Davison Van Cleve PC
Attorneys at Law
TEL (503) 241-7242 • FAX (503) 241-8160 • mail@dvclaw.com
Suite 2460
1000 SW Broadway
Portland, OR 97205

September 21, 2004

Via Federal Express

Ms. Annette Taylor
Oregon Public Utility Commission
P.O. Box 2148
Salem OR 97308-2148

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

Dear Ms. Taylor:

Enclosed please find an original and six (6) copies of the Surrebuttal Testimony of Donald W. Schoenbeck on behalf of the Industrial Customers of Northwest Utilities in the above-captioned Docket.

Please return a file-stamped copy of the testimony in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the Surrebuttal Testimony of Donald W. Schoenbeck on behalf of the Industrial Customers of Northwest Utilities upon the parties, shown below, on the official service list for Docket No. UM 1121, by causing the same to be electronically served on September 22, 2004, upon all parties who have an email address on the official service list and by U.S. Mail on September 21, 2004, postage-prepaid, to those parties who do not have an email address on the official service list.

Dated at Portland, Oregon, this 21st day of September, 2004.

/s/ Ruth A. Miller
Ruth A. Miller

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

JENNIFER CHAMBERLIN STRATEGIC ENERGY LLC 2633 WELLINGTON COURT CLYDE CA 94520 jchamberlin@sel.com	WILLIAM H CHEN CONSTELLATION NEWENERGY INC 2175 N CALIFORNIA BLVD STE 300 WALNUT CREEK CA 94596 bill.chen@constellation.com
JOAN COTE OREGON ENERGY COORDINATORS ASSOCIATION 2585 STATE ST NE SALEM OR 97301 cotej@mwvcaa.org	CHRIS CREAN MULTNOMAH COUNTY 501 SE HAWTHORNE, SUITE 500 PORTLAND OR 97214 christopher.d.crean@co.multnomah.or.us
MELINDA J DAVISON DAVISON VAN CLEVE PC 1000 SW BROADWAY STE 2460 PORTLAND OR 97205 mail@dvclaw.com	JIM DEASON CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW FIFTH AVE STE 2000 PORTLAND OR 97204-1136 jdeason@chbh.com
JAMES DITTMER UTILITECH INC 740 NW BLUE PKWY STE 204 LEE'S SUMMIT MO 64086 jdittmer@utilitech.net	J JEFFREY DUDLEY PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC1301 PORTLAND OR 97204 jay_dudley@pgn.com
GARY DUELL 11301 SE CHARVIEW COURT CLACKAMAS, OR OR 97015 gduell@bigplanet.com	JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
JAMES F FELL STOEL RIVES LLP 900 SW 5TH AVE STE 2600 PORTLAND OR 97204-1268 jffell@stoel.com	ANN L FISHER AF LEGAL & CONSULTING SERVICES 1425 SW 20TH STE 202 PORTLAND OR 97201 energlaw@aol.com
ANDREA FOGUE LEAGUE OF OREGON CITIES PO BOX 928 1201 COURT ST NE STE 200 SALEM OR 97308 afogue@orcities.org	SCOTT FORRESTER FRIENDS OF THE CLACKAMAS RIVER 2030 NW 7TH PL GRESHAM OR 97030 clackamas9@aol.com
KATHERINE FUTORNICK 14800 NE BLUEBIRD HILL LANE DAYTON OR 97114 futork@onlinemac.com	LORA GARLAND L-7 BONNEVILLE POWER ADMINISTRATION P.O. BOX 3621 PORTLAND OR 97208-3621 lmgarland@bpa.gov
LEONARD GIRARD 2169 SW KINGS COURT PORTLAND OR 97205 lgirard@teleport.com	ANN ENGLISH GRAVATT RENEWABLE NORTHWEST PROJECT 917 SW OAK - STE 303 PORTLAND OR 97205 ann@rnp.org

PATRICK G HAGER PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC0702 PORTLAND OR 97204 patrick_hager@pgn.com	ROY HENDERSON PENSION ENHANCEMENT COMMITTEE 895 NW DALE AVENUE PORTLAND OR 97229 royhensn@msn.com
MARY ANN HUTTON CANON AND HUTTON SOUTHERN OREGON OFFICE 1141 NW KRING ST ROSEBURG OR 97470 mah@canonandhutton.com	JOE JANSSENS PGE PENSION ENHANCEMENT COMMITTEE 24495 BUTTEVILLE RD NE AURORA OR 97002 osprey64@juno.com
VALARIE KOSS COLUMBIA RIVER PUD PO BOX 1193 SAINT HELENS OR 97051 vkoss@crpud.org	GEOFFREY M KRONICK LC7 BONNEVILLE POWER ADMINISTRATION PO BOX 3621 PORTLAND OR 97208-3621 gmkronick@bpa.gov
MICHAEL L KURTZ BOEHM, KURTZ & LOWRY 36 E 7TH ST STE 2110 CINCINNATI OH 45202 mkurtzlaw@aol.com	ROCHELLE LESSNER LANE, POWELL, SPEARS, LUBERSKY LLP 601 SW 2ND AVE. STE. 2100 PORTLAND OR 97204 lessnerr@lanepowell.com
KEN LEWIS 2880 NW ARIEL TERRACE PORTLAND OR 97210 kl04@mailstation.com	STEVEN G LINS GLENDALE, CITY OF 613 E BROADWAY STE 220 GLENDALE CA 91206-4394 slins@ci.glendale.ca.us
JAMES MANION WARM SPRINGS POWER ENTERPRISES PO BOX 960 WARM SPRINGS OR 97761 j_manion@wspower.com	LLOYD K MARBET DON'T WASTE OREGON 19142 S BAKERS FERRY RD BORING OR 97009 marbet@mail.com
GORDON MCDONALD PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232 gordon.mcdonald@pacificorp.com	DANIEL W MEEK DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net
THAD MILLER OREGON ELECTRIC UTILITY COMPANY 222 SW COLUMBIA STREET, SUITE 1850 PORTLAND OR 97201-6618 tmiller6@optonline.com	WILLIAM MILLER IBEW 17200 NE SACRAMENTO PORTLAND OR 97230 bill@ibew125.com
CHRISTY MONSON LEAGUE OF OREGON CITIES 1201 COURT ST. NE STE. 200 SALEM OR 97301 cmonson@orcities.org	MICHAEL MORGAN TONKON TORP LLP 888 SW 5TH AVE STE 1600 PORTLAND OR 97204-2099 mike@tonkon.com
FRANK NELSON 543 WILLAMETTE CT MCMINNVILLE OR 97128 fnelson@viclink.com	NANCY NEWELL 3917 NE SKIDMORE PORTLAND OR 97211 ogec2@hotmail.com

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

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	)
	)

SURREBUTTAL TESTIMONY OF

DONALD W. SCHOENBECK

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

September 22, 2004

Introduction and Summary

Q. PLEASE STATE YOUR NAME.

A. My name is Donald W. Schoenbeck. I am a member of Regulatory & Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. I am the same Donald Schoenbeck who sponsored direct testimony in this proceeding on behalf of the Industrial Customers of Northwest Utilities ("ICNU").

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to explain the conditions that ICNU recommends the Oregon Public Utility Commission ("OPUC" or the "Commission") adopt if the Commission intends to approve Oregon Electric Utility Company's ("Oregon Electric") proposed acquisition of Portland General Electric ("PGE" or the "Company").

ICNU's Proposed Conditions

Q. WHAT CONDITIONS DOES ICNU PROPOSE THAT THE COMMISSION ADOPT IF THE COMMISSION INTENDS TO APPROVE OREGON ELECTRIC'S APPLICATION TO ACQUIRE PGE?

