BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UF 4218 / UM 1206

In the Matter of the Application of PORTLAND GENERAL ELECTRIC COMPANY for an Order Authorizing the Issuance of 62,500,000 Shares of New Common Stock Pursuant to ORS 757.410 et seq. **UF 4218**
and
In the Matter of the Application of STEPHEN FORBES COOPER, LLC, as Disbursing Agent, on behalf of the RESERVE FOR DISPUTED CLAIMS, for an Order Allowing the Reserve for Disputed Claims to Acquire the Power to Exercise Substantial Influence over the Affairs and Policies of Portland General Electric Company Pursuant to ORS 757.511 **UM 1206**

TESTIMONY OF

RICHARD W. CUTHBERT

ON BEHALF OF THE CITY OF PORTLAND

September 16, 2005

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OF OREGON
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RICHARD W. CUTHBERT
ON BEHALF OF THE CITY OF PORTLAND

QUALIFICATIONS AND SUMMARY OF TESTIMONY

Q. Please state your name, business address, and occupation.

A. My name is Richard W. Cuthbert. My business address is R. W. Beck, Inc., 1001 Fourth Avenue, Suite 2500, Seattle, Washington 98154-1004. I am a Principal and Senior Director with the firm of R. W. Beck, Inc., Engineers and Consultants, which has its headquarters in Seattle, Washington. R. W. Beck is a nationally recognized engineering and management consulting firm serving clients throughout the United States, principally in utility matters.

Q. Please state your educational background.

A. I have a Masters of Science degree from Oregon State University in Corvallis, Oregon, where my specialization was in the fields of resource economics and statistics. Prior to this, I earned a Bachelor of Arts degree from Reed College in Portland, Oregon.

Q. Briefly describe your professional experience.

A. I have been employed by R. W. Beck since July 1981. My primary responsibilities are in the areas of financial analyses, cost of capital studies, utility

rates and cost-of-service studies, load forecasting, and various other assignments, primarily for electric and water utilities. In this capacity, I have prepared expert testimony on the cost of capital and various ratemaking issues in cases appearing before both state and Federal regulatory agencies. I have also reviewed a wide range of issues related to the appropriate regulation of public utilities, several of which have resulted in expert testimony. Prior to my employment with R. W. Beck, I worked as an economic research assistant at Oregon State University from 1978 through 1980.

Q. Have you previously testified as an expert witness concerning the regulation of public utilities?

A. Yes. I have testified before various jurisdictions at both the state and Federal levels on issues such as required rate of return, proper capitalization structure, and financial impact assessment. A full listing of my participation in various proceedings as an expert witness is provided as Exhibit COP/101 to this testimony.

Q. On whose behalf are you presenting this testimony?

A. I am testifying on behalf of the City of Portland ("the City").

Q. What information have you reviewed to develop your testimony and recommendations?

A. I reviewed the Application and Stipulation along with the supporting testimony prepared by the Applicants, certain Commission orders and other documents from prior proceedings in Oregon, various documents and information provided in response to data requests, information provided to me by the City, and various

publicly available reports and other non-confidential information regarding PGE and the proposed issuance of new PGE common stock.

Q. Have you provided any exhibits that support your recommendations?

A. Yes. I have prepared exhibits COP/101 through exhibits COP/114 to accompany this testimony.

Q. Were these exhibits prepared or organized by you or under your direct supervision?

A. Yes, they were.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address certain concerns about the Application prepared by the Applicants in this proceeding and the Stipulation entered into by a number of parties of the proceeding.

Q. What is the background of your involvement in this case?

A. On June 17, 2005, Portland General Electric ("PGE") and Enron filed their joint Application for the Commission's review of the proposed issuance of new PGE common stock, and the distribution of that stock. On July 19, 2005, a prehearing conference was held at the Commission's office to establish the schedule in this proceeding. Shortly after this date, R.W. Beck was retained by the City to provide assistance in reviewing the Application and the development of the Stipulation related to the plan to create and distribute new PGE common stock.

