ... from page 1

in the appeal are the Michigan Electric Cooperative Assn., Consumers Energy and Detroit Edison.

A PSC spokeswoman said the commission stands by the order. "We would believe we do have the authority" to impose the customer credit, she said. "We think we're on solid ground."

The standards set deadlines for restoring service under normal and "catastrophic" conditions, answering customer calls, responding to complaints, reading meters, and new service installations.

Regulators have not detailed how the financial incentive portion of the rules will work.

FERC guidelines quell fears ... from page 1

According to the PPL spokesman, the company's decision to resume reporting came from its belief that FERC statements and guidelines have reduced concerns about the "integrity" of the reporting system, which was damaged severely by revelations of so-called wash trading and lying to publishers.

He said a vice president of risk management at Allentown, Pa.-based PPL would oversee the submission of price data by e-mail, through a department that is separate from the trading floor. The company's internal auditors have reviewed the process to ensure the proper controls are in place, he said.

The spokesman also said the company would submit the data only to Platts, at least at first, and might consider reporting to other publications "at some point in the future."

PPL stopped reporting gas and power data after reports of "misleading statements" made by traders "at other companies." The spokesman said that after a "careful analysis" of PPL's own trading operations, company executives concluded none of their traders were guilty of the "abuses we saw at other places."

Also on Thursday, Piedmont Natural Gas notified FERC that it would begin immediately to report natural gas transaction data to a publisher of natural indexes. Constellation Power Source, Exelon Business Services Company and ConocoPhillips have similarly contacted FERC in recent weeks.

ConocoPhillips noted in a Jan. 9 letter to FERC that it was already reporting "month-long gas transactions." On Feb. 19, it said it began reporting daily natural gas deals.

Exelon's PECO Energy subsidiary said its reporting status changed Feb. 2, 2004, when it began reporting natural gas transactions to an index publisher. On Feb 12, Constellation said it had begun reporting gas price data as of Jan. 30, 2004.

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EXHIBIT OREGON ELECTRIC/203
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REQUEST OEUC 25:

With respect to the risk of cash insolvency, please provide information on the following questions:

- (a) Given current financial condition and capital structure, record of past experience and current expectations, is there a possibility of the event of cash insolvency during the 10-year period following the proposed transaction? If yes, please provide a detailed discussion.
- (b) If this event does appear possible within the limits set by an objective analysis of cash flow behavior, what is the magnitude of the chance of its occurrence (*i.e.*, what are the "odds" of it happening?)
- (c) How are these odds affected by the addition of debt at the holding company level?
- (d) Please provide a copy of any analyses that address the above questions.

APPLICANTS' RESPONSE TO REQUEST OEUC 25:

- (a) The Applicants believe that the possibility of such an event is remote and that there is no material risk to PGE or to Oregon Electric of such an event.
- (b) Very small likelihood.
- (c) Oregon Electric has no plans to add debt.
- (d) TPG ran numerous model scenarios in order to attempt to bracket the range of possible future outcomes for PGE's performance. Various "downside" scenarios were considered, but no analyses exist that are responsive to (d).

Please see Confidential Exhibit A to Response to Request OEUC 65, which discusses illustrates the strength and prudence of Oregon Electric's and PGE's capital structures under various "downside" scenarios.

Please also see Confidential Response to Request OEUC 37, which discusses credit statistics and liquidity assuming certain declines in earnings over time.

REQUEST OEUC 35:

Please provide the value or quantification that the Company assigns to the benefit created via the additional leverage at the holding company? Please provide any workpapers or analyses that support the value of leverage at the holding company level.

APPLICANTS' RESPONSE TO REQUEST OEUC 35:

TPG performed analyses that evaluated a multitude of factors to arrive at an appropriate value for the utility including establishing an appropriate capital structure, credit rating considerations, the minimum acceptable rate of returns to equity investors, and the purchase price required for the transaction to be viable. As part of the analyses, consideration was given to the impact of leverage at the holding company level, although that impact was evaluated as one of many considerations in establishing final purchase price and capital structure.

Please see Extremely Confidential Exhibits B, F, G, and H in Response to Request OEUC 24.

REQUEST OEUC 41:

Provide a list of all debt covenants or restrictions that apply to the Company or will be included in the proposed financing plan.

APPLICANTS' RESPONSE TO REQUEST OEUC 41:

The following table and notes present a summary of debt covenants and restrictions that are expected to apply to Oregon Electric and be included in the proposed financing plan. A full description of these covenants as currently contemplated is provided in the term sheets attached to the Highly Confidential Letter, found in Exhibit 19 to the Application. The precise terms and conditions of the financing are yet to be negotiated with lenders, and are subject to final documentation.

Summary of Illustrative Preliminary Terms and Conditions as of November 18, 2003

	OREGON ELECTRIC			
	REVOLVER	TERM LOANS	SENIOR NOTES	PGE REVOLVER
Principal Amount	\$100mm	\$582mm ¹	\$125mm ²	\$250mm
Mandatory Prepayments				
> A portion of net proceeds of any sale or issuance of equity or equity-linked securities (with exceptions to be agreed upon)	X	X		
> A portion of any sale or other disposition by the Borrower or any of its subsidiaries of any assets and subject to 364-day reinvestment right. Note: net proceeds first applied to prepay indebtedness of such subsidiary, or as required to obtain the release of such assets from any lien	X	X		
> Until earlier of a) maximum leverage test (to be defined) is achieved and b) the date upon which the corporate rating of the Borrower is at least BBB- by S&P and Baa3 by Moody's, 100% of excess cash flow beginning with the fiscal year following the acquisition	X	X		
> 100% of net proceeds of issuance of debt obligations of the Borrower (percentage subject to reduction based on achievement of leverage ratio and/or credit ratings tests, to be determined)	X	X		
Special Mandatory Prepayments				
> 100% of amounts outstanding upon a Change of Control (to be defined)	X	X		
> Net proceeds of indemnity payments received by Borrower from Seller in connection with Shared Special Indemnity Matters. No permanent reduction or termination of commitments thereunder	X			X
Affirmative Covenants: Standard for a transaction of this type	X	X		X
Financial Covenants – Levels and definitions to be agreed upon				
> Interest Coverage	X	X		X
> Leverage	X	X		
> Fixed Charge Coverage	X	X		
> Debt to Capitalization				X
> Minimum Net Worth				X
Negative Covenants: Standard for a transaction of this type	X	X		X
Events of Default				
> Nonpayment of principal, interest, fees or other amounts; inaccuracy of representations and warranties; violation of covenants; cross default; bankruptcy events; certain ERISA events; judgments defaults;	X	X		X
...and invalidity of security arrangements	X	X		
...and invalidity of any guarantee				X

Refer to notes below.

¹ Please note that the amounts of the term loans and notes are different than those amounts contained in the Highly Confidential Letter. The precise allocation between the term loans and the notes will be determined by closing.

² Id.

Oregon Electric Senior Notes – Summary of Illustrative Terms and Conditions:

- **Change of Control:** Upon the occurrence of certain change of control events (i) each holder of the Notes may require Oregon Electric to repurchase all or a portion of such holder's Notes at a purchase price of 101% of principal amount plus accrued interest, if any, to the date of purchase and (ii) Oregon Electric may elect to repurchase all or a portion of the Notes at a purchase price equal to the greater of (A) 100% of the principal amount of the Notes and (B) the present value of the remaining principal and interest on the Notes, calculated using a discount rate equal to the U.S. Treasury rate on the date of purchase plus 50 basis points, plus accrued interest, if any, to the date of purchase.
- **Certain Covenants:** The indenture will contain covenants that restrict Oregon Electric and its restricted subsidiaries from engaging in certain activities. The covenants will be subject to certain customary exceptions. The covenants will include, without limitation, limitations on indebtedness, restricted payments, restrictions on distributions from restricted subsidiaries, sales of assets and subsidiary stock, affiliate transactions, the sale or issuance of capital stock of restricted subsidiaries, liens, sale and leaseback transactions, consolidations and mergers and business activities.
- **Covenant Removal:** During any period of time that (i) the Notes maintain specified rating levels and (ii) no event of default shall have occurred and be continuing, Oregon Electric and the restricted subsidiaries will not be subject to certain of the covenants described above.
- **Events of Default:** Events of default will include nonpayment of principal when due at maturity, upon optional redemption, upon required purchase, upon declaration of acceleration or otherwise; nonpayment of interest continued for 30 days; violation of covenants for 30 days after notice; violation of any other agreements or obligations in the indenture for 60 days after notice; cross-acceleration with specified indebtedness; judgment defaults; and certain events of bankruptcy, insolvency or reorganization.

REQUEST OEUC 42:

Using the financial model(s), please provide three scenarios that assume the LIBOR is (a) one and (b) two and (c) three percentage points above those projected in the current financial model.

From these results, please provide comments on the feasibility of the transaction from a financing standpoint. Would the hypothetical results cause breach of any provision of any anticipated debt/loan covenant or cause default on payments? Please explain. Additionally, has the default risk grown beyond the level that would allow financing as currently proposed?

Note: As further clarified in teleconference with OPUC Staff on March 15, 2004, the reference to financial models is intended to be a reference to the financial models provided in Response to Request OEUC 1.

APPLICANTS' RESPONSE TO REQUEST OEUC 42:

In determining the appropriate capital structure, TPG considered the impact of changes in LIBOR over time on financing costs. As of December 31, 2003, all of PGE's long-term debt outstanding is fixed rate and not exposed to changes in LIBOR. PGE currently has a LIBOR-based, \$150 million, 364-day senior secured revolver that expires on May 27, 2004. PGE is currently contemplating replacing the existing revolver with a new LIBOR-based, \$150 million senior unsecured revolver. This credit facility serves as additional backup liquidity and is used for the issuance of letters of credit and day-to-day borrowings. PGE expects minimal draws under this revolver.

At Oregon Electric, it is anticipated that both the revolver and the term loans will be LIBOR-based and as such interest costs may be impacted by movements in LIBOR rates. Oregon Electric's revolver will be \$100 million and will be undrawn at closing, while the term loans are estimated to be \$582 million (per Scenario 3 provided in Response to Request OEUC 1). The remainder of debt at Oregon Electric will be \$125 million of senior notes that will be at a fixed rate and insulated from movements in LIBOR.

Today, LIBOR rates are at historic lows. While the interest rates for the revolver and term loans at Oregon Electric may be "floating" with LIBOR, Oregon Electric will ultimately have the ability to swap out a portion of its floating rate, LIBOR-based debt into a fixed rate. In order to capture the potential impact of movements in LIBOR in the financial model, TPG assumed that LIBOR prices would escalate over the first five years of the forecast period. As shown below, a steep LIBOR curve was assumed, which escalates up to 4.92% over the first five years of the forecast period. TPG views this curve as conservative, particularly relative to today's current three-month LIBOR rate, which is only 1.11%. The current estimate for pricing a five-year LIBOR swap is about 3.7%, which is quite consistent with the five-year average forward LIBOR rate in the financial model of 3.8% (see table below).

	2005E	2006E	2007E	2008E	2009E	05 to 09 Average
LIBOR Curve in Financial Model	2.27%	3.27%	3.96%	4.49%	4.92%	3.78%

The tables below illustrate the impact of increases in LIBOR by up to 300 basis points relative to the current curve in the financial model. (This analysis was done using Scenario 3, which assumes the building of new generation resources, and Scenario 23, which does not contemplate new resources). Each 100 basis point increase in LIBOR increases average annual after-tax interest costs at Oregon Electric by \$3 to \$4 million. TPG believes that a 300 basis point increase in LIBOR is very manageable and will not cause a breach of any covenants or payment defaults due to the substantial liquidity at both Oregon Electric and PGE and due to the strong cash flow generated by PGE. As suggested above, the forward LIBOR curve underlying the financial model is conservative and as such, the likelihood of LIBOR rates being dramatically in excess of this curve is low. Given these facts, TPG does not anticipate that changes in LIBOR will cause breach of any covenants or default on payments.

SCENARIO 3	Increase/(Decrease) in LIBOR (Basis Points) (1)								
	(100)	(50)	0	50	100	150	200	250	300
Avg Annual Pre-Tax Interest Expense at Oregon Electric (\$MM) (2)	\$35	\$38	\$40	\$43	\$46	\$48	\$51	\$54	\$57
Increase/(Decrease) relative to Baseline (\$MM)	(\$5)	(\$3)	\$0	\$3	\$5	\$8	\$11	\$14	\$17
Implied Impact on Annual Cash Flow relative to Baseline (\$MM) (3)	\$3	\$2	\$0	(\$2)	(\$3)	(\$5)	(\$7)	(\$8)	(\$10)
2005 (Year One) Liquidity (\$MM) (4)	\$121	\$120	\$118	\$116	\$114	\$112	\$111	\$109	\$107

- Changes in LIBOR impact \$582 million of term loan debt at Oregon Electric. Oregon Electric's revolver is assumed to be undrawn and therefore unaffected by changes in LIBOR. Senior notes at Oregon Electric are fixed rate and not impacted by changes in LIBOR. Excludes all debt and preferred at PGE.
- Average for first five years of forecast period (2005 to 2009).
 - Based on tax rate of approximately 40% applied to change in interest expense.
 - Represents liquidity available to Oregon Electric after taxes, interest expense and operating expenses but before repayment of Oregon Electric debt. Includes free cash flow and amounts undrawn under \$100 million revolver.

SCENARIO 23	Increase/(Decrease) in LIBOR (Basis Points) (1)								
	(100)	(50)	0	50	100	150	200	250	300
Avg Annual Pre-Tax Interest Expense at Oregon Electric (\$MM) (2)	\$31	\$34	\$36	\$38	\$40	\$43	\$45	\$48	\$50
Increase/(Decrease) relative to Baseline (\$MM)	(\$4)	(\$2)	\$0	\$2	\$5	\$7	\$9	\$12	\$14
Implied Impact on Annual Cash Flow relative to Baseline (\$MM) (3)	\$3	\$1	\$0	(\$1)	(\$3)	(\$4)	(\$6)	(\$7)	(\$9)
2005 (Year One) Liquidity (\$MM) (4)	\$181	\$180	\$178	\$176	\$175	\$173	\$171	\$170	\$168

- Notes**
- Changes in LIBOR impact \$584 million of term loan debt at Oregon Electric. Oregon Electric's revolver is assumed to be undrawn and therefore unaffected by changes in LIBOR. Senior notes at Oregon Electric are fixed rate and not impacted by changes in LIBOR. Excludes all debt and preferred at PGE.
 - Average for first five years of forecast period (2005 to 2009).
 - Based on tax rate of approximately 40% applied to change in interest expense.
 - Represents liquidity available to Oregon Electric after taxes, interest expense and operating expenses but before repayment of Oregon Electric debt. Includes free cash flow and amounts undrawn under \$100 million revolver.