A. ICNU does not believe that Oregon Electric has provided adequate assurances that PGE customers will not be harmed by the significant risk associated with this transaction. Nevertheless, if the Commission decides to approve the Application, ICNU urges the Commission to adopt a number of acquisition conditions that are designed to protect PGE customers and provide a "net benefit" associated with ownership by Oregon Electric. These conditions fall under the following general categories: 1) rate credit conditions; 2) financial and ring fencing conditions; 3)

transparency conditions; 4) so called "end game" conditions; 5) direct access conditions; and 6) conditions to which Oregon Electric has indicated that it is willing to stipulate. The specific conditions proposed by ICNU are listed in Exhibit ICNU/301.

Rate Credit

Q. WHAT IS ICNU'S PROPOSAL FOR A RATE CREDIT?

A. ICNU proposes that the Commission adopt a condition that would provide a $97 million rate credit over a period of five years following the closing of the transaction.

Q. WHAT IS THE RATIONALE FOR RECOMMENDING THIS RATE CREDIT LEVEL?

A. ICNU's direct testimony as well as that of Staff and other intervenors show that this proposed transaction imposes a higher level of risk upon customers than any other transaction considered by this Commission in recent years. In addition, the financial model runs by the Texas Pacific Group ("TPG") show cost savings and the high likelihood that TPG will make a substantial profit on the sale of PGE in five to seven years. These factors suggest that customers should receive a rate credit at least at the level that Sierra Pacific was willing to offer to customers four years ago.

Q. HOW DOES ICNU'S PROPOSED RATE CREDIT COMPARE TO THOSE ADOPTED BY THE COMMISSION IN PREVIOUS ORS § 757.511 PROCEEDINGS?

A. ICNU's proposed rate credit is comparable to the credits adopted by the Commission in other ORS § 757.511 proceedings. In the Enron merger, for example, Enron agreed to a $36 million rate credit over a period of four years,

along with a $105 million payment to PGE customers for use of the Company's name, reputation and business experience, wholesale and non-franchise retail activities, and the added value of the merged entity. Re Enron Corp., OPUC Docket No. UM 814, Order No. 97-196, Appendix A at 5-6 (June 4, 1997). Thus, the total rate benefit to customers of the Enron merger was $141 million.

In the Sierra Pacific proceeding, the Commission approved a $97 million rate credit to be provided to customers over a period of approximately six years. Re Sierra Pacific Resources, OPUC Docket No. UM 967, Order No. 00-702, Appendix B at 5-6 (Oct. 30, 2000). This is comparable to the rate credit that ICNU proposes for this proceeding.

In the Scottish Power acquisition of PacifiCorp, Scottish Power agreed to approximately $51 million in rate credits payable over four years. Re Scottish Power and PacifiCorp, OPUC Docket No. UM 918, Order No. 99-616, Appendix-Stipulation 5 at 9 (Oct. 6, 1999). Finally, although Northwest Natural Gas Company's proposed purchase of PGE in 2001 was never approved by the Commission, Northwest Natural's initial proposal for a rate credit was $31.5 million to be provided to customers over five years. Re Northwest Natural Gas Co., OPUC Docket No. UM 1045, Application, Appendix 3 at 1 (Nov. 28, 2001).

Q. WHAT RATE CREDITS HAS OREGON ELECTRIC PROPOSED IN THIS PROCEEDING?

A. Oregon Electric initially proposed no rate credit whatsoever for customers. In supplemental testimony, Oregon Electric proposed a mechanism that would have allowed PGE to share with customers an undefined percentage of any PGE earnings in excess of the Company's authorized 10.5% return on equity. As I

described in my direct testimony, however, this proposal was so vague it was essentially meaningless. ICNU/100, Schoenbeck/9. Ultimately, six months after filing the Application, Oregon Electric proposed a $15 million rate credit to be provided to customers over a period of five years beginning in 2007. Re Oregon Electric *et al.*, OPUC Docket No. UM 1121, Oregon Electric/100, Davis/31-32 (Aug. 16, 2004). According to Oregon Electric, this proposed rate credit is based on estimates of the amounts that would have been shared with customers under the profit sharing mechanism over a period seven years from closing. Id. This proposed rate credit has a net present value of approximately $9.5 million. Given level of risk and the level of complexity of this transaction, Oregon Electric's proposed rate credit is wholly unacceptable.

Q. HOW DOES OREGON ELECTRIC'S CURRENT PROPOSAL FOR A RATE CREDIT COMPARE TO THOSE ORDERED BY THE COMMISSION IN THE PREVIOUS ORS § 757.511 PROCEEDINGS?

A. The rate credit currently proposed by Oregon Electric is nowhere close to comparable to any of the rate credits approved by the Commission and is less than half of the rate credit proposed in Northwest Natural's initial application. Furthermore, customers would not see any rate credit until 2007 under the Oregon Electric proposal, which would be almost two years after Oregon Electric took over PGE if the transaction is approved.

Q. DO YOU CONSIDER THE MINIMAL RATE CREDIT PROPOSED BY OREGON ELECTRIC ADEQUATE IN LIGHT OF THE RISK ASSOCIATED WITH THIS TRANSACTION?

A. No. Oregon Electric's acquisition of PGE poses significantly more risk to customers than many of the proposed acquisitions in the past. John Antonuk and

Randall Vickroy described this risk in detail in their direct testimony in this Docket. ICNU/200, Antonuk-Vickroy/5-9. TPG is a private equity investment firm with no experience in the regulated utility industry purchasing Oregon's largest utility in a leveraged buyout. Oregon Electric, which was created by TPG to avoid regulation under the Public Utility Holding Company Act, will be a highly leveraged parent company with only one source of revenue – PGE. Overall, the transaction will result in a heavily leveraged consolidated structure that will decrease PGE's ability to weather financial stresses, leaves PGE exposed to potential liabilities associated with Enron, and does not adequately protect PGE from potentially being drawn into bankruptcy in the event that Oregon Electric is unable to make its debt payments. In addition, TPG likely will own PGE for only five to seven years. Under these circumstances, TPG will only be focused on the short term to the detriment of beneficial, long-term decisions. None of the other transactions approved by the Commission have involved this level of overall risk. This is the reason why John Antonuk, Randall Vickroy, and I all called for some tangible benefit to customers if this level of risk is going to be introduced into their utility service. The $15 million rate credit to be provided by Oregon Electric starting in 2007 is inadequate in light of the risks involved. I believe that a $97 million credit, the same rate benefit approved by the Commission in the Sierra Pacific transaction, would be an appropriate amount to compensate customers for the risk involved.

Financial and Ring Fencing Conditions

Q. WHAT IS THE BASIS FOR THE FINANCIAL AND RING FENCING CONDITIONS PROPOSED BY ICNU?

A. These conditions are primarily intended to address concerns identified in the direct and surrebuttal testimony of John Antonuk and Randall Vickroy on behalf of ICNU. In particular, John Antonuk and Randall Vickroy describe the need for conditions to prevent PGE from being drawn into any potential bankruptcy on the part of Oregon Electric, to reduce the risk associated with Oregon Electric's highly leveraged nature, to maintain PGE as a separate entity, and provide the Commission the opportunity to be involved, through an audit process, in Oregon Electric's implementation of any cost reductions at PGE. ICNU/200, Antonuk-Vickroy/38-41.

Transparency Conditions

Q. WHY ARE CONDITIONS NECESSARY TO ENSURE AVAILABILITY AND TRANSPARENCY OF INFORMATION WITH RESPECT TO THIS TRANSACTION?

A. As I described in my direct testimony, Oregon Electric has proposed a unique ownership structure that is unlike those approved by the Commission in the past. As a result, in addition to the conditions that ensure that the Commission will have appropriate access to information at PGE, it is necessary for the Commission to adopt specific conditions designed to ensure the transparency of PGE and Oregon Electric's operations and interactions. In particular, ICNU proposes a condition that would require PGE and Oregon Electric to provide information to the Commission regarding the exercise of the TPG consent rights listed in Oregon Electric/Exhibit 7. In addition, ICNU proposes a condition to provide specificity

to Oregon Electric's commitment to provide access to the PGE Board of Directors.