Q. Did your firm have previous involvement related to the City's proposal to purchase PGE from Enron?

A. R. W. Beck was hired by the City in early 2005 to help it evaluate the merits of a proposal to purchase PGE and municipalize its operations. Our efforts were centered on analyzing the potential impacts to ratepayers under a municipalization scenario. R. W. Beck also assisted the City during 2002 and 2003 in an earlier effort to purchase PGE.

Q. Regarding R. W. Beck's 2005 evaluation of the merits of a proposal by the City to purchase PGE and municipalize its operations, what conclusions did the analyses performed reach?

A. Using publicly available financial and operating data for PGE, R. W. Beck created a financial model and financial pro forma analysis of an acquisition and subsequent operation by the City of PGE as a municipal utility. From our analyses, we concluded that the City's proposed acquisition of PGE's common stock from Enron for approximately $2 billion along with the assumption of outstanding PGE debt was financially and operationally feasible. We also concluded that this transaction would enable the City to reduce PGE customer rates by approximately 10 percent.

Q. Please summarize your concerns with the Application and the Stipulation.

A. Although the Application, as modified by the Stipulated Conditions, indicates that the Applicants believe the proposed creation and distribution of new PGE common equity will serve the public interest and benefit PGE customers, I believe that the Application and Stipulation do not maintain the current level of protections afforded to PGE's customers by the existing conditions available

under Enron's ownership and do not provide a net benefit to PGE ratepayers. Additionally, I believe that the implementation of the actions proposed in the Application and Stipulation will pose increased risks and increased liabilities to PGE's ratepayers.

Two of my principal concerns with the Application and Stipulation are related to the "net benefits" test for PGE ratepayers:

1. The stock distribution plan will not in any meaningful way result in the "benefit" of a local headquarters, local management, and independence as Applicants claim on page 27 of the Application. Under Enron's ownership PGE already has the benefit of a local headquarters and local management, and with current controls imposed by Commission orders has relative independence from Enron. The Application and Stipulation do not provide any benefit not already in place, nor do they provide for future stability and adequate protection from loss of local control post transfer. This concern is due to the level of control the Reserve will have in the selection of the Board of Directors, and is amplified by the recent repeal of the Public Utility Holding Company Act ("PUHCA") by Congress. The repeal of PUHCA makes it more likely that PGE will be a takeover target, and nothing in the Application and Stipulation provides assurance of retaining the current status of local headquarters and local management.
2. The Application and Stipulation do not provide adequate protection to PGE ratepayers from Enron-related liabilities and do not provide adequate protection from potential long-term financial harm. This concern relates to inadequacies in Conditions 5, 6, 8 and 11 of the Stipulation.

As a result of these concerns, it is my view that the Application and Stipulation do not meet the Commission's net benefit test and, unless the Commission imposes additional conditions on the Application, the Application should be rejected.

Q. What additional conditions are you recommending the Commission impose as part of its acceptance of the Application?

A. I recommend the following additional conditions be imposed by the Commission:

1) PGE should be required to estimate the potential financial costs and liabilities arising from Enron's ownership of PGE, and this information should be provided to the Commission for its review and considerations. PGE should also be required to establish adequate reserves to meet these costs and liabilities.

2) The Commission should explicitly affirm its position that PGE ratepayers will not be required to cover any Enron-related costs or liabilities and that PGE's new stockholders will be financially responsible for these costs and liabilities.

3) Conditions 5 and 8 of the Stipulation should be strengthened by requiring prior Commission approval of any cash payments or dividends from PGE to its new stockholders while the Reserve holding is greater than 20 percent of total new common stock and by requiring adequate financial reserves to be established to cover all Enron related costs and liabilities.

4) In addition to these actions that address potential harms to PGE customers associated with adoption of the Application, the Commission should require an immediate rate credit of $100 million as part of the establishment of the new PGE stock issuance plan. This rate credit would

provide the necessary benefit to PGE ratepayers to meet the Commission's net benefit standard.