REQUEST OEUC 44:

Does the company intend, as specified in its proposed conditions, to hold customers harmless for the increased cost of any debt issuances that may be made at debt ratings that are lower than they were prior to the announcement of this transaction?

APPLICANTS' RESPONSE TO REQUEST OEUC 44:

Applicants are not aware of the proposed conditions to which Staff refers. At any rate, as stated in the Application, this transaction will not require an increase in rates and the costs of the transaction will not be borne by ratepayers. Further, Oregon Electric believes that this transaction will have a minimal impact on the cost of financing for PGE for the following reasons:

- The Senior Secured rating of PGE is anticipated to remain at its current rating of BBB+, and therefore there should be no impact to the cost of PGE's secured debt as a result of this transaction. At December 31, 2003, PGE had \$754.1 million of secured debt outstanding. This represents 73.6% of PGE's debt and preferred obligations. \$725.4 million of the secured debt is secured by FMBs, which, by virtue of their Indenture, constitute a direct first mortgage lien on substantially all utility property and franchises, other than expressly excepted property. This amount includes \$583 million of FMBs and \$142.4 million of tax-exempt Pollution Control Bonds (PCBs) secured by FMBs. The remaining \$28.7 million of secured debt is conservation bonds collateralized by OPUC-authorized revenues, which fund the debt service obligation.
- PGE's Senior Unsecured Rating is anticipated to be rated BBB-. However, all of PGE's senior unsecured debt has fixed rate coupons and does not begin maturing until 2010. Therefore, there will be no near-term impact to the cost of this financing and, by the time any of it matures in 2010, Oregon Electric expects to achieve investment grade ratings. Furthermore, PGE has incremental bonding capacity to replace these unsecured obligations, which would improve the credit and decrease the financing cost. At December 31, 2003, PGE had \$205.9 million of unsecured debt outstanding. This includes \$51.6 million of tax-exempt, unsecured PCBs due between 2010 and 2014 and \$149.25 million of 7.875% Senior Unsecured Notes due March 15, 2010.
- At December 31, 2003, PGE had \$5 million of 8.25% Junior Subordinated Deferrable Interest Debentures due December 31, 2035. PGE intends to redeem the remaining \$5 million balance during 2004 with proceeds from their FMB issuance in November 2004. Therefore, the cost of this debt should decrease.

- PGE had \$25 million of 7.75% Series Cumulative Preferred Stock, which is redeemable by operation of a sinking fund that requires the annual redemption of 15,000 shares at \$100 per share (\$1.5 million) beginning in 2002, with all remaining shares to be redeemed by sinking fund in 2007. At its option, PGE may redeem, through the sinking fund, an additional 15,000 shares (\$1.5 million) each year. PGE is currently redeeming 30,000 shares per year for \$3 million and forecasts the balance to be fully redeemed by 2007. The Preferred Stock Rating is anticipated to be rated BB+. However, since this is a fixed rate coupon, there should be no impact to the cost of this financing. Furthermore, PGE intends to fund the redemptions through cash from operations and FMBs, which are anticipated to be rated three notches higher than the Preferred Stock. The all-in cost of FMBs in the forecast is not expected to be higher than 7.75%.
- In addition, the cost of financing PGE's revolving credit facility is expected to decrease. It is expected that PGE will be able to replace its existing \$150 million 364-day, secured revolving credit facility with a new \$150 million multi-year, unsecured facility. The pricing, terms and conditions of this new revolver are expected to significantly improve from last year when PGE established its current credit facility due to the overall improvement in the bank credit market and PGE's improved individual credit quality. Implementing the facility on an unsecured basis will free up first mortgage bonding capacity and will also be looked upon favorably by the rating agencies. The increased size of the facility will improve PGE's liquidity and a multi-year facility would eliminate refinancing risk for a couple of years.

REQUEST OEUC 96:

Regarding the anticipated downgrade of PGE by Standard & Poor's (announced March 10) if the Company's intent is to create a "period of renewed stability and health," does the company have a financial plan which it believes will allow PGE to retain its current rating by Standard & Poor's? If yes, please provide a copy of the financial plan.

APPLICANTS' RESPONSE TO REQUEST OEUC 96:

As discussed in the Application, Oregon Electric's intent is to restore PGE to a period of renewed stability and health. PGE has been subject to a lengthy period of uncertainty and turmoil as the company has been actively shopped by Enron for over four years and the management team and employees have had to withstand the significant distractions of this lengthy auction process. PGE has also been subject to numerous liabilities and litigation, due primarily to the company's association with Enron. The acquisition of PGE by Oregon Electric will put an end to this period of uncertainty, allowing the management team to give sole focus to their core business of providing safe, reliable, and cost-effective electricity service.

While Standard & Poor's has indicated that it may downgrade PGE's corporate credit rating from BBB+ to BBB (*i.e.*, only one "notch"), Standard & Poor's has also indicated that PGE will maintain its investment grade rating and that PGE's secured debt rating is expected to remain at its current BBB+ rating. As discussed in Response to Request OEUC 44, the impact to PGE from this potential change in ratings is not expected to be material. Furthermore, Oregon Electric plans to use free cash flow to pay down debt at Oregon Electric, which will have the benefit of improving the consolidated credit profile over time. As Oregon Electric's ratings are enhanced, PGE's ratings should similarly be improved within a reasonable time period. Please see Extremely Confidential Exhibit A to Response to Request OEUC 1 and Response to Request OEUC 37, which outline these projected credit ratios and the underlying financial plan.

REQUEST OEUC 144:

Please explain how PGE could access additional equity funds from the Applicants and/or Oregon Electric (other than TPG III or TPG IV). Include an estimate of the time necessary to obtain the funds and what consents would be required.

APPLICANTS' RESPONSE TO REQUEST OEUC 144:

After closing, PGE will continue to have independent access to capital to support its operations. Therefore, Oregon Electric believes that PGE is extremely unlikely to require additional capital from Applicants and/or Oregon Electric. However, in the event that Oregon Electric requires additional capital to support PGE's operations, such capital could be raised in private or public transactions involving the issuance of equity securities or debt instruments. The specific possible sources of such capital would need to be evaluated under the circumstances that then exist.

The limited liability company operating agreement of Oregon Electric will require both approval of the Board of Oregon Electric and consent of a majority in interest of the Class A Interests in order for PGE or Oregon Electric to raise additional equity capital.

Please see Exhibit 10 to the Application, Term Sheet for Oregon Electric Utility Company, LLC.

REQUEST CUB/OEUC 11:

Page 18 of the Application states that based "upon forecasts completed by the Applicants, PGE will be able to pay approximately \$80 to \$100 million of annual dividends to Oregon Electric. These forecasts incorporate budgeted capital expenditures to support reinvestment in PGE infrastructure as well as budgeted operations and maintenance expenses. This will translate into over \$250 million of pay down of debt principle over the first five years."

- a. Provide a copy of the forecasts completed by the Applicants that are referred to above.
- b. Provide work papers that identify the details of these forecasts including the budgeted capital expenditures and operations and maintenance expenses.
- c. Do these forecasts include any changes in rates/revenue requirement? If so, when are these changes forecast, what are the amounts of the changes and what are the causes of the rate/revenue requirement changes?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 11:

- a. CUB has been provided with 48 scenarios that were generated from the electronic model TPG used to evaluate this transaction. These scenarios present an extremely wide array of different outcomes regarding the projected financial performance of PGE. For instance, in certain scenarios TPG assumed that PGE experienced limited load growth and continued to under-earn its allowed return on equity, while other scenarios assumed that PGE experienced robust load growth and/or achieved certain operating efficiencies in order to earn its allowed return on equity. Scenario 3 (which includes the building of new generation, such as Port Westward) and Scenario 23 (which does not include new generation), have been referenced for illustrative purposes in answering certain questions from CUB and the OPUC. In each scenario, PGE is expected to dividend excess cash flow to Oregon Electric after paying PGE's capital expenditures and meeting PGE's debt service requirements.

The average annual amount of cash flow that PGE would dividend to Oregon Electric over the first five years of the forecast period, as indicated in the tables below, is approximately \$90 million. Under Scenario 3, which includes \$265 million of incremental capital expenditures associated with Port Westward, the dividends in the early years are smaller but ramp up in the later years once Port Westward is completed and incorporated into the rate base.

Oregon Electric will use dividends from PGE to pay Oregon Electric's minimal operating expenses, interest on its debt, and to voluntarily pay down debt principal. On a consolidated basis, Scenario 3 implies that approximately \$255 million in debt principal is paid down over the first five years of the forecast period. In Scenario 23, debt pay down increases to approximately \$375 million

because PGE does not incur the capital expenditures associated with Port Westward. The capitalization at PGE under both scenarios meets the current 48% minimum equity ratio under the current ring-fencing provisions in all years.

To assist in an understanding of the various possible outcomes, Oregon Electric produced to CUB summary model printouts for all 48 scenarios, as well as full model printouts for Scenarios 3 and 23, under separate cover dated April 13, 2004.

- b. For details of the projected capital expenditures and operation and maintenance expenses, please refer to the model runs referenced above. In addition, please refer to Applicants' Response to Staff Request OEUC 97 for further discussion of projected capital expenditures.
- c. As a general matter across all 48 scenarios, there is no assumption for changes to base rates except for those scenarios in which Port Westward is assumed to be built. Operational efficiencies are assumed in some of these hypothetical scenarios, but no change was made in revenue requirements because the model was not intended to be used to predict rates (*i.e.*, the model assumes no changes in base rates except as noted in the prior sentence) and Applicants viewed any hypothetical operational efficiencies as contributing to PGE achieving its authorized rate of return rather than reducing revenue requirements. Lastly, it is important to note that rates will vary year to year due to changes in power costs—these power costs are incorporated into rates through the annual RVM process. Because the model does not forecast power costs (other than for illustrative purposes), it does not capture these annual changes in rates due to power costs. Power costs in the future will be driven by PGE's specific mix of resources, as well as the Pacific Northwest power markets more broadly.

In Scenario 3, which contemplates \$265 million of capital expenditures to construct Port Westward, the TPG model assumed that a rate case would be undertaken in mid-2006 to incorporate Port Westward at cost into the rate base and to adjust rates further to allow PGE to earn its allowed return on equity. This assumption is consistent with PGE's model contained in Enron's Plan of Reorganization, which assumed that Port Westward is constructed during 2004 and 2005, and that a rate case takes place in 2006 to incorporate Port Westward into the rate base and to allow PGE to earn a reasonable rate of return on equity. Given that TPG's model was designed to understand PGE's cash flow characteristics and not to properly project customer rates, the exact impact of a rate case on customer rates was not specifically contemplated and would require additional work with PGE management. Specifically, the model would have to be modified to reflect the cost and timing of constructing Port Westward, to develop a forecast of power costs over time (which represent the largest component of customer rates), and to quantify the potential reduction in rates that Port Westward would provide in the form of lower power costs.

Scenario 23 assumes that PGE does not build new generation, but rather addresses its short position with a combination of short-term power purchases and long-term

contracts. Scenario 23 does not contemplate a rate case or any changes to base rates during the forecast period.

DEBT PAYDOWN SUMMARY - SCENARIO 3 (\$MM)

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5	Average
Dividend from PGE to Oregon Electric		\$44	\$52	\$122	\$117	\$103	\$87
Debt Balances							
Oregon Electric Debt	\$707	\$690	\$667	\$574	\$484	\$405	
Annual Debt Paydown		\$18	\$23	\$93	\$90	\$79	
Cumulative Debt Paydown		\$18	\$40	\$133	\$224	\$303	
Consolidated Debt	\$1,774	\$1,805	\$1,770	\$1,686	\$1,596	\$1,517	
Annual Debt Paydown		(\$31)	\$35	\$84	\$90	\$79	
Cumulative Debt Paydown		(\$31)	\$4	\$88	\$178	\$257	
PGE Debt / Total Capitalization	51%	51%	49%	50%	50%		

DEBT PAYDOWN SUMMARY - SCENARIO 23 (\$MM)

	Closing	Year 1	Year 2	Year 3	Year 4	Year 5	Average
Dividend from PGE to Oregon Electric		\$103	\$96	\$99	\$89	\$75	\$93
Debt Balances							
Oregon Electric Debt	\$709	\$631	\$560	\$486	\$420	\$366	
Annual Debt Paydown		\$78	\$70	\$74	\$66	\$54	
Cumulative Debt Paydown		\$78	\$149	\$223	\$289	\$343	
Consolidated Debt	\$1,695	\$1,586	\$1,504	\$1,439	\$1,372	\$1,319	
Annual Debt Paydown		\$109	\$82	\$65	\$66	\$54	
Cumulative Debt Paydown		\$109	\$192	\$257	\$323	\$377	
PGE Debt / Total Capitalization	49%	48%	48%	48%	48%		

REQUEST CUB/OEUC 23:

See 3/Davis/17. With OEUC 22 in mind, please explain why it makes sense for customers to use \$240 million cash to fund the purchase price and keep only \$10 million in cash on hand, thereby raising the potential for additional borrowing to finance on-going cash needs.

- a. How as it determined that \$10 million in cash was the appropriate amount?
- b. Is this cash balance comparable to what similar utilities have?
- c. How would any additional borrowing be reflected in corporate structure?
- d. Are there limitations on what OEUC's and PGE's revolving credit facilities can be used for? If so, what are they?
- e. Can the revolvers be withdrawn by the issuer under any circumstances (e.g., a drop in investment rating)? If so, what are such circumstances?
- f. What are the anticipated interest rate terms of the revolvers? Will the interest rate and costs of the revolvers change over time?
- g. How will the expenses of PGE's revolver be treated for ratemaking purposes? Will they be considered debt or an O&M expense?
- h. PGE's revolver is expected to have "a term of longer than one year" (Davis, at 19). What exactly is the expected term? 2 years, 3 years, 5 years?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 23:

Utilities routinely pay their profits in the form of dividends to shareholders. It has long been PGE's practice to pay regular dividends to its shareholders. Beginning mid-2001, however, for reasons related to Enron's bankruptcy, PGE stopped regularly distributing profits, recognizing that a "catch-up dividend" would be paid to Enron in the future. PGE's shareholders, not its customers, have the right to this cash because it represents the retained earnings or profits in the business that are owed to equity holders. The question incorrectly suggests that customers are in effect funding a portion of the purchase price in this transaction. In fact, this cash is currently owed to Enron, not to customers, and the proceeds of the dividend will go to Enron at close. In fact, it is expected that this dividend will be paid to Enron even if the proposed transaction does not occur. This is highlighted in the financial projections for PGE that are reflected in Enron's Plan of Reorganization which show that retained earnings would be paid to shareholders with PGE retaining \$5 million in cash. Furthermore, PGE's current three-year finance plan also shows the payment of PGE's retained earnings to the company's shareholders at the end of 2004.