"End Game" Conditions

Q. WHY ARE "END GAME" CONDITIONS APPROPRIATE FOR THIS TRANSACTION?

A. Oregon Electric and TPG have acknowledged that they intend to own PGE for a limited period, most likely five to seven years. This short-term ownership focus creates risk for customers. As such, if the Commission intends to approve this transaction, it is appropriate to adopt conditions in this proceeding addressing the scenarios under which PGE will be transferred at the end of Oregon Electric's ownership.

Direct Access Conditions

Q. WHAT IS THE CONDITION THAT ICNU IS PROPOSING RELATED TO DIRECT ACCESS?

A. In the Enron merger, PGE made a commitment to file a plan with the Commission that was designed to promote the development of customer choice in retail electricity markets. ICNU proposes several conditions in this proceeding that will remedy remaining problems with direct access and provide customers additional optionality in terms of both electric service suppliers and the services available from PGE.

Q. WHAT OTHER CONDITIONS ARE LISTED ON EXHIBIT ICNU/301?

A. Exhibit ICNU/301 also includes certain conditions to which Oregon Electric has indicated it is willing to stipulate as well as certain conditions that have been adopted in other ORS § 757.511 proceedings.

Q. IF THE APPLICANTS ARE WILLING TO AGREE TO THE CONDITIONS LISTED IN EXHIBIT ICNU/301 OR IF THE COMMISSION CONDITIONS APPROVAL OF THE PROPOSED TRANSACTION ON THE ACCEPTANCE OF SUCH CONDITIONS, DOES ICNU RECOMMEND APPROVAL OF THIS TRANSACTION?

A. Yes, with some concern. This proposed transaction is different from the typical utility acquisition. Typically a utility is purchased by another utility for various strategic and financial reasons. TPG is seeking to purchase PGE solely for financial gain. TPG's business model is to buy undervalued assets, improve earnings, and then sell at a substantial profit. It is very difficult to predict all of the risks that this model may present and to protect customers from those risks. As a result, if the Commission approves this transaction, then it must very actively monitor and regulate PGE.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

ICNU PROPOSED CONDITIONS

UM 1121

Rate Credit Conditions

1. Oregon Electric agrees to provide for the benefit of PGE distribution customers, the annual Oregon Electric Credit set forth in Table 1. Within thirty (30) calendar days of the financial close of Oregon Electric's acquisition of PGE, PGE shall establish an Oregon Electric Credit Balancing Account and credit that account with the annual Oregon Electric Credit as set forth in Table 1. On the later of January 1, 2005, or the thirtieth calendar day following the financial close of Oregon Electric's acquisition of PGE, PGE shall credit the balancing account with the annual Oregon Electric Credit set forth in Table 1. Every January 1st after January 1, 2005, ending with January 1, 2009, PGE shall credit the balancing account with the annual Oregon Electric Credit set forth in Table 1. In the event that January 1 falls on a Saturday, Sunday, or national holiday for any year from 2005 to 2009, PGE shall credit the Oregon Electric Balancing Account with the amount set forth in Table 1 on the next business day.

Table 1

Later of 1-1-05 or 30 days after closing to 12-31-05	1-1-06 to 12-31-06	1-1-07 to 12-31-07	1-1-08 to 12-31-08	1-1-09 to 12-31-09
$20 million	$20 million	$19 million	$19 million	$19 million

The Oregon Electric Credit balancing account will accrue interest, compounded monthly, consistent with current Commission practices, on the unamortized balance at PGE's most recently authorized rate of return.

This rate credit will remain in place in the event that Oregon Electric sells or otherwise disposes of its interest in PGE. Notwithstanding the amounts of the Oregon Electric Credit in Table 1, any amounts that remain in, or remain to be credited to, the Oregon Electric Credit balancing account at the time of OPUC approval of a sale or other disposition of PGE by Oregon Electric shall be due in a lump sum within fifteen (15) days of the date of the OPUC's approval.

2. Amounts in the Oregon Electric Credit Balancing Account shall be distributed to customers as a bill credit designed to reduce the balance in the Oregon Electric Credit Balancing Account at the beginning of each calendar year to zero at the end of each calendar year. The bill credit shall be distributed pro rata based on the metered distribution load (in KWh) of each customer. The rate credit payments to customers shall begin on January 1, 2006.

Financial and Ring Fencing Conditions

3. PGE will be operated as a corporate and legal entity separate from all of its affiliates as defined by ORS § 757.015.

4. PGE and Oregon Electric commit to secure covenants that the lenders to the parent and affiliates will commit to rely solely on the creditworthiness of the parent and affiliates, based on the assets and equity interests owned by the parent and affiliates.

5. PGE and Oregon Electric commit that the repayment of parent and affiliate indebtedness will be made solely from the assets of the said parent and affiliate, and not from any assets or pledge of assets of PGE. For the purposes of this condition, the parents' assets include dividends received by virtue of the parent's equity interest in PGE.

6. PGE and Oregon Electric commit to secure covenants that no lenders will take any steps to procure the appointment of a receiver or to institute any bankruptcy, reorganization, insolvency, wind up, liquidation, or like proceeding that includes PGE or any of its assets.

7. No company, entity, or person, other than PGE, shall use PGE's regulated assets as collateral for any loan, guarantee, or other such use, without prior express Commission approval.

8. Oregon Electric guarantees that the customers of PGE shall be held harmless if, as a result of Oregon Electric's ownership of PGE, PGE has a higher revenue requirement.

9. Oregon Electric agrees that the allowed return on common equity and other capital costs will not rise as a result of Oregon Electric's ownership of PGE. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.

10. PGE must maintain the common equity portion of its capital structure at 48 percent or higher.

    a. PGE's total capital is defined as common equity, preferred equity, and long-term debt. Long-term debt is defined as outstanding debt with an initial term of more than one year plus the sum of committed and drawn balances greater than $150 million on any of PGE's unsecured revolving lines of credit (Unsecured Revolvers).

    b. The sum of committed and drawn balances on PGE's secured revolving lines of credit (Secured Revolvers) will be defined as long-term debt.

    c. A committed balance is the sum of the commitments used to support any borrowing capacity or other purposes, such as a commercial paper program.

    d. A drawn balance is the sum of amounts drawn against the Revolvers.

e. Hybrid securities (e.g., convertible debt) will be assigned to equity and long-term debt based on the characteristics of the hybrid security. The Commission, prior to their issuance, will determine the assignment of the equity and debt characteristics.

11. Each PGE distribution to Oregon Electric will be used by Oregon Electric exclusively to pay direct operating expenses[1] and debt service unless all of the following conditions are met:[2]

a. The sum of the drawn balances of all PGE's Unsecured Revolvers is less than $50 million; and,

b. The rolling three-month average sum of the drawn balances of all PGE's Unsecured Revolvers is less than $50 million; and,

c. The sum of the drawn balances of all PGE's Secured Revolvers is zero and there has not been a balance for three months; and,

d. The senior-secured Credit Rating for PGE is at least BBB+ at S&P and Baa1 at Moody's; and

e. Oregon Electric's consolidated capital structure[3] contains more than 40% common equity.

12. Oregon Electric shall not re-leverage, i.e., increase the amount of its outstanding long-term debt once it has been liquidated, if the increased debt would, or could reasonably be expected to, bring the consolidated capital structure[4] below 40% common equity.

13. TPG Applicants[5] will not allocate or direct bill Oregon Electric for any goods, services, supplies, or assets.

14. The Applicants[6] will not allocate or direct bill PGE for any goods, services, supplies, or assets except compensation to the Applicants for fulfillment of responsibilities as members on PGE's Board of Directors as subject to condition no. 18 below.

15. PGE, Oregon Electric, and their affiliates shall notify the Commission within 30 days of the formation of any subsidiary, affiliate, or partnership. Such notice shall include a copy of the business plan and capitalization strategy.