LACK OF NET BENEFITS OF THE APPLICATION

Q. What is the Commission's policy regarding the need for a net benefit test for a merger or change in utility ownership?

A. As staff testified in UM 1121, the Commission's role in matters such as these is to determine if the application meets the requirements of ORS 757.511. "This statute requires the applicant to 'bear the burden of showing that granting the application is in the public interest'." (Staff/100, Conway/3, lines 2-5, Exhibit COP/102). In this case the Commission is considering the Joint Application of PGE, Enron, and Stephen Forbes Cooper, LLC ("the Applicants") to create and distribute new PGE common stock which results in a change of control over the management and affairs of PGE. Such change of control requires PGE to meet the requirements of ORS 757.511.

Furthermore, during the foreseeable future, a significant amount of the new PGE common stock will be deposited into a trust fund, the Disputed Claims Reserve ("the Reserve"), which will be overseen by Steven Forbes Cooper LLC and other members of the Enron Board of Directors. During the unknown amount of time in which a substantial amount of the shares remain in the Reserve, these shares will be voted as a bloc. This voting bloc will give the Reserve, and by extension whoever controls the voting rights of the Reserve, "substantial influence" over PGE within the meaning of ORS 757.511. This change in control also requires PGE to meet the public benefit requirements of ORS 757.511. As

stated in the Joint Testimony, this standard was explained in Commission Order No. 05-114:

> "The meaning of 'serve the public utility's customers in the public interest' was the subject of a Commission investigation in docket UM 1011. Utilities, consumer groups, and Staff provided input on the applicable standard under the statute. The Commission resolved the docket by issuing Order No. 01-778, which adopted a two-pronged legal standard under ORS 757.511(3). After reviewing the text and context of the statute, the Commission 'read the verb 'serve' to indicate a net benefit standard for merger approval.' See Order No. 01-778 at 10. The Commission went on to state that providing net benefits is a specific way to cure the general concern enunciated in ORS 757.506 that a transaction could harm customers. The order then set out a second requirement: 'in addition to finding a net benefit to the utility's customers, we must also find that the proposed transaction will not impose a detriment on Oregon citizens as a whole' See Order No. 01-778 at 11." Order No. 05-114 at 17.

Additionally, the Commission explained the concept of a comparator or comparison case in evaluating the new benefit test:

> "ORS 757.506(1)(c) delineates some harms against which customers should be protected, including degradation of utility service, higher rates, weakened financial structure and diminution of utility assets. The wording of the statute presumes a review of the utility's current status to see if a proposed transaction would cause harm. ORS 757.506(2) further provides that regulation is to prevent 'unnecessary and unwarranted harm to such utilities' customers.' Reading this statute in concert with ORS 757.511, we reject Applicants' approach and conclude that we must compare the potential benefits and harms of the transaction against the PGE as it is currently configured. However, this transaction is unique, because PGE is in a transitional state. It is owned by Enron, which is in bankruptcy and is being liquidated. There is little to suggest that PGE would operate very differently after the stock distribution plan than it does now. With Enron's current hands-off approach, PGE is, essentially, currently acting as a stand-alone utility. Therefore, to take into account the current transitional nature of PGE's ownership, we will compare Applicants' proposed to PGE as a separate and distinct entity, which would function as PGE operates today." Order No. 05-114 at 18.

Q. Why did the Commission indicate that the net benefit test is important for a change in utility ownership and control?

A. The Commission stated in Order No. 05-114 that in order to show that an application for a change of ownership is in the public interest, net benefits must be specifically demonstrated as a cure to the potential harms that may occur with a change in ownership. Only by showing a net benefit relative to the existing condition or some other comparator, is the standard of ORS 757.511 satisfied.