- a. Applicants determined that \$10 million in cash on hand at closing is an appropriate level based on PGE's projected working capital requirements, the company's historic cash levels, and the availability of a \$250 million revolving credit facility that is expected to be put in place at the close of this transaction. In addition, Applicants are relying upon guidance from PGE, as well as on PGE's forecast contained in Enron's Plan of Reorganization, which assumed that a maintenance cash balance of \$5 million, along with a \$150 to \$200 million revolving line of credit, would be prudent for liquidity purposes.

On a historic basis, in eight out of nine consecutive quarters between December 1999 and December 2001 inclusive, the closing cash balance at PGE was less than \$10 million; it averaged \$10.1 million for the nine quarterly periods. This level of cash has proven adequate because PGE has historically used short-term borrowings (commercial paper and bank loans) to finance the bulk of its working capital requirements. Cash on hand from January 2002 until present is not a relevant historical reference because Enron and PGE decided not to dividend profits during that period due to bankruptcy considerations.

PGE has historically utilized a revolver of \$150 million to fund working capital. In Enron's Plan of Reorganization, PGE management proposed to upsize the revolver to \$200 million. Applicants plan to cause PGE to establish a revolving line of credit in the amount of \$250 million in order to ensure ample liquidity is available to the company. Based on Applicants' discussions with management, this line of credit amount should be more than adequate to meet PGE's working capital needs.

- b. An analysis that compares the projected PGE cash balance on hand at closing to the cash balances of comparable utilities has not been undertaken in the course of Applicants' analysis of the transaction. Applicants do not believe that such an analysis is particularly relevant. In fact, many utilities often maintain no cash balances or negative cash balances and rely solely upon their revolvers for liquidity.
- c. Any additional short-term borrowing by PGE would likely be made under its revolving credit facility ("PGE senior revolving facility") as described in the Highly Confidential Letter (see Exhibit 19 to the Application). The PGE senior revolving facility is expected to be in the amount of \$250 million. Drawings under this facility would be reflected as short-term debt under PGE's capital structure.
- d. Certain limitations on the PGE senior revolving facility and Oregon Electric's senior secured revolving credit facility are outlined in the Highly Confidential Letter. The final terms and conditions are subject to definitive documentation.
- Oregon Electric's senior secured revolving credit facility is intended to be used to finance the working capital needs of Oregon Electric in the ordinary course of business and for other general corporate purposes, including transaction fees and expenses and any payments necessary in

connection with the adjustment of the Purchase Price as defined in and pursuant to the Stock Purchase Agreement.

- PGE's senior revolving facility will be used for general corporate purposes. A portion of the facility not in excess of an amount to be determined shall be available for the issuance of letters of credit. A portion of the facility not in excess of an amount to be determined shall be available for swingline loans.
- e. The Highly Confident Letter outlines certain instances where PGE's and Oregon Electric's senior revolving credit facilities commitment can be reduced or withdrawn. The final terms and conditions of the revolvers are subject to final documentation.
- *Oregon Electric senior secured revolving credit facility:* The facility is subject to certain commitment reductions as described more fully in the Highly Confident Letter. These include, but are not limited to, reductions resulting from equity issuance, sale of assets of Oregon Electric or its subsidiaries, debt issuance, and, until the earlier of such time as a maximum leverage test or specified rating has been achieved, excess cash. All reductions will first be applied as prepayments under Oregon Electric's senior secured term loans before there is any reduction in commitment to the senior secured revolving credit facility. One hundred percent (100%) of the outstanding amount of the senior secured revolving credit facility shall be prepaid and all commitments thereunder shall be terminated in the event of a change of control. In addition, each extension of credit that increases the aggregate amount outstanding under the senior revolving facility is conditioned upon (a) the accuracy in all material respects of all representations and warranties in the Credit Documentation (including, without limitation, the material adverse change and litigation representations), and (b) there being no default or event of default in existence at the time of, or after giving effect to the making of, such extension of credit.
 - *PGE senior revolving credit facility:* There are no specified mandatory prepayment events contained in the Highly Confident Letter. However, each extension of credit that increases the aggregate amount outstanding under the senior revolving facility is conditioned upon (a) the accuracy in all material respects of all representations and warranties in the Credit Documentation (including, without limitation, the material adverse change and litigation representations), and (b) there being no default or event of default in existence at the time of, or after giving effect to the making of, such extension of credit.

No ratings trigger is envisioned in the terms provided in the Highly Confident Letter for either revolving credit facility. Also, although final documentation has not been drafted, it is expected that under each facility, a default or an event of

default could result in withdrawal of the facility and cause acceleration of the debt repayment obligation of Oregon Electric or PGE. The events of default under each facility will include nonpayment of principal, interest, fees or other amounts; inaccuracy of representations and warranties; violation of covenants; cross default; bankruptcy events; certain ERISA events; judgments defaults; and invalidity of any guarantee.

- f. The Highly Confident Letter sets forth preliminary interest rates for PGE's and Oregon Electric's senior revolving credit facilities. The exact interest rate cannot be known until the financing has been raised, which will be concurrent with the closing, as both spreads and the underlying base rate may be different from what was envisioned in November 2003 when the letter was provided.

OEUC senior secured revolving credit facility: OEUC may elect either (i) the Eurodollar Rate plus the Applicable Margin of 1.75%, or (ii) ABR plus the Applicable Margin of 0.75%.

PGE senior revolving facility: PGE may elect either (i) the Eurodollar Rate plus the Applicable Margin of 1.75%, or (ii) ABR plus the Applicable Margin of 0.75%; provided, that all Swingline Loans shall bear interest based upon the ABR.

The three-month Eurodollar rate as of April 26, 2004 is approximately 1.10%. ABR as of April 26, 2004 is approximately 4.00%. The approximate interest rate on the drawn revolvers currently would be Eurodollar (1.10%) plus the applicable margin (1.75%), *i.e.*, 2.85%.

The interest rate and cost of the senior revolving credit facilities will change over time in line with movements in the Eurodollar Rate and/or ABR.

Note: "ABR" means the higher of (i) the rate of interest publicly announced by the Administrative Agent as its prime rate in effect at its principal office in New York City (the "Prime Rate"), and (ii) the federal funds effective rate from time to time plus 0.50%.

- g. Applicants do not intend to change PGE's current treatment of its senior revolving credit facilities expenses for ratemaking purposes. PGE revolving credit facilities, whether the duration is one year or longer, are considered short-term debt.
- h. The expected initial term of PGE's revolver is three (3) years.

REQUEST CUB/OEUC 28:

PGE provided TPG with numerous financial and operating forecasts. In its own analysis, were there times when TPG chose to override PGE's forecasts with its own or with outside forecasts or estimates? If so, when and why?

APPLICANTS' RESPONSE TO REQUEST CUB/OEUC 28:

Yes.

In assessing the investment opportunity, TPG ran numerous different model scenarios, 48 summary printouts of which were produced to CUB under separate cover dated April 13, 2004. The basis of these scenarios was PGE's financial and operating forecasts that were provided to TPG. However, TPG varied certain assumptions from those in the PGE forecasts, such as growth rates and operating expense levels. These assumptions were varied to provide TPG with a range of potential outcomes in its assessment of the investment opportunity.

REQUEST ICNU/OEUC 3.6:

Of the 48 scenarios provided in response to Staff Data Request OEUC 1, which scenario does TPG currently expect or represent is the most likely. If the most likely scenario is any other than 3 or 23, please provide the full model printout.

APPLICANTS' RESPONSE TO REQUEST ICNU/OEUC 3.6:

There is no one model scenario that TPG considers to be the most likely. TPG ran numerous model scenarios in an attempt to capture a wide range of potential outcomes and associated returns. However, given the Integrated Resource Plan proceedings now pending before the Oregon Public Utility Commission, it appears more likely than not that the construction of Port Westward will be acknowledged. If acknowledged, Scenarios 1 to 16, which contemplate the building of new generation, are therefore more likely as a group than Scenarios 17 to 48, which do not contemplate the building of new generation.

REQUEST ICNU/OEUC 3.7:

For each of the 48 scenarios supplied in response to Staff Data Request OEUC 1, please describe how TPG used the figures to generate an expected purchase price and provide an example for Scenario 3. In particular, how did TPG use the information on page 3, in the third box on the right hand side containing six lines, shown in each of the printouts? (Please call if you are unsure of what we are referencing; we are not identifying by title because the document is confidential.)

APPLICANTS' RESPONSE TO REQUEST ICNU/OEUC 3.7:

TPG ran a number of different model scenarios in order to capture a wide range of potential outcomes for PGE's operating results in order to help inform views on valuation. The data referenced on page 3 of the model printouts (third box on the right hand side of the model) were used as one subset of reference points to show the potential impact of a variety of exit assumptions on projected investment returns as various operating scenarios were run. Investment returns were not evaluated based on the single point estimate referenced on page 3. Rather, a range of potential returns was evaluated for each case based on various exit assumptions as well as the variety of other factors affecting PGE operating results. While the potential returns generated by the model scenarios were one factor used in determining purchase price, numerous other factors were also considered, such as exposure to liabilities, availability of financing, the regulatory environment for PGE, and the purchase price required by the sellers in order to secure a transaction.

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2
3 **BEFORE THE PUBLIC UTILITY COMMISSION**
4 **OF OREGON**
5 **UM 1121**
6

7 In the Matter of

8 OREGON ELECTRIC UTILITY COMPANY, LLC,
9 et al.,

10 Application for Authorization to Acquire Portland
11 General Electric Company

12
13
14 **REBUTTAL TESTIMONY**
15 **OF**
16 **JERRY JACKSON**
17 **ON BEHALF OF OREGON ELECTRIC**
18

19
20
21
22 **August 16, 2004**
23
24
25

I. INTRODUCTION

1
2 **Q. Please state your name and describe your professional experience and education.**

3 A. My name is Jerry D. Jackson. I have been working in various capacities in the electric
4 utility industry and government for more than 30 years. I earned a law degree from the
5 University of Arkansas in 1968. From late 1973 to mid-1975, I was a member of the
6 Arkansas Public Service Commission. After several years in a private law practice
7 representing clients before regulatory agencies, I joined Entergy Corporation as a senior
8 executive in 1979 and retired in March 2003. Entergy Corporation is an integrated
9 energy company engaged primarily in electric power production, retail distribution
10 operations, energy marketing and trading, and gas transportation. At Entergy, I held a
11 number of executive positions. Some of those positions included General Counsel and
12 Secretary of the Board of Directors for Entergy Corporation, Chief Executive Officer of
13 Entergy Louisiana, Inc., and Group President of Utility Operations, where I supervised
14 the company's five regional utility operating companies. As Board Secretary, I
15 participated in all meetings of the Entergy Corporation Board of Directors. At various
16 times during my career, I served on the Board of Directors of the Entergy utility
17 operating companies: Entergy Arkansas, Inc.; Entergy Gulf States, Inc.; Entergy
18 Louisiana, Inc.; Entergy Mississippi, Inc.; and Entergy New Orleans, Inc. After retiring
19 from Entergy in March 2003, I joined the law firm of Skadden, Arps, Slate, Meagher &
20 Flom LLP as Of Counsel in its Washington, DC office. Please also see my curriculum
21 vitae, attached as Exhibit Oregon Electric/301, Jackson/1.

22 **Q. Have you previously testified before this Commission?**

23 A. No.
24
25

1 **Q. On whose behalf is this testimony presented?**

2 A. This testimony is presented on behalf of Oregon Electric Utility Company, LLC
3 (“Oregon Electric”).¹

4 **Q. What is your relationship to Oregon Electric in this case?**

5 A. If the Commission approves this Application, Oregon Electric will appoint the Board of
6 Directors of PGE. Oregon Electric has asked me to serve on the PGE Board and I have
7 accepted. I should emphasize that I am not a representative of TPG, and I will not be
8 serving on the Board of Directors of Oregon Electric. If this Application is approved, I
9 will be an independent PGE Board member, which is to say I will not be employed or
10 otherwise engaged by the owners of PGE.

11 **II. PURPOSE**

12 **Q. What is the purpose of this testimony?**

13 A. The purpose of this testimony is to address some of the assertions that various
14 intervenors have made in their Direct Testimony, particularly those assertions relating
15 to the duties and responsibilities of PGE’s Board members, and the value and benefit
16 that local Board members will bring to PGE.

17 **III. DUTIES OF CORPORATE DIRECTORS**

18 **Q. In their Direct Testimony, witnesses testifying on behalf of certain intervenors**
19 **imply that the interests of the corporation’s investors and customers are mutually**
20 **exclusive.² Based on your experience, do you believe this statement is accurate?**

21 A. No. It is correct that, as a Board member, I would have a fiduciary duty to PGE and its
22 investors. That means I am obligated to act in PGE’s best interests. However, PGE’s
23 best interests are largely coextensive with the best interests of PGE’s customers and the
24

25 ¹ Throughout this testimony, I will use “Oregon Electric” to refer to Oregon Electric Utility Company, LLC, or to all Applicants, as the context may imply.

² See CUB/100, Jenks-Brown/25; COP/100, Anderson/8-9.

1 community. Specifically, the interests of the company and its investors are best served
2 if the customers and the community are also well served. This is particularly true in a
3 regulated environment where a positive regulatory relationship and the provision of safe
4 and reliable electric service at reasonable rates are critical to the company's success. As
5 I explain more below, it is my firm belief from 30 years of experience working in the
6 electric utility industry as a senior executive, board member, regulatory attorney, and
7 former regulator, that, right behind safety, a utility board member's next most important
8 goal is to ensure that the interests of the customers are well served in a positive
9 regulatory environment. I will go further and say that such a focus is essential to the
10 financial success of the utility. The implication in the testimony of the intervenors that,
11 somehow, the interests of the investors and customers are mutually exclusive is simply
12 not true.

13 **Q. Can you give an example?**

14 **A.** Yes. Suppose that PGE failed to invest adequately in operations and maintenance in an
15 attempt to cut costs. The likely result would be increased outages, a decrease in service
16 quality, and dissatisfied customers and regulators. Businesses dependent on safe and
17 reliable electric service might relocate or choose to develop their business elsewhere.
18 Retail customers might choose a different source of energy, such as natural gas, for
19 appliances and home heating. Customer complaints would increase at the Commission,
20 resulting in increased regulatory activity, possible disallowances of imprudently
21 incurred costs, or even financial penalties. Financially, the utility would suffer as its
22 load decreased and regulatory relationships suffered. It is difficult to imagine how PGE
23 or its investors would benefit from this type of a scenario.

24 By contrast, if PGE provides exemplary service, pursues efficiencies that do not
25 negatively affect safety and reliability, and makes prudent long-term investments,

1 overall costs – and by extension, rates – will decrease. Rate stability, long-range
2 planning, and excellent service will, in turn, encourage outside industrial customers to
3 relocate or develop new business in the area, and retail customers, given the option, will
4 be more likely to choose electricity, thus increasing PGE’s load and consequently its
5 financial strength. PGE’s relationship with regulators will be strengthened, which will
6 decrease the costs of regulation and allow PGE to have greater financial flexibility to
7 address community needs and make prudent management decisions. As a result of this
8 alignment of interests between PGE’s customers and its investors, when PGE’s
9 customers are well served, PGE becomes financially stronger.