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[1] Direct operating expenses are expenses that were incurred from services, supplies, or assets provided by Oregon Electric personnel directly and are not based on any type of allocation from an affiliate (parent or subsidiary).
[2] According to Oregon Electric, Commission Staff has revised this proposed condition, which may change ICNU's proposed condition on this issue.
[3] The consolidated capital structure includes long-term debt and equity as described in the Condition regarding PGE's common equity floor and all debt (short- and long-term) and equity at Oregon Electric.
[4] See supra note 3.
[5] See Re Oregon Electric, *et al.*, OPUC Docket No. UM 1121, Application at 6 (Mar. 8, 2004). TPG Applicants also includes Tarrant Partners.
[6] The Applicants for this condition means the Local Applicants and the TPG Applicants.

16. Except for products and/or services included in schedules filed under Chapter 757 of the Oregon Revised Statutes, PGE, Oregon Electric, and their affiliates will provide the Commission with notification, within 30 days, of any new product and/or service, or any material change in the terms and conditions of existing products and/or services. The notification will include the name and description of the product and/or service, who it is offered to, and the specific terms and conditions.

17. 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.

18. PGE's revenue requirement shall not include more than 50% of the total fees and costs of PGE's Board of Directors. This does not preclude any party from advocating that ratepayers pay less than the 50% of the total fees and costs of PGE's Board of Directors.

Transparency and Access to Information Conditions

19. 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 on a quarterly basis and at any additional times upon request of the Commission. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of information in such records. However, for each exercise of a consent right described in a record that has been provided to the Commission, the following information shall not be subject to protection and shall be made available to the public from the Commission: the date of the action; the subject matter; and the enumerated consent right authority (from Exhibit 7 to Oregon Electric's March 8, 2004 Application) under which the action was taken.

20. Oregon Electric and PGE commit that a representative from each customer group that is precertified to receive intervenor funding pursuant to OAR § 860-012-0100 may attend no less than two (2) of the regular meetings of the PGE Board of Directors per year. Attendance of customer groups of any more than two (2) of the regular meetings of the PGE Board shall be allowed at the Board's discretion. At each PGE Board meeting in which a representative of a customer group attends, PGE shall permit each customer group to make a presentation to the Board.

21. Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all available information provided to and received from common stock and bond rating analysts, and other financial institutions, which directly or indirectly pertain to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided and presentations made to common stock analysts, bond rating analysts, and other financial institutions. For purposes of this condition, "available" information includes, but is not limited to, any written or printed material, audio and

videotapes, computer disks, and other electronically- or optically-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.

22. 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.

Audit and Benchmarking Review Conditions

23. PGE and Oregon Electric agree to hire, within twenty-four (24) months of the closing of the transaction, an independent outside auditor, approved by the Commission, to conduct an audit of PGE's operations. The audit will be conducted at PGE shareholders' expense and will be funded by PGE in an amount not less than $400,000. This audit will include an examination that includes, but is not limited to, the following areas:

    - Strategic and operational planning;
    - Budgeting;
    - Capital expenditures;
    - O&M expenditures;
    - Measures of work planned and performed;
    - Maintenance planning, performance, and backlogs;
    - Performance measurement; and
    - Comparative and trended expenditures and work performance.

24. PGE will be subject to a process improvement and benchmarking review ("PIBR"), including a management audit. The PIBR shall include detailed review and benchmarking of PGE's functions, systems, and processes. The PIBR shall be performed by an independent third party (the "Auditor") with significant expertise in performing such audits. A customer advisory committee shall be established to assist in the selection of the Auditor and to monitor the progress of the audit. The Commission shall select the Auditor with input from the customer advisory committee. PGE shareholders shall pay the cost of the audit.

End Game Conditions

25. Oregon Electric, PGE, and TPG agree to not merge or dispose of PGE, to any party or entity, unless the sale is structured in such a manner that an ORS § 757.511 filing is required by the purchaser(s). This provision shall not apply in the event the stock controlling PGE is sold through a public offering.

26. Oregon Electric, PGE and TPG agree to not restructure PGE or Oregon Electric or convert the shares of PGE in a manner that does not require an ORS § 757.511 filing. This provision shall not apply in the event the stock controlling PGE is sold through a public offering.

Direct Access Conditions

27. a. i. PGE shall offer customers with aggregate load larger than 1 aMW a three-year and a five-year option to opt out of the cost of service rate with a fixed transition amount under the same terms as current Schedule 483 (effective September 1, 2004). The Schedule 483 offer shall be made each September for a 30-day period for so long as PGE is required to offer direct access.

ii. PGE shall develop and file, within six months of closing of the transaction, a plan to offer to all customers eligible for direct access who do not qualify for Schedule 483 a multi-year option to opt out of the cost of service rate with a fixed transition amount at least one time each year. The plan shall include a mechanism for determining the costs of administering such program for various size loads and aggregated loads and the appropriate allocation of costs. The plan shall include the opportunity for aggregation.

b. PGE shall offer all customers eligible for direct access an opportunity to elect direct access for a period of seven calendar days (similar to the current November offering) at least once each month. PGE shall make a filing within 90 days of closing of the transaction to initiate a process for developing and obtaining regulatory approval for the proposal.

c. PGE shall in consultation with customers eligible for direct access and energy service suppliers develop a new methodology for calculating energy imbalance penalties, which accounts for the benefits of the diversity of PGE's system. The goal of the methodology shall be to provide imbalance service to direct access customers on the same basis that PGE provides imbalance service to cost of service customers. PGE shall make a filing with the Federal Energy Regulatory Commission within 90 days of closing of the transaction requesting approval of such changes.

d. PGE in consultation with customers eligible for direct access and energy service suppliers shall develop an option that allows direct access customers to purchase flat blocks of energy from energy service suppliers, while having the option to purchase load shaping and other necessary services from PGE. PGE shall make a filing within 90 days of

closing of the transaction to initiate a process for developing and obtaining regulatory approval for the proposal.

Enforceability Condition

28. Any party to OPUC Docket No. UM 1121 shall have the right to enforce violation of condition nos. 1, 2, 6, 8, 24, and 25 by PGE or Oregon Electric in the appropriate Oregon state court or before the OPUC. Enforcement rights are given to the Commission, Commission Staff, and any customer group that is precertified to receive intervenor funding pursuant to OAR § 860-012-0100.

Miscellaneous Conditions

29. Oregon Electric agrees that PGE's ratepayers shall be held harmless for any liability associated with Enron's ownership of PGE.

30. Oregon Electric agrees that PGE will receive the sole benefit of the Stock Purchase indemnifications related to the following potential liabilities listed in the Stock Purchase Agreement: 1) Shared Special Indemnity Matters; 2) Non-Shared Special Indemnity Matters; and 3) Tax and Benefit Matters. For categories 1 and 2, this indemnification will be in the amount of no less than $94 million. For category 3, this indemnification is in the amount of no less than $1.25 billion.

Conditions Agreed to by Oregon Electric

31. 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.

32. 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.

33. 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.

34. 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 Oregon Electric and/or PGE has violated any of the material conditions, contained herein, more than two times within a rolling 24-month period.

d. Oregon Electric and/or PGE shall have the opportunity to demonstrate to the Commission that subsection (c) should not apply on a case-by case basis.

Davison Van Cleve PC
Attorneys at Law
TEL (503) 241-7242 • FAX (503) 241-8160 • mail@dvclaw.com
Suite 2460
1000 SW Broadway
Portland, OR 97205

September 21, 2004

Via Federal Express

Ms. Annette Taylor
Oregon Public Utility Commission
P.O. Box 2148
Salem OR 97308-2148

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

Dear Ms. Taylor:

Enclosed please find an original and six (6) copies of the Surrebuttal Testimony of John Antonuk and Randall Vickroy on behalf of the Industrial Customers of Northwest Utilities in the above-captioned Docket.