Q. What net benefits are claimed by the Applicants?

A. The Applicants state in their Joint Testimony in support of the Stipulation that the unique nature of this change in ownership is the basis for the proposed conditions in the Stipulation and that these conditions are designed "… to provide net benefits as a whole …" (page 14 of Joint Testimony). Section VII of the Application describes separately those conditions that purportedly prevent harm to ratepayers and those conditions that purportedly benefit rate payers over the status quo. The Application presents the Commission with only three reasons why it believes that the Application "serves the public interest and benefits customers" (which for ease of reference, I will refer to as the "Three Reasons"):

- The first of the Three Reasons concludes that no risks will be borne by PGE or its customers from the transaction, identifying the absence of new debt or liability at the PGE level and the shareholder level, and stating that one-time costs will not be passed through to customers ("First Reason").
- The second of the Three Reasons concludes that becoming a publicly traded company will focus direction and management decisions solely on operating a public utility in Oregon, and that PGE will have access to the public equity markets ("Second Reason").

- The third of the Three Reasons concludes that PGE will pay its taxes directly to taxing authorities once it is no longer consolidated with Enron ("Third Reason").

Not one of the Three Reasons actually describes a benefit to ratepayers over the status quo. Nor do any of the Three Reasons discuss or address the statutory requirement to demonstrate a "net benefit" accruing to the ratepayers as a result of approval of the change of control requested by PGE.

The First Reason describes a lack of risk, but no benefit. The status quo already has none of the risks identified by PGE in the First Reason. As discussed below, however, the proposed transaction imposes significant risk for the ratepayers and thus a reduction of benefits.

The Second Reason has two parts, neither of which addresses a benefit to ratepayers over the status quo. I will address the lack of change in status regarding local headquarters, local management and independence later in my testimony. PGE currently has access to the public equity and the public debt markets, and has outstanding preferred stock and outstanding independent debt not owned or controlled by Enron. Current statutory authority exists for PGE to seek approval from the Commission to issue and sell additional equity securities and debt instruments. PGE does not claim that Enron's ownership of its stock has had a detrimental effect on its provision of service to its ratepayers and PGE does not present any examples of how or why the change to Stephen Forbes Cooper and Enron creditors' ownership of its stock will improve service to its ratepayers. The more plausible argument is that by removing many of the protections against manipulation by Enron imposed by prior Commission orders, the ratepayers will be worse off under the control of Stephen Forbes Cooper and Enron creditors as

proposed in the Application. I will address this issue further later in my testimony.

The Third Reason has nothing to do with the PGE ratepayers at all, much less purport to benefit the ratepayers. Paying taxes to the federal government, the state government, and other taxing jurisdictions benefits the public generally, not the ratepayers. It is noteworthy only because Enron has not paid the taxes PGE collected from the ratepayers. To be a benefit to ratepayers, PGE would have to refund to the ratepayers, through a rate credit, the taxes PGE collected but Enron did not pay. PGE has not proposed such a rate credit in the Application.

Q. Do the Application and Stipulation meet the Commission's net public benefit test?

A. I do not believe they do. As explained above, the Application and Stipulation do not demonstrate any benefit, much less a net benefit to ratepayers. The Stipulation as it currently stands does not even rise to the same level of protection and benefits to PGE ratepayers that were established by the Commission in the Enron/PGE merger proceeding, or even those proposed by Oregon Electric Utility in its PGE acquisition approval application rejected by the Commission earlier this year. Additionally there is no rate relief for PGE customers from rate levels that are among the highest in the region.

Q. Have PGE ratepayers been negatively impacted by Enron ownership of the company?

A. Although this is difficult to assess quantitatively, significant liabilities associated with PGE's ownership by Enron will continue to be a factor impacting the company for many years. Among the negative factors affecting PGE are:

- In the Oregon Electric Utility proceeding, staff witness Morgan identified a $5 to $7 million increase in PGE debt expense attributed to Enron. (Exhibit COP/103.)
- Forgiveness of Enron accounts payable to PGE: PGE's 2004 Form 10-K report filed with the Securities and Exchange Commission ("SEC"), at pages 117 through 120 (see Exhibit COP/104) reveals in excess of $73 million owed by Enron and its affiliates to PGE that have been written off, waived or released.
- The recent dividend payment of $150 million from PGE to Enron – referred to as a "catch-up dividend": The question is whether it was a benefit to the ratepayers to have this money paid out as dividends or held in reserve until the resolution of Enron liabilities is complete. Also, instead of paying this money to Enron, it could have been used to cover the accounts receivable just mentioned.
- A significant number of liabilities are discussed in Appendix A of the Application and PGE's most recently filed form 10-Q for the second quarter of 2005, none of which have been definitively resolved, or if resolved, have not been submitted to the Commission in this docket. Even though Enron has agreed to indemnify PGE and its ratepayers for matters related to federal taxes and employee benefits, there are other matters related to unfair and deceptive trade practices in the western energy markets in 2000 and 2001 and unpaid Multnomah County taxes, among other things, that are still unresolved. Additionally, Enron has not stated whether its indemnity for taxes and pension liabilities is a cash funded indemnity or a creditor claim indemnity which will be added to the queue of other creditor claims to be paid with pennies on the dollar. Enron's

recent dollar settlements of other non-PGE California related liabilities were converted to creditor claims and not cash funded. Accordingly, without providing a cash funded indemnity dedicated to PGE and approved by the bankruptcy court, any claimed indemnity by Enron is illusory.

The bottom line is that the Application and its supporting testimony have failed to note or quantify the potential negative impact of Enron ownership of PGE on ratepayers and how the loss of protection from these liabilities could negatively impact PGE ratepayers before releasing Enron from its indemnity obligations under existing conditions.

Q. Why should these issues be considered by the Commission in this proceeding?

A. When Enron acquired PGE in 1997, the Commission agreed with Enron that the acquisition would be "in the public interest" because it provided net benefits to PGE's customers. Rate credits were guaranteed by Enron and the Commission found this, along with other conditions that provided adequate ring-fencing, satisfied the "net benefits" test. Now Stephen Forbes Cooper and Enron creditors must demonstrate that their proposed acquisition of PGE common stock also results in "net benefits" to the ratepayer, which must be over and above the existing conditions agreed to in the Enron/PGE merger, and not a mere substitute. Basic fairness to the ratepayers dictates that at a minimum, the ratepayers receive the net benefit promised them in the 1997 Enron acquisition. By statute, the ratepayers deserve to receive a net benefit from this transaction as well.

ISSUE OF CLAIMED BENEFITS FROM LOCAL CONTROL

Q. Please describe your concern with the benefits of local control identified in the Application.

A. Starting on page 27 of the Application, PGE discusses the public benefits that will arise from the local control that will result from this stock distribution. PGE claims in its Application that one of the benefits of its plan is that "policy, direction and management decisions for PGE will be made by PGE's board of directors and management . ." Further on a number of occasions, PGE management has touted one of the benefits of the Application being a return to "local control" for PGE which will now be headquartered in Portland. (See for example, citation by PGE chief financial officer in COP/105.)

As stated above, PGE is currently headquartered in Portland. Transferring PGE stock to Stephen Forbes Cooper and Enron creditors does not change the location of the company. The Stipulation does not provide any assurance that PGE headquarters will remain in Portland. Neither does the Stipulation provide for or can it guarantee "local control" over management of PGE. Further, we note that in the Oregon Electric Utility proceedings the Commission in Order No. 05-114 (Exhibit COP/106, page 32) rejected such "local control" aspects as "benefits" saying,

> "Applicants claim that they will restore the local focus of PGE with a commitment to maintain at least five Oregonians on the PGE Board of Directors. An Oregonian will also serve as chair of the Board. Oregon Electric contends that this strong local presence will bring greater sensitivity to local issues, along with providing PGE with a higher degree of accountability to customers.

> "We find no benefit from this commitment. PGE currently has a local focus. Moreover, a local presence on the board of directors is common in the energy industry, especially here in the Pacific Northwest. As ICNU notes, Northwest Natural Gas Company, Avista Corporation, Puget Sound Energy, and PacifiCorp all have strong local representation on their board of directors."