10 **Q. Some parties in this proceeding suggest that the interest of PGE’s investors in**
11 **making a profit conflicts with the interests of PGE’s customers.³ Do you agree?**

12 **A.** No. Let me be clear that I am not asserting that PGE’s investors do not have a right to
13 seek a fair and reasonable return on their investment. In fact, PGE’s customers can only
14 be well served if PGE is able to sustain itself financially. That is why the Commission
15 is charged with “balanc[ing] the interests of the utility investor and the consumer...”⁴
16 Indeed, regulation is built, operates, and depends on a balancing of interests. In my role
17 as Group President of Utility Operations at Entergy, we employed a simple formula for
18 success: excellent customer service + strong regulatory relationships = financial
19 success of the utility. We utilized a “balanced scorecard” approach with which we
20 looked not just at earnings, but also at customer satisfaction, including such key
21 indicators as quality of service and customer complaints. By increasing customer
22 satisfaction, our relationship with the regulators improved and, in turn, our earnings
23 improved. As a PGE Board member, I similarly would be responsible for balancing the
24 interests of the customers with those of the corporation and its investors to ensure that

25 ³ See, e.g., ICNU/200, Antonuk-Vickroy/26-28.

⁴ ORS 756.040(1) (2004).

1 PGE is a financially sound utility, capable of providing customers with safe, reliable,
2 and affordable service, and investors with a satisfactory return on their investment.

3 **Q. Some intervenors have suggested that cuts to operations and maintenance**
4 **("O&M") or capital expenditure budgets may not be felt for many years, allowing**
5 **a short-term owner to maximize profits and exit before the negative effects of cost-**
6 **cutting can be felt.⁵ Do you agree?**

7 **A.** No. In my experience, dramatic cost-cutting of O&M budgets would be manifested in a
8 relatively short period of time, certainly within a matter of two to three years. Service
9 quality reacts quickly to unwarranted budget cuts, particularly cuts in personnel and
10 customer service. On the other hand, by focusing on the importance of improved
11 customer service and customer satisfaction, the utility provides better service quality
12 and experiences fewer outages, improved response, fewer customer complaints, and
13 improved safety and, accordingly, dramatically improves its financial performance. As
14 a PGE Board member, I would not support actions, including unwarranted cost-cutting,
15 that were contrary to the long-term interests of PGE or that would adversely impact
16 quality of service.

17 **Q. You mentioned earlier that a negative regulatory relationship can affect the**
18 **financial health of a utility. Can you explain how this might occur?**

19 **A.** As a regulated utility, PGE is subject to scrutiny and investigation for matters relating to
20 customer service, safety, reliability, and rates; essentially, any matter over which the
21 Commission has jurisdiction. I am confident that, if PGE loses the trust and confidence
22 of its customers and the Commission by failing to provide safe utility operations and
23 excellent customer service (either in terms of service quality or responsiveness), it will
24 subject PGE to higher levels of scrutiny, prudence reviews, and possibly financial
25

⁵ See, e.g., CUB/100, Jenks-Brown/11-12; ICNU/200, Antonuk-Vickroy/6, 34.

1 penalties. The financial impact of such regulatory activity would include direct costs
2 associated with appearance and practice before the Commission, and indirect costs
3 related to the manner in which PGE initiatives might be treated or investigated in the
4 future. In addition, the regulatory relationship will be highly scrutinized by future
5 investors, and a negative relationship with regulators will negatively affect the value of
6 the utility. It is obvious to me that PGE must strive to maintain a strong, positive
7 relationship with the Commission. Because the regulatory relationship is so critical,
8 and because regulators are acutely aware of the interests of customers, it is in the best
9 interests of PGE to have a strong reputation for quality service and good, solid customer
10 and community relations.

11 **Q. One intervenor argues that even if PGE Board members do act in the customers'**
12 **best interests, the benefit is fleeting because of the short-term nature of Oregon**
13 **Electric's ownership.⁶ Do you agree?**

14 **A.** No. Let me reiterate that as a PGE Board member, I am required to act in the best
15 interests of PGE for the short as well as the long-term. PGE's best interests are served
16 by providing safe, reliable, and responsive customer service, achieving long-term
17 growth and stability, and building the trust and confidence of our regulators. When
18 making decisions as a PGE Board member, I will always be concerned with PGE's
19 long-term future. While Oregon Electric's investment in PGE may be for a limited
20 term, PGE itself will go on, and PGE's Board will continue to act in the long-term best
21 interests of PGE and its customers. When PGE's investors sell PGE, they will have to
22 demonstrate to any potential buyer that thoughtful, long-term planning is in place and
23 that the company is viewed positively by its customers and regulators, or risk a loss of
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⁶ See CUB/100, Jenks-Brown/25.

1 return on the investment. While I serve on PGE's Board, I will work to the best of my
2 ability to benefit the utility and its customers for the long-term.

3 **Q. Do you agree with the Citizens Utility Board witnesses that "[e]very time there is a**
4 **rate filing, the corporation's investor's interest is in conflict with the customer and**
5 **the community"?⁷**

6 A. Absolutely not. The investors, as well as the customers and communities served by the
7 company, benefit from reducing unnecessary costs and maximizing efficiencies. It is
8 also in the interest of all parties to make prudent long-term investments that can be
9 recovered in rates. Investors benefit from these long-term investments because they
10 improve the overall financial health and value of the utility, while customers and the
11 communities served benefit from improved infrastructure, better service, and stable
12 rates over the long-term. Oregon Electric's commitment to support PGE in advancing
13 the Port Westward project is a good example of forward-thinking, long-range planning
14 that will benefit both the utility and its customers. Although it is true that Oregon
15 Electric and customers may have competing interests when it comes to setting an
16 authorized return on equity, all share the interests of preserving the financial strength of
17 the utility, and ensuring community growth and economic development. Such an
18 approach ultimately leads the parties to one result—a balanced rate structure that
19 protects the interests of both investors and customers.

20 **Q. How do you react to the suggestion that your ability to serve PGE's customers will**
21 **be limited by TPG's consent rights?⁸**

22 A. The consent rights provide TPG with a check on certain PGE Board decisions of
23 importance to the company's investors. The intervenors' suggestion appears to be that
24 Board members such as myself will take direction from and be influenced by TPG in

25 ⁷ *Id.*

⁸ *See Confidential CUB/100, Jenks-Brown/24.*

1 managing PGE, to the detriment of PGE and its customers. On the contrary, as a former
2 regulator, and as one with 30 years of experience in the utility industry, I am personally
3 satisfied that TPG shares my philosophy and goal of achieving a balanced approach
4 with respect to actions that affect both the company's customers and its investors, and
5 to pursuing strategies that benefit both. If I did not believe that TPG shared this
6 philosophy, and understood the importance of keeping customers at the forefront, I
7 would not have agreed to act as a Board member of PGE.

8 **IV. BENEFITS OF LOCAL REPRESENTATION**

9 **Q. Do you agree with Oregon Electric that the presence of local representatives on**
10 **PGE's Board is a benefit of the Proposed Transaction?**

11 **A.** I do. As I mentioned earlier, a utility benefits if its customers and the communities it
12 serves also benefit. If the economy of the service area grows and prospers, PGE will
13 also benefit. Board members who live and work in the area served by PGE are in a
14 unique position to understand the factors that drive the economy of the area, the needs
15 of the local communities, areas of special concern, and opportunities for growth. One
16 of the reasons I became interested in being a part of the PGE Board was the opportunity
17 to work with a Board whose membership includes a substantial number of qualified
18 local representatives and members of the local community. I am confident that, with
19 this local representation, the PGE Board will do a better job of serving PGE and its
20 customers, and will be particularly well-positioned to respond to the needs of the
21 communities served by PGE.
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1 **Q. In his Direct Testimony on behalf of the Industrial Customers of Northwest**
2 **Utilities, witness Donald Schoenbeck contends that local representation is not a**
3 **benefit of this transaction because it is not unusual in the industry.⁹ Do you agree?**

4 **A.** No. Other than the company CEO, PGE does not currently have local representation on
5 its Board of Directors, so the addition of local board members is clearly a benefit which
6 is not currently enjoyed. There is no requirement that a utility provide any local
7 representation, but Oregon Electric has nonetheless committed that the PGE Board will
8 have at least five Oregonians as members at all times, and that the Chair will be an
9 Oregonian (and in fact Oregon Electric has announced the names of *seven* local
10 representatives who have agreed to serve on the PGE Board). Absent this transaction,
11 there is no assurance PGE would have such representation, either in the short or long-
12 term. While it may be true that some other utilities may also enjoy the benefits of local
13 representation, that fact does not negate the reality of the benefit to PGE, its customers,
14 and the communities it serves by virtue of Oregon Electric's commitment. Moreover, I
15 believe the extent of the commitment, particularly the commitment to having a Chair
16 who is an Oregonian, provides a clear and significant benefit to PGE and its customers.

17 **V. CONCLUSION**

18 **Q. Do you have any further thoughts regarding the Proposed Transaction and your**
19 **role as a member of the PGE Board?**

20 **A.** Yes. In my experience in the electric industry over many years, as a regulator,
21 executive, and board member, I have learned that a utility can only thrive by remaining
22 absolutely committed to customer service. While a board member has a fiduciary duty
23 to protect the interests of the corporation he or she serves, the interests of the investors
24 align, rather than conflict, with the interests of the customers. In short, only by serving
25

⁹ See ICNU/100, Schoenbeck/4-5.

1 PGE's customers can PGE Board members truly serve the interests of the corporation
2 and its investors. I am personally satisfied and convinced that the collection of local
3 representatives, industry professionals, and experienced business leaders assembled by
4 Oregon Electric and TPG will provide exceptional service to PGE and its customers. I
5 look forward to having the opportunity to serve this first-class utility, its customers, and
6 this community.

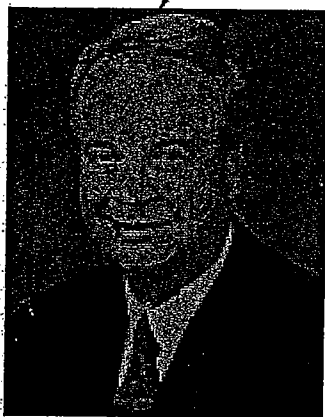
7 **Q. Does that conclude your testimony?**

8 **A. Yes.**

O r e g o n E l e c t r i c U t i l i t y C o m p a n y , L L C

Jerry Jackson

*Former Executive Vice President and Group President, Utility Operations
Entergy Corporation*



Jerry Jackson is a former executive vice president and former group president, utility operations with Entergy Corporation and an attorney whose career in the electric utility industry and government spans more than 30 years. After retiring from Entergy in March 2003, Mr. Jackson joined the international law firm of Skadden, Arps, Slate, Meagher & Flom LLP as Of Counsel in its Washington, D.C. office.

Mr. Jackson had been a senior executive at Entergy since 1979 and has significant experience in Entergy's senior management, with oversight of utility operations, legal, regulatory, finance, marketing, external affairs and corporate administrative functions. Entergy Corporation is an integrated energy company engaged primarily in electric power production, retail distribution operations, energy marketing and trading, and gas transportation. Entergy delivers electricity to 2.6 million utility customers in Arkansas, Louisiana, Mississippi, and Texas.

Mr. Jackson successfully helped lead the company through key initiatives to address sweeping changes that have taken place in the energy industry. He supervised the company's five regional utility operating companies as group president, utility operations, and was instrumental in improvements in a number of areas, including safety, regulatory compliance, financial results and customer service.

Prior to joining Entergy, Mr. Jackson was a member of the Arkansas Public Service Commission from 1973 until 1975.

Mr. Jackson earned his law degree from the University of Arkansas in 1968. He is admitted to the Arkansas bar and the District of Columbia bar, as well as the U.S. Supreme Court; U.S. District Court, Eastern and Western Districts of Arkansas; U.S. Court of Appeals, 8th Circuit; and the D.C. Circuit Court.

He has been active in many community service organizations having served as a member of the board of directors of the Urban League of Greater New Orleans (Chairman - 1998 - 1999), INROADS (Chairman - 1999), the University of New Orleans Foundation, Metrovision, the Arts Council of New Orleans, Tulane Medical Center, LISC, the Committee of 100 and SECURE. He is a past president of the Southeast Louisiana Council of the Boy Scouts of America and is a former member of the Council for a Better Louisiana. He is a resident of New Orleans.

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2
3 **BEFORE THE PUBLIC UTILITY COMMISSION**
4 **OF OREGON**
5 **UM 1121**
6

7 In the Matter of

8 OREGON ELECTRIC UTILITY COMPANY, LLC,
9 et al.,

10 Application for Authorization to Acquire Portland
11 General Electric Company

12
13
14 **REBUTTAL TESTIMONY**
15 **OF**
16 **KARL A. McDERMOTT**
17 **ON BEHALF OF OREGON ELECTRIC**
18

19
20
21 **August 16, 2004**
22
23
24
25

I. INTRODUCTION

Q. Please state your name.

A. My name is Karl A. McDermott. I previously offered direct and supplemental direct testimony in this proceeding on behalf of Oregon Electric Utility Company, LLC (“Oregon Electric”).¹

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to certain assertions in the testimony filed by the Staff of the Oregon Public Utilities Commission (“Staff”), and certain intervenors, including the Citizens Utility Board (“CUB”) and the Industrial Customers of Northwest Utilities (“ICNU”).

Q. Please summarize your rebuttal testimony.

A. Staff and intervenors have posited numerous harms and risks they believe are presented by the Proposed Transaction. Among these are concerns about Oregon Electric’s capital structure, its commitment to invest in and maintain Portland General Electric’s (“PGE’s”) operations and assets, and its willingness to operate as “transparently” as the regulatory structure requires. The implicit—and in some cases explicit—basis for these fears appears to be an assumption that the Proposed Transaction will fundamentally alter the traditional regulatory paradigm and the relationship between the Oregon Public Utility Commission (“Commission”) and PGE. These parties seem to suggest that the Commission cannot exert effective control over PGE, simply due to the nature of the Proposed Transaction. I show, by responding to specific assertions, that the Proposed Transaction will neither undermine the traditional regulatory paradigm nor adversely affect the application of Oregon law or the enforcement of rules by the Commission. Indeed, the Proposed Transaction benefits customers and is in the public interest.

¹ Throughout this testimony, I will use “Oregon Electric” to refer to Oregon Electric Utility Company, LLC, or to all Applicants, as the context may imply.

1 address why, even if the parties' assumptions were true, the Commission will have the
2 ability to mitigate this alleged risk.

3 **Q. Please summarize your response to these allegations.**

4 A. The parties' assumption that the Commission will be powerless flies in the face of the
5 evidence. First, if the Proposed Transaction is approved, the Commission will have all
6 the authority it has today to regulate PGE. Oregon Electric has not requested a waiver of
7 any substantive rule or regulation under which PGE will be required to operate in the
8 future.