Please return a file-stamped copy of the testimony in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the Surrebuttal Testimony of John Antonuk and Randall Vickroy on behalf of the Industrial Customers of Northwest Utilities upon the parties, shown below, on the official service list for Docket No. UM 1121, by causing the same to be electronically served on September 22, 2004, upon all parties who have an email address on the official service list, and by U.S. Mail on September 21, 2004, postage-prepaid, to those parties who do not have an email address on the official service list.

Dated at Portland, Oregon, this 21st day of September, 2004.

/s/ Ruth A. Miller
Ruth A. Miller

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

JENNIFER CHAMBERLIN STRATEGIC ENERGY LLC 2633 WELLINGTON COURT CLYDE CA 94520 jchamberlin@sel.com	WILLIAM H CHEN CONSTELLATION NEWENERGY INC 2175 N CALIFORNIA BLVD STE 300 WALNUT CREEK CA 94596 bill.chen@constellation.com
JOAN COTE OREGON ENERGY COORDINATORS ASSOCIATION 2585 STATE ST NE SALEM OR 97301 cotej@mwvcaa.org	CHRIS CREAN MULTNOMAH COUNTY 501 SE HAWTHORNE, SUITE 500 PORTLAND OR 97214 christopher.d.crean@co.multnomah.or.us
MELINDA J DAVISON DAVISON VAN CLEVE PC 1000 SW BROADWAY STE 2460 PORTLAND OR 97205 mail@dvclaw.com	JIM DEASON CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW FIFTH AVE STE 2000 PORTLAND OR 97204-1136 jdeason@chbh.com
JAMES DITTMER UTILITECH INC 740 NW BLUE PKWY STE 204 LEE'S SUMMIT MO 64086 jdittmer@utilitech.net	J JEFFREY DUDLEY PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC1301 PORTLAND OR 97204 jay_dudley@pgn.com
GARY DUELL 11301 SE CHARVIEW COURT CLACKAMAS, OR OR 97015 gduell@bigplanet.com	JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
JAMES F FELL STOEL RIVES LLP 900 SW 5TH AVE STE 2600 PORTLAND OR 97204-1268 jffell@stoel.com	ANN L FISHER AF LEGAL & CONSULTING SERVICES 1425 SW 20TH STE 202 PORTLAND OR 97201 energlaw@aol.com
ANDREA FOGUE LEAGUE OF OREGON CITIES PO BOX 928 1201 COURT ST NE STE 200 SALEM OR 97308 afogue@orcities.org	SCOTT FORRESTER FRIENDS OF THE CLACKAMAS RIVER 2030 NW 7TH PL GRESHAM OR 97030 clackamas9@aol.com
KATHERINE FUTORNICK 14800 NE BLUEBIRD HILL LANE DAYTON OR 97114 futork@onlinemac.com	LORA GARLAND L-7 BONNEVILLE POWER ADMINISTRATION P.O. BOX 3621 PORTLAND OR 97208-3621 lmgarland@bpa.gov
LEONARD GIRARD 2169 SW KINGS COURT PORTLAND OR 97205 lgirard@teleport.com	ANN ENGLISH GRAVATT RENEWABLE NORTHWEST PROJECT 917 SW OAK - STE 303 PORTLAND OR 97205 ann@rnp.org

PATRICK G HAGER PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC0702 PORTLAND OR 97204 patrick_hager@pgn.com	ROY HENDERSON PENSION ENHANCEMENT COMMITTEE 895 NW DALE AVENUE PORTLAND OR 97229 royhensn@msn.com
MARY ANN HUTTON CANON AND HUTTON SOUTHERN OREGON OFFICE 1141 NW KRING ST ROSEBURG OR 97470 mah@canonandhutton.com	JOE JANSSENS PGE PENSION ENHANCEMENT COMMITTEE 24495 BUTTEVILLE RD NE AURORA OR 97002 osprey64@juno.com
VALARIE KOSS COLUMBIA RIVER PUD PO BOX 1193 SAINT HELENS OR 97051 vkoss@crpud.org	GEOFFREY M KRONICK LC7 BONNEVILLE POWER ADMINISTRATION PO BOX 3621 PORTLAND OR 97208-3621 gmkronick@bpa.gov
MICHAEL L KURTZ BOEHM, KURTZ & LOWRY 36 E 7TH ST STE 2110 CINCINNATI OH 45202 mkurtzlaw@aol.com	ROCHELLE LESSNER LANE, POWELL, SPEARS, LUBERSKY LLP 601 SW 2ND AVE. STE. 2100 PORTLAND OR 97204 lessnerr@lanepowell.com
KEN LEWIS 2880 NW ARIEL TERRACE PORTLAND OR 97210 kl04@mailstation.com	STEVEN G LINS GLENDALE, CITY OF 613 E BROADWAY STE 220 GLENDALE CA 91206-4394 slins@ci.glendale.ca.us
JAMES MANION WARM SPRINGS POWER ENTERPRISES PO BOX 960 WARM SPRINGS OR 97761 j_manion@wspower.com	LLOYD K MARBET DON'T WASTE OREGON 19142 S BAKERS FERRY RD BORING OR 97009 marbet@mail.com
GORDON MCDONALD PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232 gordon.mcdonald@pacificorp.com	DANIEL W MEEK DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net
THAD MILLER OREGON ELECTRIC UTILITY COMPANY 222 SW COLUMBIA STREET, SUITE 1850 PORTLAND OR 97201-6618 tmiller6@optonline.com	WILLIAM MILLER IBEW 17200 NE SACRAMENTO PORTLAND OR 97230 bill@ibew125.com
CHRISTY MONSON LEAGUE OF OREGON CITIES 1201 COURT ST. NE STE. 200 SALEM OR 97301 cmonson@orcities.org	MICHAEL MORGAN TONKON TORP LLP 888 SW 5TH AVE STE 1600 PORTLAND OR 97204-2099 mike@tonkon.com
FRANK NELSON 543 WILLAMETTE CT MCMINNVILLE OR 97128 fnelson@viclink.com	NANCY NEWELL 3917 NE SKIDMORE PORTLAND OR 97211 ogec2@hotmail.com

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

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	)
	)

SURREBUTTAL TESTIMONY OF

JOHN ANTONUK AND RANDALL VICKROY

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

September 22, 2004

Introduction and Purpose of Testimony

Q. MR. ANTONUK, PLEASE STATE YOUR NAME.

A. My name is John Antonuk. I am the President of The Liberty Consulting Group. I, along with Mr. Vickroy, previously offered direct testimony in this proceeding on behalf of the Industrial Customers of Northwest Utilities ("ICNU").

Q. MR. VICKROY, PLEASE STATE YOUR NAME.

A. My name is Randall E. Vickroy, and I am Liberty's principal consultant for utility financial matters.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. This testimony addresses some of the issues raised in the rebuttal testimony filed by various Portland General Electric Company ("PGE" or "the Company") and Oregon Electric Utility Company ("Oregon Electric") witnesses. ICNU believes that the transaction as proposed lacks adequate bankruptcy protections, relies upon unnecessarily high levels of debt at the parent company, and does not contain adequate assurances that there will be no deterioration in service quality and reliability. In the event that the Commission decides to approve this transaction, we propose three conditions to address these concerns, and recommend that the Commission adopt them as conditions of approval. Additional conditions that ICNU recommends that the Commission adopt if the transaction is approved are set forth in the surrebuttal testimony of Donald Schoenbeck.

Bankruptcy Protection

Q. WHAT IS YOUR POSITION REGARDING ADDITIONAL BANKRUPTCY PROTECTION?

A. We remain unconvinced by the testimony of the PGE and Oregon Electric witnesses who maintain that their proposed ring-fencing provisions provide adequate protection. We believe that the Commission should adopt the specific bankruptcy language that we set forth in our direct testimony, with the addition related to dividends proposed by Ms. Wheeler in her rebuttal testimony.