It is worth noting that the Commission also rejected the notion of "local control" as providing any benefits in the Oregon Electric Utility proceeding. Order No. 05-114 at page 33 (Exhibit COP/106):

> "On this record, we cannot conclude that Applicants' commitment to local focus, TPG's expertise, and the end of Enron ownership provide ratepayers any benefit they would not receive if PGE continues to operate as a stand-alone entity."

Again, there is no explanation by the Applicants as to how and why transferring stock to Stephen Forbes Cooper and Enron creditors provides any improvement from the current status.

The concern that local control will be lost by this transaction and the removal of Enron ring-fencing has been heightened by the recent repeal by Congress of the Public Utility Holding Company Act ("PUHCA"). PUHCA has been an important utility law in the past because it has restricted ownership of electric assets in this country.

Q. Please describe how the repeal of PUHCA has implications for PGE in this proceeding.

A. PUHCA has made it difficult for both utilities and non-utility businesses to acquire utility assets across state lines. The law was enacted 70 years ago to simplify the complexities of utility ownership and to make it easier for state regulators to oversee intrastate utility operations. Under PUHCA, lengthy SEC

approval was required in certain cases involving utility mergers and acquisitions. Under the new regulations, the SEC will no longer be involved in utility regulatory oversight – rather this responsibility will shift to the Federal Energy Regulatory Commission ("FERC"). In addition, domestic and foreign non-utility entities will be allowed to invest in utility assets across state and country lines. Experts have predicted that the rate of mergers and acquisitions will increase after PUHCA, especially for small- to medium-sized utilities within a single jurisdictional market, like PGE. (See COP/107, COP/108, and COP/109 for more information on PUHCA's repeal and possible impacts of this repeal on PGE.)

Q. What other concerns do you have with regard to the local control issue?

A. While the scenario of local control may or may not occur in the long term under a Wall Street controlled public market for PGE stock, in the short term the direction and policies of PGE will be set by an Enron controlled new Board that will be selected by the new PGE common stockholders. Because the Reserve administrator is estimated to hold an initial holding of 70 percent of new PGE common stock, the same Reserve administrator who currently controls the PGE Board will continue to have control of the new PGE Board. While the primary purpose of the Reserve is to distribute the remainder of the PGE stock, the fact remains that the primary duty of the Reserve administrator is to maximize the value of PGE in the interest of the Enron creditors. The Reserve administrator's and Enron creditors' short-term interests in maximizing PGE's short-term value do not align with the long-term interests of the ratepayers of PGE. It is prudent for the Commission to be concerned that the control of PGE by parties with short-term monetary interests will result in the same short-term cost cutting and operations manipulations that can generate short-term spikes in net earnings,

which in part led the Commission to deny approval of the Oregon Electric Utility transfer approval application.

Finally, there is no proof or empirical data provided to demonstrate that a publicly traded utility company results in "local control" or provides any "local control" benefit to the ratepayers. The major investors in publicly traded utility companies frequently are mutual funds and institutional investors few of whom are located in Oregon. These investors, and not local residents and ratepayers, will ultimately control PGE.

Q. Has PGE provided a specific timeline for the distribution of stock from the Reserve to new shareholders?

A. No. Except for the initial 30 percent stock distribution which is expected to take place in the first quarter of 2006, there is no specific timeline for the distribution of the remainder of the stock by the Reserve. In addition, no stock can be distributed until and unless PGE receives approval from the SEC, the FERC, the Nuclear Regulatory Commission and the Federal Communications Commission, among others, as referenced on page 13 of the Application. None of these approvals has been obtained and no timetable for obtaining such approvals has been provided by the Applicants.

Q. How much local control of PGE will there really be if the majority of its new stock is controlled by the Reserve?

A. Potentially very little. In the immediate future I am concerned about the inherent short-term perspective of a Board elected primarily by the Reserve. While the Stipulation contains a number of limits and restrictions designed to protect the financial stability of PGE, I do not believe that these conditions adequately

account for the loss of local control of PGE in the short term. The specific conditions in question will be addressed later in my testimony.