9 Second, the Commission's authority, via the applicable statutes, regulations, and
10 policies, is sufficient to maintain the proper level of control over PGE, while at the same
11 time providing the flexibility that PGE's management requires to manage and operate a
12 sustainable utility.

13 Third, the commitments that have been made by Oregon Electric with respect to
14 service quality standards, affiliate transactions, and access to the books and records
15 enhance the Commission's authority to ensure that Oregon Electric adheres to the
16 regulatory requirements.⁵

17 **Q. Please explain what is meant by the "traditional regulatory paradigm."**

18 A. The "traditional regulatory paradigm," or simply the "regulatory paradigm," is the set of
19 overarching principles that have evolved over the years as regulation was applied to
20 public utilities. These principles were derived in part from the public interest theory of
21 regulation that was the dominant philosophy governing regulatory design since the late
22 nineteenth century. Later, other philosophies of regulation emerged in light of the actual
23 experience of regulators. For example, the law and economics movement of the 1950s
24 and 1960s suggested that efficiency in the application of laws (*i.e.*, regulation) should be
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⁵ See Oregon Electric/100, Davis/*.

1 taken into account in the arena of public policy. The regulatory paradigm is therefore an
2 amalgam of philosophical principles applied in light of practical experience.

3 **Q. Please describe the relevant principles of the traditional regulatory paradigm.**

4 A. The traditional regulatory paradigm includes principles that have been articulated by
5 regulators, legislators, and courts over the years. For example, one principle is that,
6 given the monopoly position of the utility in providing an essential service, customers
7 should be protected from paying monopoly profits to the utility. At the same time, courts
8 have made clear that utilities should be offered a reasonable opportunity to recover costs,
9 including capital costs, incurred in serving customers.⁶ The traditional regulatory
10 paradigm is also based on the principle that rates should be just and reasonable, and,
11 while the metric used for judging rates has changed over the years (*e.g.*, whether rates
12 should take into account embedded costs, marginal costs, *etc.*), the basic principle that
13 rates be reflective of costs is fundamental to the traditional regulatory paradigm.

14 **Q. Please describe the Commission's authority to regulate PGE and to ensure that
15 customers are protected if the Proposed Transaction is approved.**

16 A. The Commission has three broad areas of authority, which are part of the regulatory
17 paradigm that ensure customer protection. These areas include:

- 18 • *Broad supervisory authority.* This authority is granted by the legislature and
19 includes the following:
 - 20 ○ general power to protect customers and the public (ORS 767.040);
 - 21 ○ power to investigate the management of the utility (ORS 756.070);
 - 22 ○ power to investigate matters relating to the utility (ORS 756.515);

23
24
25 ⁶ Mr. Jenks and Ms. Brown suggest that the traditional regulatory paradigm "guarantees" a return. This is simply not true. The regulatory paradigm offers a guarantee of an *opportunity* to recover prudent costs including capital costs. See CUB/100, Jenks-Brown/5.

- 1 ○ various powers to control and approve PGE financing decisions, *e.g.*,
2 control of guarantees of others' indebtedness and control of issuances of
3 securities by the utility (ORS 757.440, 405, 410, 415, and 435 and OAR
4 860-027-0030);
5 ○ service quality standards (ORS 757.020 and OAR 860-023-0005, 0015,
6 0020 and 0090 through 0160); and
7 ○ authority over affiliate transactions, including cost allocation (ORS
8 757.490 and 495 and OAR 860-027-0040 through -0044 and -0100).
- 9 • *Ratemaking authority.* Ratemaking is crucial in protecting customers from
10 monopoly abuse. For example, ORS 756.515 and 757.205, 210, 215, 220 and
11 225 provide the Commission with authority to investigate rates and determine
12 final approved rates.
- 13 • *Merger/acquisition conditioning policies.* The Commission also enjoys
14 significant regulatory authority through its ability to condition mergers and
15 acquisitions upon the implementation of additional safeguards that address
16 specific areas of concern. (ORS 757.511(3)). Significant conditions that the
17 Commission has imposed in the past include:
- 18 ○ *Financial ring-fencing* conditions that provide customers with additional
19 safeguards beyond those imposed by rules and regulations. These
20 include requirements that PGE maintain separate debt and preferred
21 stock ratings, a preclusion of distributions to the parent if PGE falls
22 below a threshold level of equity, and a requirement that customers be
23 held harmless from increases in cost of capital as a direct result of the
24 merger or acquisition.
25

- 1 ○ *Transparency* conditions that provide the Commission with the authority
- 2 to audit books and records and to review information concerning any
- 3 transactions with affiliated interests.
- 4 ○ *Prohibition on cross-subsidization* of affiliates as a result of allocation,
- 5 and a prohibition on directly charging a utility for unauthorized
- 6 expenses.
- 7 ○ *Service quality standards* in addition to those contained within Oregon
- 8 law and administrative rules.

9 **Q. Please comment on the suggestion that the Proposed Transaction represents a**
10 **massive shift in the traditional regulatory paradigm.⁷**

11 A. Frankly, I do not see any evidence whatsoever that the regulatory paradigm will be
12 affected by the ownership structure proposed by Oregon Electric. CUB seems to be
13 suggesting that the regulatory paradigm can encompass *only* a local vertically integrated
14 utility with investors willing to take a “modest” return, which I take to mean a risk-
15 adjusted, market-based return.⁸

16 CUB witnesses appear to ignore the fact that Oregon Electric is, in fact, proposing
17 to return PGE to a local, vertically integrated public utility. The financial return to
18 Oregon Electric, as the investor in that utility, will indeed be a market return *based on the*
19 *risks Oregon Electric is willing to undertake*. CUB confuses the issue by pointing to the
20 greater returns that investors in Oregon Electric *may* realize and arguing this is a
21 departure from the regulatory paradigm because those investors expect a higher return

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23 ⁷ See CUB/100, Jenks-Brown/4.

24 ⁸ If Jenks and Brown mean to say that investors in utilities expect something less than a risk-adjusted, market-
25 based return, I take some issue with that implication. It simply is not true. Utility investors, whether they are
major institutional owners (as is the case with many large utilities) or individual investors, accept an expected
return as a compensation for the risk they bear. The expected return on equity is the market price for capital of a
similar risk profile. Utility investors are not expecting a “modest” return – if that term means less than market –
but rather the risk-adjusted, market-based expected return.

1 than utility investors normally receive. However, CUB is mixing apples and oranges.
2 The paradigm CUB advocates is predicated on viewing the utility on a stand-alone basis.
3 It is the return from the *utility* that is relevant, not the return from the holding company or
4 to any one individual investor.⁹ Moreover, “[t]he form of business enterprise should be
5 of no consequence to the Commission, as long as the utility obeys regulatory mandates
6 and procedures, does not present conflicts with the interests of Oregon customers, does
7 not expose customers to greater risks of higher costs or lower service quality, and is
8 capable of economically and reliably providing the services offered to customers now and
9 in the future.”¹⁰

10 The traditional regulatory paradigm will continue to operate after the Proposed
11 Transaction is approved. The Commission will continue to have the authority to set
12 PGE’s rates, and PGE will continue to be required to follow all laws and regulations
13 including any conditions adopted as part of this proceeding.

14 Furthermore, Oregon Electric, in acquiring PGE, understands that it is subject to
15 all the rules and laws that govern regulated utilities in Oregon, including the limitations
16 associated with the Enron ring-fencing conditions¹¹ that exist today. The ability of

17 ⁹ CUB surely cannot be suggesting that any individual investor who buys a utility stock at a low level and sells it
18 at a higher level, potentially obtaining a return far in excess of the utility’s allowed return, is somehow acting
19 inappropriately or distorting the traditional regulatory paradigm. Or that an investor who buys a utility stock on
20 margin (*i.e.*, with a loan from a broker) to obtain a greater overall return is likewise inappropriate. Regulators, of
course, do not look at the return to ultimate individual investor, as it is the cost of equity capital for the utility that
matters.

21 ¹⁰ OPUC Order No. 01-778 (Sept. 4, 2001) at 11.

22 ¹¹ For purposes of this testimony, by “Enron ring-fencing” or “ring-fencing,” I am referring to the following
merger conditions imposed by the Commission in UM 814:

- 23 • PGE shall maintain separate debt and, if outstanding, preferred stock ratings;
- 24 • PGE shall not make any distribution to Enron that would cause PGE’s equity capital to fall below 48
percent of the total PGE capital without Commission approval. The Commission Staff, PGE, and Enron
may re-examine this minimum common equity percentage as financial conditions change, and may
request that it be adjusted; and
- 25 • Enron, PGE, and the Commission Staff agree that the allowed return on common equity and other costs
of capital will not rise as a result of the merger. These capital costs refer to the cost of capital used for
purposes of rate setting, avoided cost calculations, affiliated interest transactions, Least Cost Planning,
and other regulatory purposes.

1 Oregon Electric to finance its operations and return value to its investors is affected by
2 the Commission's exercise of ratemaking authority over PGE's pricing structure and
3 tariffs. The Commission's ability to exclude costs that are not related to utility operations
4 or that are imprudently incurred is not trivial. Simply stated, the traditional regulatory
5 paradigm, as embedded in Oregon's laws and regulations, will not be altered by the
6 Proposed Transaction.

7 **Q. You claim that the Commission will continue to exercise its authority over PGE**
8 **after the Proposed Transaction. What evidence do you have that this will be the**
9 **case?**

10 A. One example is the Enron purchase of PGE and the Commission's actions during its
11 ownership. Enron was a multi-national corporation with multiple affiliates, many with
12 different financing mechanisms and different operational focuses. In 1997, the
13 Commission approved the sale of PGE to Enron and placed a set of ring-fencing
14 conditions (as well as multiple other conditions) on PGE. During the period of Enron
15 ownership, several major issues, not necessarily anticipated in 1997, came before the
16 Commission that demonstrate the Commission's willingness, ability, and authority to
17 effectively regulate PGE.

18 First, in 1999, the Commission issued Order No. 99-033, which was directed at an
19 application by PGE for approval of a "Customer Choice Plan." In this plan, PGE
20 proposed to divest itself of its generation assets and become a "wires" company. The
21 Commission, however, rejected PGE's plan in favor of an alternative. As part of this
22 alternative plan, the Commission, in principle, approved PGE's divestiture of its non-hydro
23 assets, with the understanding that any asset sale would still require Commission
24 approval. Later in 1999, PGE filed an application for approval to sell its Colstrip assets.
25

OPUC Order No. 97-196 (Jan. 4, 1997) Appendix A (Stipulation).

1 After review of the proposal, the Commission found that PGE's proposed sale of these
2 resources would harm customers and denied the application. Another proposal for a
3 restructuring plan was filed by PGE in late 2000, on which the Commission took no
4 action. Later, the Oregon Legislature amended SB 1149 requiring that a cost-based rate
5 be provided to all customers, and thereafter PGE revised its Least Cost Plan.

6 Of course, after this time period, Enron became financially unstable and moved
7 toward bankruptcy. During Enron's bankruptcy, the Commission continued to
8 effectively regulate PGE by acting on PGE's periodic requests to issue securities and by
9 continuing to review PGE's Least Cost Plan for acquiring resources to meet its load. As
10 recently as July of this year, the Commission issued an order that acknowledged PGE's
11 filing of its Least Cost Plan and the inclusion of a generic gas resource in the plan.¹²

12 The facts concerning the actions of the Commission during this time are beyond
13 dispute. The Commission has continually worked to promote the public interest and has
14 exerted its authority over PGE and other Oregon utilities, even as new ownership
15 structures have evolved in the industry. There is no reason to believe that the
16 Commission will not be able to continue its regulatory mission if the Proposed
17 Transaction is approved.

18 **Q. Are there proposals in this case that would alter the Traditional Regulatory**
19 **Paradigm as applied to PGE?**

20 A. Yes, but ironically they are not proposed by Oregon Electric, but are proposed by the
21 intervenors. One of the fundamental aspects of traditional regulation is the connection
22 between costs and prices. Traditionally, prices are designed to reflect the underlying
23 costs incurred to provide service. Those costs deemed prudent by the Commission are
24 allowed to be recovered in the rates charged to consumers. Several intervenors seem to

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¹² OPUC Order No. 04-375 (July 20, 2004).

1 suggest that PGE should be required to reduce its rates now in the expectation, or even
2 without an expectation, of future cost savings in order to pay for the alleged increased
3 risks associated with the Proposed Transaction. While I understand the pressure on
4 parties to obtain tangible and easily explained benefits from this proceeding, if the
5 Commission were to break the link between costs and prices it would fundamentally alter
6 the regulatory paradigm that currently operates in Oregon.

7 III. ASSESSMENT OF ALLEGED RISKS

8 A. Introduction

9 **Q. Please discuss the alleged risks or harms that the parties claim to be associated with**
10 **the Proposed Transaction.**

11 **A.** In their testimony, the parties have presented numerous risks or harms that they assert are
12 associated with the Proposed Transaction. Examples include:

- 13 • *Leverage.* Some parties suggest that the leverage at Oregon Electric presents
14 risks that will be borne by PGE and PGE customers.¹³
- 15 • *Lack of Transparency.* Some parties assert that Oregon Electric and its
16 principal investor, TPG, will not operate with the level of transparency
17 required in the regulatory environment.¹⁴ Other parties suggest that TPG's
18 consent rights will mask PGE's decision-making from the Commission and
19 customers.¹⁵
- 20 • *Short-term investment with no certainty as to next owner.* Oregon Electric has
21 explained that it will sell its position in PGE within the next 12 years. Some
22 parties argue that this fact means that Oregon Electric will have no incentive
23 to make long-term investments in PGE's future. In addition, some allege that
24

25 ¹³ See, e.g., CUB/100, Jenks-Brown/2; Staff/200, Morgan/28-32; ICNU/200, Antonuk-Vickroy/20-24.

¹⁴ See, e.g., CUB/100, Jenks-Brown/2; Staff/100, Conway/10.

¹⁵ See ICNU/100, Schoenbeck/6.

1 Oregon Electric has poor incentives as an owner, because, their theory goes, it
2 is looking for capital gains and not a regulated rate-of-return.¹⁶

- 3 • *Income tax.* Some parties have suggested that the benefits to the investors of a
4 holding company structure should accrue to customers through a reduction in
5 the income tax expense for PGE (although at the same time, and in direct
6 contradiction of this position, they assert that PGE should not share the
7 burdens of leverage at the holding company).

8 **Q. The parties suggest that all of these risks are unmitigated and that they would not**
9 **exist absent the Proposed Transaction. Please summarize your response to these**
10 **concerns.**

11 A. The parties' claims are incorrect. Many of the harms they posit do not exist and many of
12 those that do exist are normal utility risks. All of the risks that do exist are mitigated by
13 regulatory protections.