Q. THE TESTIMONY OF MS. WHEELER DISTINGUISHES THE CIRCUMSTANCES OF NUI AND NORTHWESTERN, EACH CITED IN YOUR DIRECT TESTIMONY, FROM WHAT WILL BE THE CASE HERE. WHAT IS YOUR RESPONSE?

A. It misstates and trivializes our testimony to suggest that we view the reasons for their ultimate difficulties to be analogous to what can happen here. We understand and we believe that we stated quite clearly that excessive leverage and exposure to variable rate debt are the concern here, not non-utility investments, cash commingling, or the other factors cited in Ms. Wheeler's testimony. Our point in raising these two cases, which, again, we thought we stated quite clearly, was to point out the extreme difficulty the Commission will have should an Oregon utility be dragged into bankruptcy due to the utility's thinly capitalized parent being unable to meet its very heavy debt obligations as they come due.

This difficulty is why we emphasize the importance of taking in advance adequate measures to insulate the utility from bankruptcy, however remote the Applicants think that possibility might be. The "it can never happen here"

assertion is one that we are quite sure NorthWestern and NUI would have made as well.

Beyond this limited use of these other two examples, it is useful to point out that the NUI circumstances strongly illustrate the need to incorporate the separate operation, no-utility reliance, and commitment to prevent lender actions against the utility provisions we have proposed. Because the NUI parent was at grave risk of failing to meet its obligations, the precise situation faced by the utility subsidiary was a piercing of the corporate veil by lenders and other creditors as a way of securing repayment from the only entity remaining with the resources to provide that repayment, the utility.

Q. HOW DOES THE NUI CASE HAVE THE POTENTIAL FOR APPLYING HERE?

A. Should utility dividends be too low, or should variable debt costs rise too substantially, that is precisely what will be the case here. No entity but the utility will have the resources to make holding company interest payments as they become due. In that case, one can expect lenders to seek to pierce the corporate veil. The lenders can be expected in that event also to seek to get greater control over the utility's assets in bankruptcy litigation than they might expect to have should they (through the utility) be limited to asking this Commission for relief from dividend limits or utility equity maintenance to the extent necessary to get more cash up to the parent to pay its debts.

Q. DO YOU AGREE, THEN, WITH MS. WHEELER'S STATEMENTS ABOUT YOUR BANKRUPTCY PROTECTION CONDITIONS?

A. No. First, the fact that there are public requirements for separate utility operation does not moot the need for affirmations by lenders and borrowers that such separation actually exists. Public requirements for separate utility operation state what is required without involving an affirmation by either party that the requirement is being met. Affirmations by lenders and borrowers of the separation, which we propose, constitute an acknowledgment that the required separation does exist. Such an affirmation has clear relevance in the event that there is a subsequent effort to assert that the required separation did not in fact exist.

Second, if, as Ms. Wheeler says, the lenders do anticipate relying solely on Oregon Electric assets, there should be no difficulty in them explicitly committing to this in legal documents. If they refuse to commit, then it is reasonable to presume that they wish to preserve the right to argue otherwise. It seems clear that lenders would want to preserve the right as a way of persuading a bankruptcy court that it is proper to include the utility in the bankruptcy estate because there was reasonable lender reliance on utility assets when they extended their commitments. A simple affirmation of what Ms. Wheeler testifies is her understanding seems a straightforward and appropriate way of foreclosing a later argument that could be used to the utility's and this Commission's detriment.

Third, to say that the protection against consolidation in bankruptcy by lenders provides no protection is wrong. An enforceable promise by lenders not to seek consolidation, at the very least, provides a credible argument for the utility

and for this Commission to use, should the lenders try to do so. Moreover, it misses the point to argue that the clause will not provide much protection or has not been used before. The better way to look at the issue is thus:

- If the lenders have no intention to preserve such an option, why would they object to language confirming that intent?
- If they do, then that is exactly why the clause, combined with the other elements of our proposed condition, is important.

We have always been troubled by the argument that such clauses have not been seen and are therefore somehow not worthy of consideration. This argument ignores many important concepts and facts. First, leveraged buyouts of utilities are not an established business whose rules and mechanisms are all "down pat." Second, if lenders do not want this kind of language, it is not likely to be because it is irrelevant, but because they do not want to deprive themselves the opportunity to recover from as many sources of revenue as possible. Third, it may be that banks will charge more to lend money to holding companies for giving up this option. If so, however, why should shareowners at the holding company be enriched by saving the resulting premium at the expense (or risk, more precisely stated) of utility customers and regulators who will have to deal with the consequences of utility consolidation into the estate of a bankrupt parent or affiliate?

Finally, Texas Pacific Group ("TPG") has not yet issued the debt that is expected to be applied toward the purchase price at the time of closing. This only

increases the lack of certainty and risk associated with this transaction because the specific terms of the financing are still unknown.

Our bottom line is this: if there is no risk of consolidation, why is there so much opposition to what should, at worst, be a meaningless provision? If there is such a risk, then our proposed provisions are important.

Q. MS. WHEELER RECOMMENDED A CHANGE TO YOUR BANKRUPTCY LANGUAGE, TO PROVIDE THAT THE PARENT'S ASSETS INCLUDE THE DIVIDENDS RECEIVED FROM PGE. WHAT IS YOUR RESPONSE TO THAT PROPOSED CHANGE?

A. Our proposed condition assumed this situation, *i.e.*, lenders would be relying upon the payment of dividends from PGE to the parent. It is important to make clear, however, that the dividends being relied on are those permitted under the remaining conditions, such as utility equity maintenance. With this understanding, we are in agreement with her addition.

Reduction in Leverage Risk

Q. WHAT IS YOUR POSITION REGARDING THE USE OF HIGH AMOUNTS OF LEVERAGE IN THIS TRANSACTION?

A. We are not persuaded by the testimony of the rebuttal witnesses that the reliance on high levels of debt at the parent level represents a normal level of risk. In the absence of clear benefits from the transaction, we believe it is critical that the Applicants lower the percentage of debt at the parent level and therefore mitigate risk. We recommend that the parent be required to secure and maintain at all times at least an investment grade rating for its publicly held debt. This condition would also satisfy our concerns about variable rate debt, because the rating agencies will consider such debt in their analyses. Alternatively, it would be

acceptable, but less desirable, to require that there be no decrease in the utility corporate credit ratings.

Q. HOW DO YOU RESPOND TO THE CONTENTION THAT THIS PROCEEDING IS NOT A PROPER ONE TO EXAMINE THE COMMISSION'S APPROACH TO TAX CONSOLIDATION?

A. We strongly favor the mitigation of risk by reducing leverage and interest-rate risk at the parent level. Including our additional ring-fencing provisions is also important to mitigation of risk. Such mitigation of utility risk should be achieved by addressing the leverage and utility protection issues. This would render moot the need to consider providing for customers a share of tax benefits in consideration for the increase in risk levels due to the deal. Should the Applicants not accept mitigation of risk through such measures, however, we think it is entirely appropriate for the Commission to consider decreasing the risk to customers through other means. One method of compensating customers for the increased risk would be to examine the increased return potential that occurs to a single-purpose, highly leveraged parent (and one exposed to potentially significant interest-rate risk) in major part from the deductibility of high levels of interest and determining whether this is an appropriate occasion to adopt a different method of determining what tax expenses should be included in rates. After all, this is not a case where an affiliate separate from the utility is experiencing business losses. This is instead a calculated plan to produce deductions from interest payments for debt that increases utility exposure and will be issued only because of utility revenue streams, but gives the utility no compensation. If it is appropriate to add such risk, it is equally appropriate to

question why the added debt is not placed within the utility, in order to reduce its costs for ratemaking purposes.

Our focus here is on reducing leverage. That said, however, we believe that if additional utility risk is to be introduced as a result of this transaction, the next question for the Commission to address is the potential for sharing the benefits gained from taking the added risk (*i.e.*, sharing the benefits of the increased income tax deductions due to interest payments).