Q. When will the new PGE Board be elected?

A. Based on testimony from Rogan/Palmer filed on August 8, 2005 (Rogan-Palmer Testimony, page 9), the new PGE Board will be elected at the earliest in 2007. Before this time, decisions regarding dividend policy and funding capital expenditures could favor short-term benefits to the Reserve owners and be counter to the long-term interests of PGE customers. Rather than there being more local control, as asserted in the Application, this suggests that in the short term there could actually be less.

Q. Is local control of PGE a benefit of the Application?

A. In light of the repeal of PUHCA and the short-term perspective that is the Reserve's natural interest, the benefits related to local control and autonomy as set forth in the Application are indiscernible, and no better or different, if not worse, than the current status quo.

INADEQUATE FINANCIAL PROTECTION OF PGE RATEPAYERS

Q. What are your concerns related to the inadequate financial protection for PGE ratepayers provided by the Application and Stipulation?

A. The Application and Stipulation purport to address protection of PGE ratepayers in a number of ways:

- In Condition 5, PGE agrees that it will not make any distributions to shareholders that would cause PGE's common equity ratio to fall below

48 percent without Commission approval. The condition also states that as the Reserve holding of PGE stock diminishes, there will be no minimum common equity ratio percentage that limits such distributions.

- Condition 5(c), which provides for a temporary hold back of $40 million of equity, seems to be a small amount to cover the potential liability of Enron related to Condition 10 in Order No. 97-196. The adequacy of this reserve level needs to be determined.

These conditions of the Stipulation do not provide adequate protections to ratepayers from potential long-term financial harm arising from existing liabilities. This concern also relates to conditions 6, 8 and 11 as described below.

Q. What are your concerns with regard to Condition 5?

A. If PGE is serious about improving its financial status during the next two to three years without large rate increases to cover Enron-related liabilities, it should have higher equity ratio targets than those included in the Application and the Stipulation. As always, a caveat allowing "Commission approval" of a lower equity ratio level than in the Stipulation if unforeseen circumstances arise would protect the interest of PGE and its shareholders. Holding PGE to at least a 50 percent equity ratio level "without prior Commission approval" would be more consistent with the Application.

Additionally the Condition 5(c) provision for reserving $40 million of equity seems to be a small amount to cover the potential liability of Enron related factors covered by Condition 10 in Order No. 97-196.

Q. How was the $40 million figure arrived at?

A. No explanation is provided in the Stipulation, nor is any rationale identified in the Joint Testimony. However, since this is not a cash funded reserve to pay Enron related liabilities, its existence provides no real protection to PGE ratepayers. Just as importantly, it provides no net benefit to ratepayers. Under current Commission orders and oversight related to Enron, the ratepayers have more protection from Enron related liabilities. Furthermore, the $40 million could be quickly drained by existing, identifiable liabilities. For example, PGE has indicated that its exposure to the California Refund matter by itself is approximately $60 million, of which $40 million is reserved, per PGE's presentation to Moody's Investor Service on October 13, 2004, page 14 (Exhibit COP/110) and in the 2004 10-K report, page 122 (Exhibit COP/104).

Q. What are your concerns with regard to Condition 6?

A. Although Conditions 6(a) through 6(c) provide some level of protection for the ratepayers, Condition 6(d) puts a very short fuse on some of these protections, as little as 30 days after PGE's new rates from its next rate case become effective. Assuming PGE makes a filing next spring and there is a nine-month regulatory review process by the Commission, many ratepayer protections could expire by the end of 2006. Given the complexity and magnitude of many of the potential Enron related liabilities, this "one bite at the apple" approach is not acceptable. I believe there should not be any time limitation following the issuance of new PGE stock for coverage of liabilities arising out of Condition 10 in Order No. 97-196.

Q. Please describe your concerns related to the inadequate protection of PGE ratepayers that would result from adoption of the Application and the Conditions in the Stipulation.