14 There is no doubt that regulation operates in an uncertain world as do the
15 companies that are regulated. Thus, there will always be some degree of risk attendant to
16 any merger or acquisition of a public utility. However, the Commission has a vast array
17 of powers to deal with events as they arise and to prevent certain negative events from
18 happening. This is the role of any public utility commission, and I expect this
19 Commission to continue to exert its authority. I conclude that these alleged risks do not
20 fall outside of what might normally be addressed by the Commission in discharging its
21 duties as regulator of PGE and, therefore, that these alleged risks or harms do not negate
22 the benefits of the Proposed Transaction.

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¹⁶ See, e.g., CUB/100, Jenks-Brown/2.

1 B. *Oregon Electric's leverage does not present a significant risk to PGE or its customers.*

2 **Q. Please describe your understanding of the concern parties to this case have with**
3 **respect to the proposed capital structure of Oregon Electric.**

4 A. These concerns appear to relate to the possible increase of debt costs at the utility and the
5 fear that PGE would be dragged into a bankruptcy if one should occur at
6 Oregon Electric.¹⁷ Another concern is related to possible cost-cutting pressure. Oregon
7 Electric witness Carrie Wheeler addresses in her rebuttal testimony the cost-cutting
8 issue.¹⁸ I will address the effect of holding company leverage generally on customers.

9 **Q. From a former regulator's perspective, why does leverage at Oregon Electric pose**
10 **minimal risk to PGE?**

11 A. The Commission retains authority over PGE's finances, operations, and investment.
12 Specifically, the Commission retains regulatory authority to monitor PGE to determine if
13 investment, financing, or other policies of the company would be detrimental to the
14 provision of safe, reliable, and reasonably priced service.

15 Ring-fencing measures, such as precluding PGE from paying dividends to Oregon
16 Electric unless PGE's equity is at or above 48%, help maintain credit quality at the
17 utility. With such a measure in place, if PGE does not generate enough earnings in a
18 given year, then Oregon Electric and its investors are at risk, not PGE or its customers.
19 Moreover, even if PGE incurred a higher cost of debt, it is unlikely customers would pay
20 for this increment.¹⁹ Customers are not even at risk until the next rate case, because debt
21 service costs were fixed in the 2000 general rate case. If borrowing were to become more
22 costly before the next rate case, rates would not change, which means shareholders, not
23 customers, would bear that cost. For purposes of an eventual rate case, Oregon Electric

24 ¹⁷ See, e.g., ICNU/200, Antonuk-Vickroy/13-32.

25 ¹⁸ See Oregon Electric/200, Wheeler/*.

¹⁹ Note that PGE witness Piro discusses the inability of any analyst to determine the exact effect of the Enron
bankruptcy on PGE bond ratings. See PGE/100, Piro/*.

1 has agreed to hold customers harmless against increases in the cost of capital for PGE
2 resulting solely from its acquisition of PGE. This means that if there is an adverse credit
3 impact that results in higher capital costs for PGE, it will not affect customers.

4 *C. The transparency of the regulatory process will not be compromised*
5 *by the Proposed Transaction*

6 **Q. Please describe the concern over transparency.**

7 A. Staff is concerned that Oregon Electric will not be forthcoming with critical data if the
8 Proposed Transaction is approved.²⁰ Specifically, Staff is concerned that Oregon Electric
9 was not timely in its responses to staff discovery requests, did not provide information
10 required to be provided by an Administrative Law Judge, and was overly sensitive to
11 proper discovery. CUB is concerned that, because TPG is a private company, overall
12 transparency will be reduced.²¹

13 **Q. Please summarize your response.**

14 A. I am convinced that the Proposed Transaction is unlikely to decrease the level of
15 transparency in the future and, in fact, is likely to improve the transparency of the
16 process.

17 **Q. Please describe the purpose of transparency in the regulatory process.**

18 A. Transparency allows the regulator an opportunity to make decisions based on all of the
19 relevant facts. However, transparency does not mean that the parties, whether a utility,
20 staff, or an intervenor, should be held to unreasonable standards of discovery.

21 **Q. Does the Proposed Transaction represent a move toward a less transparent**
22 **regulatory process in Oregon?**

23 A. No. Transparency is not a function of the ownership structure of the utility. Rather,
24 transparency is a function of the regulatory processes and practices in place in Oregon.

25 ²⁰ See Staff/100, Conway/11.

²¹ See CUB/100, Jenks-Brown/15-16.

1 As a former regulator, I can attest to the importance of transparency, and I understand
2 Staff's and the Commission's need for complete and accurate information. I also
3 understand that a new owner brings with it new personalities, but the regulatory process
4 is robust enough to handle changes in ownership.

5 I do not believe that TPG's status as a private investor would affect the reporting
6 and transparency of the information the Commission needs in order to regulate PGE.
7 TPG is not a holding company; it is an investor. PGE will maintain separate books and
8 records, and it will continue in the normal course its reporting to the Commission. In
9 addition, Oregon Electric has committed to a number of conditions which, if this
10 transaction is approved, will only serve to increase the transparency of the process. The
11 specifics of these conditions are described by Kelvin Davis in his rebuttal testimony.²²
12 After reviewing Oregon Electric's proposed conditions regarding disclosure, it is my
13 opinion that the Commission is likely to have all the rights under law and regulation, and
14 through Oregon Electric's voluntary acquiescence to open its books and records to the
15 Commission, all that the Commission needs to exercise proper regulatory oversight of the
16 utility.

17 **Q. How do you respond to Staff witness Conway's concerns regarding the discovery**
18 **process in this proceeding?**²³

19 A. Staff contends that Oregon Electric has been less than forthcoming in the discovery phase
20 of this proceeding. As a former regulator (and staff member), I have substantial
21 experience with the discovery process. I can find nothing in the record to justify Staff's
22 fears. While private investment firms operate in a competitive market and must
23 necessarily guard their sensitive and proprietary information, Oregon Electric produced
24 an enormous amount of information and documents.

25 ²² See Oregon Electric/100, Davis/*.

²³ See Staff/100, Conway/10-13.

1 Staff also contends that Oregon Electric was not timely in responding to
2 discovery. However, as Mr. Davis indicates in his rebuttal testimony, Oregon Electric
3 was granted stipulated extensions on most of these data requests and those extensions
4 were brief. Such extensions are not unusual in my experience and, in reviewing the time
5 table of responses to Staff and intervenors' discovery requests, it does not appear to me
6 that there was an unreasonable delay in the proceeding.

7 Further, I have reviewed a number of responses provided by Oregon Electric to
8 Staff and have come to the conclusion, based on my experience as a former regulator and
9 staff member, that Oregon Electric has been forthcoming in responding to Staff's
10 requests. My conclusion, based on this evidence, is that this does not indicate
11 unreasonable behavior on the part of Oregon Electric and, in fact, shows that Oregon
12 Electric has been reasonable in its actions during the discovery phase of this proceeding.

13 *D. The fact that the TPG investment in Oregon Electric is not permanent*
14 *does not pose significant incremental risk to ratepayers*

15 **Q. What concerns do parties have related to the duration of Oregon Electric's**
16 **investment in PGE?**

17 A. The general concern seems to be that, because Oregon Electric is not a permanent
18 investor, it will only take a short to mid-term view and not concern itself with issues that
19 might arise after it has sold its stake in PGE. Witnesses have alleged a parade of
20 horribles including reduced investment, excessive cost-cutting, an absence of long-term
21 accountability, and a lack of commitment to long-term planning and public policies.²⁴

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²⁴ See, e.g., CUB/100, Jenks-Brown/8; CUB/200, Dittmer/28-30.

1 **Q. Do you have any initial comments on these assertions?**

2 A. Mr. Davis' testimony addresses why these fears are unfounded given Oregon Electric's
3 goals as an investor. I will address why they are unfounded given the nature of economic
4 regulation.

5 **Q. Will the regulatory framework help ensure that PGE maintains a long-term outlook**
6 **under Oregon Electric's ownership?**

7 A. It is indisputable that PGE has an obligation under Oregon law and Commission practice
8 to serve its current customers and provide for long-term investment that will maintain
9 service to customers in a reliable and cost-effective manner.²⁵ I can state from experience
10 that regulators do not, as they should not, take these requirements lightly. It is their
11 obligation to administer the law as it is written and to make sure that utilities are
12 providing for long-term investment to maintain and expand the system.

13 It is also indisputable that the Commission has supervised PGE's least-cost
14 planning process throughout the Enron bankruptcy and that the Least Cost Plan details
15 the capital investment that is needed over time. The Commission clearly has the
16 authority to determine the final form of that plan and will do so as it has done in the
17 past.²⁶ In addition, under Oregon law, the Commission has the ability to investigate the
18 operations of PGE and order the company to rectify any deficiencies in practice or
19 investment that it believes are endangering the long-term safety and/or reliability of the
20 company's services.²⁷

21 The Commission's ability to regulate PGE applies to PGE *regardless of*
22 *ownership structure*. Accordingly, any alleged short-timer's incentive would be more
23 than off-set by the rules and regulations in place in Oregon. Indeed, the next Integrated
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25 ²⁵ ORS 757.020 and OAR 860-023-0005,-0015,-0020, and -0090 through -0160.

²⁶ See, e.g., OPUC Order No. 04-375 (July 20, 2004).

²⁷ ORS 756.070, 075.

1 Resource Planning process for PGE will be conducted during the very first year of
2 Oregon Electric's ownership and every two years thereafter. There simply will not be the
3 opportunity, as intereვენors' fear, to avoid appropriate long-term planning.

4 **Q. What aspects of a utility's relationship with the regulator suggests that Oregon
5 Electric ownership of PGE will be consistent with the long-term health of PGE?**

6 A. First, I note that Mr. Davis explains why PGE's owner would be foolish not to attend to
7 the appropriate long-term needs of the company based on its own financial motives.²⁸ In
8 addition, if for no other reason, PGE's owners will be motivated to maintain the utility's
9 long-term health to maintain a positive relationship with the Commission. Remember
10 that a utility derives its income from the level of rates that are allowed by the
11 Commission. The Commission has the ability to "disallow" costs that are imprudently
12 spent and monitor and investigate a utility that appears to be imprudently budgeting for
13 the long-term viability of its system. No utility wants to have a regulatory body
14 constantly investigating its operation and maintenance practices and policies, and,
15 therefore, it has an incentive to carefully plan for the future. Any rational buyer would
16 understand that the level of current *regulatory goodwill* has a direct impact on its ability
17 to operate successfully in the regulated environment. If Oregon Electric was to
18 purposefully violate the Commission's rules and regulations or the general spirit of the
19 regulatory relationship, it would simply be diminishing the value of its principal asset.

20 **Q. Has Oregon Electric made any commitments that support its contention that it will
21 invest in PGE's long-term future?**

22 A. Yes. I think it is very telling that Oregon Electric is committed to moving forward with
23 the Port Westward project to the extent that it is the prudent and least-cost alternative.
24 This commitment is important because it stands in direct opposition to the allegation of
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²⁸ See Oregon Electric/100, Davis/*.

1 “short-timers disease,” and demonstrates that Oregon Electric will make decisions in the
2 best long-term interest of the customers. Further, I might add that Mr. Davis’ description
3 of the process by which TPG determined to support Port Westward is the type of
4 analysis²⁹ that the Commission should expect a well-run utility to undertake in its Least
5 Cost Planning.

6 **Q. Some parties have expressed concern about Oregon Electric selling PGE to a
7 strategic buyer³⁰ in the future. Please comment.**

8 A. As a matter of public policy, this simply is not an appropriate issue for the Commission
9 to address at this point. The parties seem to simply overlook the fact that the
10 Commission has the authority to review any future proposed merger or acquisition when
11 it is proposed. If PGE is offered for sale to a strategic investor, another ORS 757.511
12 proceeding would be required and, if net benefits were found, the Commission would
13 approve it. This is not a risk, nor is it unique to this transaction, but rather the product of
14 sound regulation.

15 **Q. There is a suggestion that Oregon Electric should provide a free option to a public
16 authority to purchase PGE.³¹ Please comment.**

17 A. The Commission should not be in the business of facilitating a condition that offers free
18 options to any entity. There is no overriding public policy that demands or justifies such
19 a free option and the Commission does not have sufficient evidence to determine whether
20 this free option is in the public interest. This proposal must be rejected.

21 **Q. What do you conclude from these proposals?**

22 A. These parties appear to have a very short-sighted view of the world. There is no evidence
23 in the record to allow the Commission to decide today who might be the best owner for
24

25 ²⁹ See Oregon Electric/100, Davis/*.

³⁰ A strategic buyer means another utility or energy company.

³¹ See CUB/100, Jenks-Brown/34.

1 PGE at the time when Oregon Electric should decide to sell. In no event should the
2 Commission restrict flexibility regarding the universe of future buyers without a
3 demonstrated benefit.

4 It is also important to remember that when PGE's ownership is sold to a
5 controlling party other than Oregon Electric, this Commission will have the same
6 authority it has today in this process to review and approve (or deny) the transfer.
7 Likewise, intervenors will have the same rights of participation in that process, and, if the
8 concerns or philosophy they express today about future ownership of PGE are relevant,
9 they will be able to have the Commission consider them.

10 *E. Calculating income taxes for PGE on a normalized, stand-alone*
11 *basis is sound regulatory policy*

12 **Q. What issues do the parties raise with respect to income tax calculations?**

13 A. The general concern is related to the actual taxes paid to the government as opposed to
14 the taxes that are calculated for inclusion in the utility's rates. One party calls this a "tax
15 loophole" that is a direct burden on customers.³² Another party suggests that this tax
16 benefit should be used to offset the alleged risks of the Proposed Transaction.³³

17 **Q. Do you have any general comments on this issue?**

18 A. First, income tax treatment is not a "risk" of the Proposed Transaction. Oregon has had a
19 policy of stand-alone income tax calculation for a number of years, and any buyer of PGE
20 would expect this policy to continue. For example, it is my understanding that the
21 Commission has utilized a stand-alone (normalized) income tax calculation in every
22 ratemaking order for all major electric utilities in Oregon since holding companies came
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25 ³² CUB/100, Jenks-Brown/14.

³³ See ICNU/200, Antonuk-Vickroy/42.

1 to widespread use in the early 1990s.³⁴ This includes PGE during its ownership by
2 Enron.

3 Second, in my opinion, this proceeding is not the appropriate venue for
4 determining a ratemaking treatment of taxes. This is not a ratemaking proceeding in
5 which the Commission has evidence regarding all of the costs and revenues of the utility
6 and therefore the Commission should not make a ratemaking decision based on this
7 single issue.