Q. PLEASE ELABORATE ON THIS ISSUE OF ADDED RISK TO THE UTILITY DUE TO HIGH LEVERAGE AT THE HOLDING COMPANY.

A. A leveraged buyout of a utility by an entity whose sole material business purpose is to own the utility presents uncommon circumstances regarding capital structure. The atypical capital structure created here drives very significant differences in tax circumstances for the utility's owners, as compared with what is usually the case. It is no more inappropriate to consider changes in the ratemaking implications of income taxes than it is to consider the approval of a buyout that will produce such high leverage.

The primary goal of our direct testimony was not to secure a change in how this Commission determines recoverable income tax expense. It was to reduce leverage at the single-purpose parent, which would reduce risk at the utility. The type of parent involved here is quite different from the typical holding company parent. Among the differences is that this holding company does not intend to operate a family of companies or businesses—it will operate only a utility. Therefore, it gains no diversity of risk by combining enterprises with different risk profiles. The holding company has two principal sets of risks.

The first are the usual utility risks. The second are the financial risks that are imposed by its overlaid capital structure, the two most notable components of which are much greater leverage than utilities generally have and exposure to potentially sizeable interest rate variability.

The parent has only the utility to rely upon for payment of its debt, absent firm, clear commitments to add equity at the parent. Oregon Electric has not offered such commitments. Thus, its thin (relative to a utility) equity capitalization becomes an issue. The use of a parent to hold the added debt provides some insulation, the degree and quality of which are obviously matters in contention in these proceedings. However, it must be observed that this Commission should look to the utility as the only real source of financial strength of the single-purpose parent, just as the creditors will do. Therefore, the capitalization of the parent and the utility will remain intertwined to a material degree and to a far greater extent than exists in the case of a holding company that houses diverse, substantial enterprises.

This intertwining will advantage the new owners substantially, in terms of opportunity to achieve returns. If it did so without risk to the utility, there might be no public concern. Here, however, there is added risk to the utility.

Q. MR. DAVIS TAKES ISSUE WITH YOUR CONCLUSION THAT MANY OF THE PROPOSED BENEFITS OF THIS TRANSACTION, SUCH AS LOCAL, STABLE MANAGEMENT, REINVESTMENT IN THE BUSINESS, SIMPLICITY AND TRANSPARENCY, LONG-TERM PLANNING, LOCAL BOARD PARTICIPATION, AND INVESTOR EXPERIENCE, ARE BASELINE RESPONSIBILITIES. WHAT IS YOUR RESPONSE?

A. We have been reviewing utility management and operations for many years, at many utilities, and in many places across Liberty's seventeen years of operation. We can say categorically that the following are basic, elemental principles of good utility practice:

- No utility can operate successfully in meeting public service responsibilities without comprehensive, well-designed, and faithfully performed long-range planning.
- Utilities should make sufficient reinvestment in the business to continue to meet public service obligations.
- Board member familiarity with and understanding of the nature and needs of the service territory is important in assuring that representation of investor interests is tempered by recognition of what it takes to provide public service under a franchise or similar grant of authority.
- Management should not be remote and it should not be unstable.
- There should be no significant barriers to the transfer of information it takes to give regulators full understanding of the operation of the utilities and the affiliates whose interactions affect them.

There is also an assertion about the experience of the investors. Such experience is not material except to the extent that ownership will exercise

substantially more direct involvement in utility management and operations than traditional utility shareowners do. The fact that ownership will have that power here is not a matter for comfort—it actually poses an added risk.

Oregon Electric has promised nothing more here than the basic, elemental principles of good utility practice. Although Oregon Electric has claimed that exceptional leadership is an added benefit, that claim is both highly subjective and is one that we would not be prepared to support, given what we have seen in the industry. It is not that we criticize leadership, but we are not prepared to praise it as superior to what we believe should be expected of current management of this or any other similar utility enterprise. In short, the "benefits" that Oregon Electric has promised here are not exceptional. In fact, despite Mr. Davis's argument, the failure to offer what Oregon Electric puts forth as a benefit would be evidence of imprudent conduct. Although the question of the experience of investors may be a separate consideration, we do not see that as a material issue to successful operations, unless ownership is concentrated and may have more direct involvement in utility management and operations, as apparently is proposed here. What the Applicants have offered in these specific regards is not to be criticized as deficient. At the same time, and more to the point, it is also not to be praised as exceptional. It should not take a buyout to bring about what is no more than baseline capability.

Q. THE REBUTTAL TESTIMONY OF MR. JACKSON NOTES YOUR DIRECT TESTIMONY "SUGGESTS THAT THE INTERESTS OF PGE'S INVESTORS IN MAKING A PROFIT CONFLICTS WITH THE INTERESTS OF PGE CUSTOMERS." WHERE DID YOU SAY THAT?

A. We did not suggest this in our testimony, nor do we believe it. An opportunity for investors to earn a reasonable return on capital invested to provide public service is an important cornerstone of utility regulation. It trivializes important issues of financial risk, the distribution of benefits that arise from taking that risk, and growing indications of under-spending by utilities on infrastructure growth and maintenance to state otherwise. Nevertheless, utility-type returns are not what motivate the shareholders that Mr. Jackson would serve as a director—returns far in excess of those are the goal. The real issue is determining what financial and service-quality risks arise from pursuing that goal, how they should be mitigated, and how the positive and negative results of those risks should be apportioned.

Q. MR. PIRO TAKES ISSUE WITH YOUR DIRECT TESTIMONY IDENTIFYING KEY FINANCIAL DRIVERS. WHAT IS YOUR RESPONSE?

A. Clearly we have done no independent analysis. Equally clearly, our testimony, beginning at the cited portion of page 28, addresses the variables on which the financial analysis of the buyers focused. We reported accurately what their analyses addressed. Moreover, a substantial portion of fuel costs, and the vast majority of non-fixed ones, are O&M in any event.

Service Quality and Reliability

Q. WHAT IS YOUR POSITION REGARDING SERVICE QUALITY AND RELIABILITY?

A. We remain unconvinced by the arguments of the Oregon Electric and PGE witnesses that there is no basis for concern about service quality and reliability after the change in ownership. To that end, we recommend that the Commission adopt a condition to approval that PGE commit to funding an outside management and operations audit to address the effect of the change in ownership on the maintenance of adequate service quality and reliability. This audit would take place in the event the Commission decided that such an audit is appropriate.

We believe that the Applicants' commitment to continue reporting service-quality measures is appropriate and beneficial. However, we believe that such measures are lagging indicators, and the effect of any near-term reductions in O&M and capital expenditures may not manifest themselves for years.

Q. HOW DO YOU DEFINE LAGGING AND LEADING SERVICE QUALITY MEASURES?

A. A lagging measure is one that quantifies performance at the customer-visible level; *e.g.*, outage frequency, outage duration, times to install or repair, time to answer a phone call, or time in queue. Leading measures examine plans, resources, and activities that drive these results; *e.g.*, equipment replacement and augmentation expenditures, maintenance backlogs, inspection results, and customer call center personnel levels.

Q. WHAT HAS BEEN YOUR EXPERIENCE WITH THE USE OF LAGGING, AS OPPOSED TO LEADING, MEASURES?

A. In work for both commissions and utilities, we have found that lagging measures are often more misleading than validating when it comes to assessing quality across any measurable period of time. We focus on a review of leading measures when we look at service quality and we are simply proposing that the same be done here. An independent review after new ownership has exercised authority for a year or two is an important way to assure that significant changes in expenditures or activity levels have sound analytical and operational foundations, and that there remains a focus on maintaining service quality over the long term. Our work has disclosed cases where performance as quantified by lagging measurements has failed to alert management or inform commissions adequately about looming problems that become much harder to address the more they linger.