8 **Q. Why should a utility be treated as a stand-alone entity for ratemaking purposes?**

9 A. There are several reasons. First, under the traditional regulatory paradigm, the utility is
10 the entity charged with the obligation to serve customers. Therefore, the projected costs
11 associated with serving those customers should be included in customers' rates. This
12 concept is fundamental to the Commission's policy on separating the utility from other
13 operating companies with which it might be affiliated. Staff notes that this approach
14 helped protect customers from financial difficulties associated with Enron.³⁵

15 Second, the Commission has a policy of stand-alone ratemaking. In a
16 memorandum to the Commission in March 2003, Staff noted:

17 Calculating PGE's costs, including income taxes, for ratemaking on a stand-
18 alone basis protects PGE's customers from the financial difficulties
19 experienced by Enron's other subsidiaries. When the Commission approved
20 Enron's acquisition of PGE, it had the option of incorporating the effects of
21 Enron's non-utility operations in PGE rates or treating PGE as a stand-alone
22 entity. *Consistent with long-standing OPUC policy*, the Commission chose
the latter approach. In adopting the stipulation in Docket UM 814, the
Commission created a wall between PGE's operations and Enron's other
subsidiaries.³⁶ (emphasis added)

23 ³⁴ Further evidence of the Commission's preference for stand-alone tax calculations is found in OAR 860-027-
24 0048(3)(g). This rule relates to the allocation of costs when transferring assets between regulated and non-
25 regulated activities and states as follows: "[I]ncome taxes shall be calculated for the regulated activity on a stand-
alone basis for ... ratemaking purposes."

³⁵ See Staff/500, Johnson/8.

³⁶ Oregon Electric/401, McDermott/4.

1 Third, consolidating taxes with the holding company would either amount to
2 asymmetric regulation or negatively affect customers. As Staff notes:

3 If PGE's rates were set in a manner that captured some of Enron's tax
4 losses, PGE's rates would also have needed to reflect the expenses that
5 created those tax savings, and customers would be worse off. Staff's
6 counsel advised that it would be difficult for the OPUC to justify picking
7 and choosing which of Enron's revenues and expenses — including tax
8 savings — to include for purposes of setting Oregon customers' rates.
9 Moreover, such an approach may lead to confiscatory rates.³⁷

10 Allowing the Commission to consolidate PGE with Oregon Electric for income tax
11 purposes would not always work to the benefit of customers.³⁸

12 In my work, I am often asked to provide education for new commissioners and
13 staff members on the proper application of regulatory principles at a program called
14 "Camp NARUC."³⁹ In doing so, I always caution regulators not to stray from the long
15 standing policy of isolating and protecting customers from any non-utility activities or
16 affiliates, or to put it another way, to foster stand-alone treatment of the utility in
17 ratemaking and otherwise.

18 Finally, as noted by ICNU witnesses, Oregon's policy represents the prevailing
19 regulatory policy in the United States.⁴⁰ Nevada, for example, has decided as a matter of
20 policy that it would not require a utility (Sierra Pacific Power Company) to reflect the tax
21 savings of a consolidated company, even though non-utility subsidiaries had losses that
22 would have lowered the amount of income taxes borne by ratepayers through their
23 rates.⁴¹ The Nevada Commission has continued to follow this policy since 1992. Utah
24 follows a similar policy. The Public Service Commission of Utah explained that "[t]his

25 ³⁷ *Id.*

³⁸ See Staff/500, Johnson/8.

³⁹ As I noted in my Direct Testimony, I am on the faculty of Michigan State University's Institute for Public Utilities annual regulatory studies programs.

⁴⁰ See ICNU/200, Antonuk-Vickroy/42.

⁴¹ See *Re Sierra Pacific Power Co.*, 129 PUR 4th 470, 534 (Nev. PSC, 1992) (Courtesy copies available upon request).

1 adjustment prevents ratepayers from paying additional taxes arising as a result of affiliate
2 earnings or, as is the case here, paying less in taxes as a result of affiliates' losses."⁴²
3 Thus, the Utah Commission made an adjustment to state income taxes to remove
4 incremental tax savings allocated to Questar Gas as a result of Questar Corporation's
5 consolidated Utah tax return, which increased Questar Gas's state tax expense by
6 \$49,232.⁴³

7 IV. APPLICATION OF THE NET BENEFIT TEST

8 **Q. Please describe how the Commission applies the net benefits test.**

9 A. In Order No. 01-778, at 11, the Commission stated:

10 We do not believe that this [net benefits] standard is either rigid or
11 arbitrary...We do not intend to reduce the net benefit standard to economic
12 considerations as a matter of policy. We will consider the total set of
13 concerns presented by each merger application in determining how to assess
14 a net benefit. This allows us to retain flexibility in our decision making, a
15 desideratum in today's uncertain climate. Because potential harm from
16 merger transactions is often difficult to verify, recent orders have required
17 monetary terms as a way to demonstrate that customers will receive a net
18 benefit. This need not always be the case.

15 **Q. Please describe the Staff and intervenors' approach to the net benefit test.**

16 A. Neither Staff nor intervenors provide a clear statement regarding how they propose to
17 have the Commission apply the net benefits standard. Nevertheless, throughout their
18 testimony, they repeat certain arguments that reveal the criteria they apparently would
19 have the Commission apply. Application of their criteria would virtually guarantee that
20 the net benefits test would never be met and render that test meaningless. Staff and
21 intervenors' criteria, and my responses to each, are as follows:

22 **Staff and Intervenor Criterion 1: Only perfectly certain monetary benefits**
23 **may be considered as a benefit of the Proposed Transaction. Benefits that**
24 **are possible or that cannot be fully quantified do not merit consideration by**

25 ⁴² See *In the Matter of the Application of Questar Gas Co. for a General Increase in Rates and Charges*, Docket
No. 99-057-20 (Aug. 11, 2000) (Courtesy copies available upon request).

⁴³ *Id.*

1 **the Commission. However, the Commission must fully consider alleged**
2 **harms or costs no matter how unlikely.**

3 Staff concedes that Oregon Electric’s application may provide a benefit to PGE’s
4 customers.⁴⁴ However, Staff suggests that Oregon Electric cannot show net benefits
5 without providing guaranteed monetary savings in the form of up-front rate credits.⁴⁵
6 Other intervenors take a similar view, rejecting out of hand every benefit that Oregon
7 Electric offers as “uncertain,” “nebulous,” or insufficiently “concrete.”⁴⁶

8 However, while Staff and intervenors are quick to discount admitted benefits,
9 they conveniently neglect to discount the “harms” and “risks” by the very uncertainties
10 that they believe require Oregon Electric to offer guaranteed monetary savings. Indeed,
11 Staff and intervenors readily attach significant weight to a parade of horrors – e.g.,
12 bankruptcy, harmful cost-cutting, service degradation – without analyzing whether any of
13 those events are likely, whether they are unique to this Proposed Transaction, or whether
14 they are mitigated by ring-fencing.⁴⁷ Engaging in this kind of arbitrary one-sided
15 analysis of benefits and risks runs afoul of the Commission’s approach to the net benefit
16 standard and the Commission’s duty to balance the interests of the utility and its
17 customers.⁴⁸ The bogeyman of uncertainty and risk can be invoked in any transaction.
18 Without more, uncertainty cannot be the basis for requiring guaranteed monetary
19 benefits, or else the net benefit test reduces to economic considerations in violation of
20 Commission policy.⁴⁹

23 ⁴⁴ See Staff/100, Conway/15.

24 ⁴⁵ *Id.* at 16.

25 ⁴⁶ See CUB/100, Jenks-Brown/28-29; ICNU/100, Schoenbeck/9.

⁴⁷ See, e.g., Staff/200, Morgan/46-51.

⁴⁸ See OPUC Order No. 01-778 (Sept. 4, 2001) at 11.

⁴⁹ *Id.*

1 **Staff and Intervenor Criterion 2: The Commission must consider all**
2 **unknowns as harms, even if they might benefit customers.**

3 Staff and intervenors conclude that every unknown presents a “risk” of harm,
4 even where such unknown may lead to benefits. For example, Staff criticizes Oregon
5 Electric’s plan to look for savings in operating expenses and capital expenditures as
6 presenting a potential “risk” to PGE, even though cost-cutting to improve efficiencies
7 (without sacrificing safety and reliability) is encouraged because it benefits customers
8 through lower rates.⁵⁰ Similarly, Staff points to the uncertainty surrounding Oregon
9 Electric’s “exit strategy” as a potential “risk,” even though parties seem to like the
10 possibility of PGE becoming an independent publicly-traded company.⁵¹ This “heads I
11 win, tails you lose” approach to analyzing “unknowns” is arbitrary and ignores the
12 Commission’s approach to the net benefit standard.⁵²

13 **Staff and Intervenor Criterion 3: Any benefit cited by Oregon Electric must**
14 **be unique to this transaction (i.e., such benefits could not feasibly be**
15 **provided by any other potential buyer), but harms or risks need not be**
16 **unique.**

17 Some intervenors believe that the net benefits test requires that Oregon Electric
18 provide not just benefits, but *unique* benefits “that alternative owners could never
19 supply,” such that a proposed transaction represents “the best of the available options.”⁵³
20 The net benefit test does not include a “uniqueness” requirement; the intervenors have
21 invented it.⁵⁴ Moreover, it is telling that, while intervenors argue that benefits must be
22 “unique” to a proposed transaction, any risk or uncertainty is counted as a “harm,” even if
23 that risk or uncertainty would exist in every transaction. The Commission should reject
24 this one-sided approach to analyzing benefits and risks.

25 ⁵⁰ See Staff/200, Morgan/46-47.

⁵¹ See Staff/200, Morgan 54-55; CUB/100, Jenks-Brown/16-20.

⁵² See OPUC Order No. 01-778 (Sept. 4, 2001).

⁵³ CUB/200, Dittmer/25; CUB/100, Jenks-Brown/21. See also ICNU/100, Schoenbeck/4-5 (commitment to five Oregonians on PGE Board is not “unique or unusual” benefit).

⁵⁴ See OPUC Order No. 01-778 (Sept. 4, 2001) at 11.

1 **Staff and Intervenor Criterion 4: Any commitment to an action or policy**
2 **that parties believe a utility “should” undertake is not a benefit, even if these**
3 **items are not currently undertaken or proposed to be undertaken.**

4 Some intervenors reject out of hand any commitment by Oregon Electric to do
5 things that, in the intervenors’ view, every utility should do as a matter of course.
6 According to the intervenors, this kind of commitment is not a true “benefit.”⁵⁵ There is
7 no support for this view; whether benefits *should* already exist is not the appropriate test.
8 The Commission considers the “total set of concerns” and determines whether customers
9 receive a net benefit from a proposed transaction.⁵⁶ For example, one concern could be a
10 utility’s failure to meet minimum expectations, and, therefore, a benefit would be the
11 opportunity to remedy that situation with new ownership.

12 **Q. How should the net benefits test be applied?**

13 A. The net benefits test as applied in the traditional regulatory paradigm involves a
14 comparison of the expected costs and benefits associated with the transaction. Utilities
15 and regulators do not operate with perfect knowledge or certainty; what a regulatory
16 examination attempts to do is to evaluate the set of incentives and controls in order to
17 assess the *probability* and *magnitudes* of the outcomes of the regulatory process.
18 Therefore, the net benefits test must examine the probability and magnitude of each
19 reasonably possible outcome in a symmetric manner. The parties in this case choose to
20 look only at the changes in the probability of *bad* outcomes, and completely ignore the
21 evidence for the increased probability of *good* outcomes. Again, this asymmetric
22 application of the net benefits test is inappropriate.

23 **Q. How do regulators address the probability and magnitude of future outcomes?**

24 A. Generally, a set of rules and regulations are established that restrict the ability of a utility
25 to engage in behavior that could raise the probability or magnitude of an adverse outcome

⁵⁵ See, e.g., CUB/100, Jenks-Brown/25 (ratepayers and the regulatory system already assume “that companies are well-run, prudently managed, and have strong, dedicated boards”); ICNU/100, Shoenbeck/2 (same).

⁵⁶ See OPUC Order No. 01-778 (Sept. 4, 2001) at 11.

1 for consumers. Further, the Commission must review the incentives under which a utility
2 operates in order to understand how these factors affect the probability and magnitude of
3 outcomes.

4 **Q. What is the next step in the analysis?**

5 A. The next step in the analysis is to examine the expected benefits of the transaction. For
6 example, one of the advantages of this transaction is concentrate the ownership of PGE,
7 which will give the incentive for the owner to effectively monitor and manage PGE's
8 operations. When combined with TPG's long track record of employing best-practices
9 management techniques to improve operations and add value to companies in which it
10 invests, the effect is to increase the probability that benefits will result, and the magnitude
11 of the potential benefits will increase as well. The net benefits test would be applied this
12 way to all of the benefits of the Proposed Transaction.

13 **Q. Please describe the overall analysis of the net benefits test in this case.**

14 A. The Commission should apply the net benefits test in the context of the regulations under
15 which PGE operates and the policy conclusions the Commission has made concerning
16 application of the test. In this case, the effect of the Commission's rules and regulations
17 will not allow the probability or the magnitude of harms to increase appreciably. At the
18 same time, the Proposed Transaction provides an ownership structure that will increase
19 the probability and magnitude of benefits in the future. As a result, the Commission's net
20 benefit test is passed.

21 **Q. In your experience as a regulator and staff member, are there any benefits to the
22 Proposed Transaction that you find particularly compelling?**

23 A. Yes. In my direct testimony I identified the following benefits of the Proposed
24 Transaction:⁵⁷

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⁵⁷ See Oregon Electric/4, McDermott/4.

- 1 • An *immediate* end to the uncertainty and instability surrounding the
- 2 bankruptcy proceedings;
- 3 • Benefits related to Texas Pacific Group's ("TPG's") role as a private equity
- 4 investor;
- 5 • Greater alignment of owner and customer interests;
- 6 • Application of best management practices; and
- 7 • Local emphasis and accountability.

8 Mr. Davis has identified other benefits of the Proposed Transaction.⁵⁸ I find particularly
9 compelling the benefit of the immediate end to Enron ownership; the benefits of TPG as
10 a private investor; the application of best management practices; and the earnings sharing
11 mechanism Oregon Electric proposed in its supplemental testimony.

12 **Q. Please comment on the benefits of an immediate end to Enron ownership.**

13 A. This transaction would immediately end the uncertainty surrounding the Enron
14 bankruptcy. While Oregon regulators clearly have the tools to maintain regulatory
15 control over PGE, the uncertainty surrounding Enron ownership and the possible future
16 states of the world for PGE make it difficult to move past these issues and re-focus
17 completely on regulating PGE to the benefit of local consumers. Examples include the
18 uncertainty concerning the legal issues related to the Enron control-group liabilities and
19 the possible outcomes from the bankruptcy. This proposal effectively deals with those
20 issues. This is a positive move forward for PGE and its customers.

21 **Q. Please comment on the benefits associated with TPG's role as a private investor.**

22 A. While TPG has the same incentive to maximize its returns as other equity holders, it has
23 different tools at its disposal. These tools suggest that Oregon Electric is likely to be a
24 more effective owner than a dispersed group of shareholders. Small diverse shareholders,
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⁵⁸ See Oregon Electric/100, Davis/*.

1 while nominally the owners of a firm, often have very little incentive to monitor the
2 actions of management to ensure that it is optimizing value. The metrics that a
3 shareholder reviews are typically very narrow, and most investors have little or no
4 interaction with company management. The costs a small shareholder would have to
5 incur to monitor the actions of management can far outweigh any marginal benefits to
6 that shareholder. On the other hand, the owners of a privately held firm have a strong
7 incentive to provide effective oversight because the marginal returns from this oversight
8 will likely outweigh the costs.⁵⁹

9 Moreover, even in the short-term, there is a clear connection between customer
10 interests and owner interests. As I noted in my direct testimony, Oregon Electric has
11 every incentive to create value in PGE and thereby maximize its returns. This will,
12 almost by necessity, require it to become very customer-focused both at the outset and
13 throughout the period of time it owns PGE. Oregon Electric's incentive for local focus
14 and customer satisfaction will only be enhanced by the local nature of the Board. This
15 situation provides the Commission with more assurance that the utility will maintain its
16 service quality, while providing customers with a high-value service. Regulators are
17 generally looking for ways to ensure this type of behavior on the part of utilities.

18 **Q. Please comment on the value of the application of best management practices.**

19 A. Some parties have suggested that application of best management practices is expected of
20 utility management, and, therefore, this should not be considered a benefit.⁶⁰ However,
21 while it is true that management should be expected to continually improve, utility
22 management practices are expected to be prudent. The prudence standard is a standard of
23 reasonableness and can entail a wide range of outcomes. Regulators expect that utility
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25 ⁵⁹ Mr. Davis describes some of the tools that TPG uses to help monitor its investments. *See Oregon Electric/3, Davis/11.*

⁶⁰ *See CUB/100, Jenks-Brown/27.*

1 management operates prudently, or reasonably, but cannot expect that every utility will
2 operate as a best in class. This would be an unreasonable expectation on the part of the
3 regulatory system. Under the Proposed Transaction, Oregon Electric has the incentive to
4 go beyond the reasonable management standard, and there is ample evidence that TPG
5 has provided guidance in the past to companies in order to do so.⁶¹

6 **Q. Can you point to any regulatory policy that supports your conclusion that**
7 **regulators do not expect best management practices under traditional regulation?**

8 A. One example is alternative regulation.⁶² Alternative regulation is focused on providing
9 incentives to utilities to go beyond the prudence standard of management. There are
10 many examples of legislatures explicitly noting that “efficiency” or “cost containment” is
11 a goal of alternative regulation. For example, ORS 757.210 explicitly instructs the
12 Commission to review a proposed alternative form of regulation to determine if the plan
13 “[p]romotes increased efficiencies and cost control.” If the utility was expected to have
14 best in class management, why would the Oregon legislature allow the Commission to
15 look for ways to provide incentives for increased efficiency? It is simply inconsistent
16 with the traditional regulation paradigm to expect utilities to always be best in class.

17 **Q. Staff and intervenors take the position that the earnings sharing mechanism**
18 **(“ESM”) is too uncertain to give as a benefit. Do you agree?**

19 A. No, I do not. Granting customers a clear opportunity to share profits with the owners is
20 absolutely a benefit that cannot be obtained in the absence of an ESM.

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25 ⁶¹ See, e.g., Oregon Electric/4, McDermott/12.

⁶² Alternative regulation is a broad concept that entails any altering of the cost-based rate of return approach of the traditionally regulatory paradigm.

1 **Q. Please comment on Mr. Davis' offer to guarantee a rate credit amount equal to the**
2 **amount Oregon Electric expects customers would earn under the ESM.**

3 A. On principle, I do not agree that a certain level of sharing must be guaranteed to
4 customers in order for the ESM to prove a benefit. However, this proposal clearly
5 indicates that the ESM had value to customers in its original form. The prospective
6 owners are simply reformulating that value in a more concrete way.

7 **V. CONCLUSIONS**

8 **Q. Do you still maintain, as you testified in your direct testimony, that the Proposed**
9 **Transaction is in the public interest?**

10 A. Yes. Nothing in my review of the direct testimony of the Staff and intervenors in this
11 case has changed my opinion. My conclusion remains that the Commission has sufficient
12 evidence to find that the Proposed Transaction meets the **letter and spirit** of Oregon law
13 and will promote the public interest. The Proposed Transaction provides net benefits to
14 ratepayers and will not harm the larger public in Oregon.

15 **Q. Does this conclude your rebuttal testimony?**

16 A. Yes it does.
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ORDER NO. 03-214

ENTERED APR 10 2003

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1074

In the Matter of)	
)	
UTILITY REFORM PROJECT)	
)	
Petition for an accounting of the Federal, State)	ORDER
and Local Income Tax Payments of)	
PORTLAND GENERAL ELECTRIC CO.,)	
since its acquisition by ENRON Corp., and)	
Appropriate Rate Adjustments and Refunds.)	

DISPOSITION: PETITION FOR INVESTIGATION DENIED

On March 7, 2003, the Utility Reform Project (URP) filed a petition to open an investigation along with a complaint.¹ The Public Utility Commission (PUC) assigned Docket No. UM 1074 to this filing. URP's petition asks the Commission to commence an investigation to determine the amount that Portland General Electric (PGE) has paid in income taxes since 1997, and order PGE to refund to ratepayers, with interest, funds collected for paying income taxes that were not used for that purpose.

URP's petition is styled as both a request for an investigation under ORS 756.515 and a complaint under ORS 756.500. Staff's recommendation in this matter addresses only the request for investigation under 756.515.

At its public meeting on March 31, 2003, the Commission adopted Staff's recommendation to deny URP's petition to open an investigation regarding PGE's income taxes. Staff's recommendation is attached as Appendix A and is incorporated by reference.

¹ URP's Complaint that accompanied this petition has been docketed as UCB 13, and will be processed by the Administrative Hearings Division.

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ORDER

IT IS ORDERED THAT Utility Reform Project's request to open an investigation is denied.

Made, entered and effective _____.

BY THE COMMISSION:

Becky Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

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ITEM NO. 3

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: March 31, 2003**

REGULAR X CONSENT _____ EFFECTIVE DATE _____ NA _____

DATE: March 24, 2003

TO: John Savage through Lee Sparling

FROM: Ed Busch

SUBJECT: UTILITY REFORM PROJECT: (Docket No. UM 1074) Requests Commission to open an investigation and order Portland General Electric to refund funds collected to pay income tax.

STAFF RECOMMENDATION:

I recommend the Commission deny URP's request to open an investigation regarding PGE's income taxes.

DISCUSSION:

On March 7, 2003, the Utility Reform Project (URP) filed a petition to open an investigation along with a complaint. The filing was docketed as UM 1074. URP's petition asks the Commission to commence an investigation to determine the amount that Portland General Electric (PGE) has paid in income taxes since 1997 and order PGE to refund to ratepayers, with interest, funds collected for paying income taxes that were not used for that purpose.

URP's petition is styled as both a request for an investigation under ORS 756.515 and a complaint under ORS 756.500. Staff's recommendation in this matter addresses only the request for investigation under 756.515.

In its petition, URP states that Enron Corp. (Enron), the parent company of PGE, has paid little or no federal, state or local income taxes since 1997 despite collecting over \$400 million from PGE for that purpose. URP also states that "Substantial evidence exists that Enron/PGE engaged in a pattern of fraud and deceit upon the agency when it provided "proof" in rate proceedings that it would incur such tax liabilities but in fact had put in place numerous schemes for the avoidance and evasion of income tax liabilities. . .". URP's petition includes several figures that it believes were amounts

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included in customer rates for payment of income taxes that were not used for that purpose. According to the petition, PGE's rates "are based on fraud and misrepresentation by PGE."

Background

By Order 97-196 (Docket UM 814), the Commission approved Enron's application to exercise influence over PGE. The Internal Revenue Code allows a parent corporation to elect to file a consolidated federal income tax return that reports the combined income and expense items of the consolidated group. From 1997 until May 2001, Enron filed consolidated tax returns that included PGE's income and expenses. During that period, PGE calculated its federal and state income tax liability on its results of operations and forwarded to Enron those amounts. From May 2001 through 2002, while Enron was unconsolidated, PGE made its income tax payments directly to the taxing authorities

For ratemaking purposes, the Commission sets PGE's rates to reflect the costs of the company's regulated operations. That is, in a rate proceeding, PGE's rates are set based on its own revenues, costs and rate base for a given test year. Income taxes are calculated using PGE's net operating income. The tax effects of Enron's other operations are ignored for purposes of setting rates. This is consistent with standard ratemaking principles.²

Calculating PGE's costs, including income taxes, for ratemaking on a stand-alone basis protects PGE's customers from the financial difficulties experienced by Enron's other subsidiaries. When the Commission approved Enron's acquisition of PGE, it had the option of incorporating the effects of Enron's non-utility operations in PGE rates or treating PGE as a stand-alone entity. Consistent with long-standing OPUC policy, the Commission chose the latter approach. In adopting the stipulation in Docket UM 814, the Commission created a wall between PGE's operations and Enron's other subsidiaries. As stated by Order No. 97-196: "These conditions and commitments provide important measures and requirements, beyond those provided by the Commission's statutory authority and existing rules, to protect PGE's customers, competitors, and the public generally."

If PGE's rates were set in a manner that captured some of Enron's tax losses, PGE's rates would also have needed to reflect the expenses that created those tax savings, and customers would be worse off. Staff's counsel advised that it would be difficult for

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² See Attachment to this staff report containing excerpts from Accounting for Public Utilities.

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the OPUC to justify picking and choosing which of Enron's revenues and expenses—including tax savings—to include for purposes of setting Oregon customers' rates. Moreover, such an approach may lead to confiscatory rates.

Issues

URP's petition raises two main issues relating to whether ratepayers are entitled to a refund. First, did PGE make "false or misleading representations" regarding the amount of income taxes that should be included in its customers' rates? Second, did PGE collect funds from its customers to pay taxes that were not used for that purpose?

The answer to the first question is clear. URP's petition contains no evidence that PGE made false representations in calculating the amount of income taxes that should be included in customer rates. As described above, PGE's rates that were in effect in 1997 and subsequent years were set on a "stand alone" basis in Docket UE 100 (effective December 1, 1996). Staff believes that income taxes were accurately calculated in that rate case using PGE's test year revenues, expenses and rate base.

As to the second question, it also is clear that PGE made its federal and state income tax payments to Enron while on a consolidated basis, and directly to the proper taxing authorities while on an unconsolidated basis. As reported in the company's annual report, FERC Form 1, from 1997 through 2001, PGE paid a total of \$463.4 million in federal and state income taxes, of which \$445.1 million related to its electric operations. In fact, this is more than the amount of income taxes that customers' rates were set to collect over this period, a total of \$430.5 million. Hence, there is no substance to the argument that PGE collected amounts for payment of income taxes that it did not use for that purpose.

Even if PGE had paid out less for income taxes than it collected from customers, there would be no issue for an investigation. Rates are set based upon a utility's revenues and expenses (including income taxes) for a particular test period; actual results in subsequent years are almost certain to be higher or lower than estimated for the test period. In this case, PGE paid out more in income taxes than the amount calculated in the most recent rate case.

Staff certainly does not condone tax evasion by Enron, if that were proved to be the case. However, the OPUC does not have jurisdiction over whether or not Enron as a corporation appropriately paid its income taxes during the period Enron elected to file its

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taxes on a consolidated basis. Federal and state taxing authorities are responsible for ensuring that Enron paid the income taxes it owed.³

In short, staff believes that income taxes were properly included in PGE's revenue requirement and customer rates, and that PGE properly paid its income tax liability to its parent or to the taxing authorities, as appropriate. Whether or not Enron properly paid its income taxes to the IRS and the State of Oregon is beyond the purview of the OPUC. Any underpayments by Enron would be owed to those taxing authorities and their constituents, not to ratepayers.

Alternatives

The Commission can approve URP's application to open an investigation or it can deny the application. PGE has indicated that prior to this public meeting it will provide records that will enable the Commission to verify that PGE did, in fact, make its income tax payments reported in the company's FERC Form 1 for 1997 through 2001 either to Enron or directly to the taxing authorities. Regardless, URP's petition asks the Commission to take action in an area (possible underpayment of income taxes) in which the OPUC does not have jurisdiction. What the OPUC does have jurisdiction over is whether PGE's rates were set properly to include the company's income tax liability on a stand-alone basis. Staff finds that to be the case. Therefore, staff believes there is no reason for the Commission to open an investigation.

As noted above, URP's filing is also a complaint by URP against PGE under ORS 756.500. Staff's counsel advises that URP is still free to pursue that complaint. It may serve the complaint on PGE, if it hasn't already done so, and it may, at a hearing, present whatever evidence it chooses to support its complaint and its request for refunds.

PROPOSED COMMISSION MOTION:

Utility Reform Project's request to open an investigation be denied.

UM 1074
Attachment

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³ As stated in Accounting for Public Utilities (section 17.04[1]): "The election to file a consolidated tax return makes the parent corporation the agent of all corporations included in the affiliated group. This agency relationship includes, but is not limited to, the duties to file proper and timely consolidated tax returns, to receive deficiency notices, to file refund claims, to execute waivers of the statute of limitations, to respond to Internal Revenue Service audits, and to conduct proceedings in the courts."

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Attachment

**Excerpts from Accounting for Public Utilities
(Publication 016, Release 19, November 2002)**

Section 7.08[3]:

"It is not uncommon for a regulated utility to have subsidiary operations that produce tax losses which, on a consolidated tax return, offset taxable income from utility operations. . . The only approach that is consistent with standard ratemaking principles that prohibit cross-subsidization between utility and non-utility activities is to put the regulation operations on a 'stand-alone' basis and to assign the full tax burden to the taxable gain source and a tax benefit to the tax loss source. The basic theory is that the regulated costs should not be affected by the results from nonregulated operations."

Section 17.04[3]:

"Income tax normalization is consistent with a fundamental principle of the cost of service approach to ratemaking; the principle that consumers should bear only costs for which they are responsible. Under this principle, there is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

"Regulators have long used a ratemaking procedure that explicitly embraces this principle. The procedure is to identify utility activities (revenues and costs) and compute taxes directly related to the utility activities.

"Non-utility operations involve financial risks that are different from a utility's regulated operations. When these risks are not borne by the ratepayers, it is unfair to make use of the business losses generated in those nonregulated entities to reduced the utility's cost in determining the rates to be charged for utility services. By the same token, when a company's nonjurisdictional activities are profitable, the ratepayers have no right to share in those profits, but neither are they required to pay any of the income taxes that arise as a result of those profits. Thus, a "stand alone" method (as opposed to a consolidated effective tax rate method) for computing the income tax expense component of cost of service is the proper and equitable method to be followed for ratemaking purposes."