Q. MR. HAWKE AND MR. ELLIOTT DISCUSS "X MEASURES" IN THEIR REBUTTAL TESTIMONY. HOW DO YOU RESPOND?

A. We reviewed both the "UM 814 Proposed Stipulations for Service Quality Measures," which sets forth the service quality measures for PGE following the Enron merger, and the "Stipulations for PGE Service Quality Measures UM 814/UM 1121" that PGE and Oregon Electric have agreed to in this Docket. The Proposed Stipulations from UM 814 set forth a series of what may properly be called measures, which we define to be aspects of service delivery that have been subjected to an objective, quantifiable measurement of results. Those standards are limited to:

- At fault customer complaints per thousand customers
- 3-year weighted average SAIDI (an interruption duration measure)
- 3-year weighted average SAIFI (an interruption frequency measure)
- 3-year weighted average MAIDI (an interruption duration measure for momentary outages)
- Number of major safety violations.

The UM 814 Proposed Stipulations contain an "objective," which is blank in all but the last case, and which implies that there will be an effort to establish a performance standard for each of these measures (*e.g.*, average interruption durations will not exceed xx minutes for the measurement period). Furthermore, the document also indicates that there will be a revenue requirements reduction (*i.e.*, a penalty) associated with the failure to meet each standard, after that standard is adopted. These standards are unquestionably lagging ones.

The document then goes on to list a number of other "measures" designated by the letter "X." We presume that these are the X measures the witnesses referred to in their testimony. These items include:

- An annual review of vegetation management
- An annual review of the basic "I&M" (which we take to mean inspection and maintenance)
- An annual review of any special programs.

The measurements established in these areas are satisfaction of company goals. The only "standard" that one could say is established by these goals is that a failure to meet historical expenditure levels in certain key areas related to the

preceding lagging measures can lead to a customer refund, but only if there is a failure to meet standards, and there is moreover a performance deficiency that exceeds these same lagging standards. The X measures in the Proposed Stipulation from UM 814 are similar in substance and nature to those provided in the Stipulations for PGE Service Quality Measures UM 814/UM 1121 under which PGE will operate if the proposed transaction is approved.

In other words, there are no standards apart from lagging ones, which is what we attempted to say, and which remains true, despite the testimony of Messrs. Hawke and Elliott to the contrary. In short, their criticism of our statement is made in error.

Q. THAT SAID, WHAT IS YOUR OPINION OF THE STANDARDS YOU HAVE JUST DISCUSSED?

A. We have no qualms with the lagging measures, but they are basic ones, and, for the reasons set forth in our testimony, should not be relied upon to determine that public-service needs are being met on a short- and long-term basis. Similarly, we support the conduct of the regular reviews identified. However, we would be troubled if the implication of these X measures is that things will be considered in good order if historical expenditure levels are met or if there are no violations of the lagging standards above some threshold level. If that implication is intended, then we think that the use of the X measures actually may prove to cause more harm than good to service quality.

Apart from attempting to link historical expenditure levels and threshold violations of a small set of lagging standards to presumptions of prudent performance or conduct in accord with good utility practice, we are very

supportive of the process of making Commission Staff a participant in scheduled reviews of planned and accomplished activities that in fact drive service performance results. That is the concept underlying our recommendation to allow for an outside audit. The main difference is that an audit will give the Commission's participation the benefit of a perspective that is independent and informed by a breadth of industry experience. That perspective will also be unconstrained by any presumption (which we consider wholly inappropriate) that meeting expenditures that may or may not have been appropriate for a historical period will satisfy current and future needs. It will also avoid the potentially dangerous conclusion that the lack of current degradation in lagging indicator results establishes confidently that none is looming.

Our recommendation does not compel the performance of an audit; it merely allows the Commission to direct, secure, and manage an audit as a means of giving the Commission what we believe to be much better and more robust information about the drivers of service quality under new ownership that will operate under significant financial pressure and which, despite extensive experience in other businesses, cannot fairly claimsubstantial utility expertise.

Q. MR. JACKSON STATES THAT "DRAMATIC" CUTS IN EXPENDITURES WOULD MANIFEST THEMSELVES QUICKLY IN HIS EXPERIENCE. WHAT IS YOUR RESPONSE?

A. First, the "dramatic" cuts Mr. Jackson discusses are not the only ones that have consequence. Our experience teaches that commissions should be concerned about more than major, one-time cuts. Second, words like "dramatic" cannot be given objective dimensions; however, we can say that reductions over a period of

time do not always have consequence in the time period Mr. Jackson suggests. Major storms do not arrive on cue to show what can happen to service from reductions in vegetation management. Equipment on a pole does not fall off the day, month, or even year after an inspection is missed or a logged maintenance item becomes overdue. His reported experience is markedly different from what we have seen in examining service reliability for a number of public utility commissions and utilities.

Q. BUT WHAT DO YOU SAY TO THE POINT THAT IT IS NOT IN OWNERSHIP'S INTEREST TO SHORTCHANGE THE FUTURE TO SERVE THE PRESENT?

A. We say that we have seen enough exceptions to this supposed truism to make it dangerous for a commission to rely substantially on it, in lieu of a more active and direct examination of the drivers of service quality over the long term.

Q. MR. DAVIS SAYS THAT YOU "SUGGEST" THAT ANY COST CUTTING WOULD BE CONTRARY TO THE INTERESTS OF PGE CUSTOMERS. WHAT IS YOUR RESPONSE?

A. Mr. Jackson mischaracterizes our testimony. As we state quite explicitly in our direct testimony (at pages 39 and 40) in response to a direct question on the subject, we do not hold to the view that there is a necessary connection between expenditure reduction and decreased service quality. Our long record in serving utilities and the commissions that regulate them is testament to our firm's belief that targeted, effective cost reduction is an important component of prudent utility management.

The circumstances in this case, however, warrant Commission involvement, through an outside audit, in the process that this company will quite

clearly undertake under new ownership to seek out cost reductions that benefit both owners and customers. This issue should be the focus of the discussion before the Commission rather than the scenario that Mr. Davis stated was "suggested" in our testimony.

The other thing that this portion of Mr. Davis's testimony does is to point to the experience that TPG has from making investments in over 50 companies, which he says has produced "substantial experience in this area." We pay great deference to the general business knowledge of TPG, but we want to make sure that we are defining the right "area" of interest. We are talking about a public service industry whose rates and service are subject to what must be described as particularly close scrutiny. Electric service is essential to businesses and individuals and, as a result of the need for a stable and reliable supply of electricity, utilities have been granted a monopoly to provide that service. It is not clear to us that experience in other industries, however extensive the base of that experience, brings one particularly closer to what it takes to succeed in operating a regulated utility. Among our concerns is assuring that judgments made in the early years of new ownership get made with the right kinds of perspective and experience. The prospective owners seem to value the insight that they will get from bringing in good management and good board members. It appears to us that it is just as important and valuable to add to that experience the perspectives and judgments that would come from an outside review under the direction of another recognized stakeholder and source of relevant expertise; *i.e.*, this Commission.

We do not ask that the new owners turn over management and operation of the utility to an outsider. We ask only that they agree to support an outside Commission review (and even then only if the Commission asks for it) of what they are doing and how, as they move into a new industry and do so under a structure that remains a very novel one in the industry.

Q. PLEASE SUMMARIZE YOUR POSITION ON THE TRANSACTION.

A. We recommend the following specific conditions in the event that the Commission decides to approve this buyout:

- The parent should be required to secure and maintain at all times at least an investment grade rating for its publicly issued debt. Alternatively, it would be acceptable, but less desirable, to require that there be no decrease in the utility corporate debt ratings.
- The Applicants should be required to adopt the specific bankruptcy protection language set forth in our direct testimony, with the addition related to dividends as proposed by Ms. Wheeler.
- The utility should commit to funding an outside management and operations audit addressing compliance with all buyout conditions and addressing efforts to maintain adequate service quality and reliability in the event that the Commission decides that one is appropriate.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.