A. The Stipulation recognizes that there are potentially significant levels of unknown outcomes relative to increased costs associated with Enron's ownership of PGE. This will not come as news to the Commission: Staff testified in UM 1121 that, "The ultimate liability exposure to PGE could be large enough to drain PGE's financial capacity." (Staff/200, Morgan/9, lines 18-19, COP/111.) While Enron has offered indemnification for two specific issues, federal taxes and employee benefits, as described in Article III of the Separation Agreement, it has offered no cash funded reserve to cover the full range of potential liability exposures (and, as stated above, there are no guarantees that its indemnity on federal taxes and pension will be cash funded). The Stipulation merely offers a temporary increase in equity by a delay of paying dividends of $40 million in Condition 5(c), which amounts could disappear when PGE concludes its next rate case. It is important also to note that this is not a $40 million cash reserve to fund Enron's related liabilities that ultimately will flow to ratepayers, but merely reflects a potential timing delay on paying dividends. A funded cash reserve on the order of $100 million or more may be necessary to properly protect the ratepayers from Enron related liabilities. The actual level of exposure should be determined or estimated by PGE.

Q. What are your concerns with some of the other Stipulation conditions?

A. I believe that several of the conditions are of little value in protecting PGE ratepayers:

- Condition 8 allows that PGE will provide the Commission with "written notice" of dividend declarations "at the same time that PGE discloses this information to the public." In my view this is a nearly meaningless condition. This benefit is inconsequential, as stock exchange regulations will require PGE to provide standard public notice of any board approval to issue dividends as a publicly traded company. Giving simultaneous, direct notice to the Commission is of no benefit to ratepayers without some corresponding authority for the Commission to act to protect ratepayer interests. The condition is noticeably silent in this regard.
- Condition 11 only holds PGE to maintaining its existing BBB+ bond rating in order to have free license in dividend and cash distributions. Again, this is a very weak protection for PGE ratepayers. Especially in light of PGE's projected net income for 2007 of $125 million as presented at a May 6, 2005 Banker Meeting that was provided to the City of Portland by Enron early this year (Exhibit COP/112) (which is an increase of 36 percent from PGE's net income of $92 million in 2004), it appears that PGE should be able to increase its equity ratio and its bond rating. Events in California several years ago demonstrate the sometime volatile nature of bond ratings, where instead of a slow and predictable decline in ratings, under certain circumstances a more precipitous decline occurs. Maintenance of PGE's existing bond rating is essentially another meaningless protection, especially from the PGE ratepayer perspective.

Q. What is an appropriate remedy to address your concerns regarding these issues?

A. I believe it is appropriate for the Commission to have authorization over dividend and other cash distributions for the immediate future. Commission approval of proposed dividend payments prior to their being declared by the PGE Board would provide protection and benefit to ratepayers. I believe this is particularly appropriate during the time that the Reserve has substantial influence over the PGE Board. It would provide a protection to ratepayers from potential short-term interests that might arise at PGE during the time that the Reserve still controls 20 percent or more of the new PGE common stock.

Q. What actions should the Commission take to address the concerns with the Application and Stipulation that you have raised?

A. There are a number of remedies I believe the Commission could implement that would address these concerns. Specifically:

- The Commission should clearly state as part of any approval of a PGE stock issuance plan that Enron or new PGE stockholders should continue to provide protection for PGE ratepayers from liabilities arising from Enron ownership of the company; i.e., that Enron-related costs shall not be borne by PGE ratepayers in any future rate proceedings. Having now emerged from bankruptcy, Enron could reconfirm this responsibility or the new stockholders could take this responsibility. This condition would reduce uncertainty and more accurately reflect the potential risks and liabilities associated with the PGE new common stock.
- Additionally, the Commission should order PGE to quantify the potential worst case level of liabilities arising from Enron ownership and then to establish significant cash funded reserves sufficient to cover these liabilities before any additional dividend payments are made. As these

claims mature in the future, the Commission can authorize reductions in the reserve levels, which will protect the legitimate interests of the new PGE stockholders.

- The Commission should order rate credits for PGE customers as a condition of its Application approval. These rate credits would provide compensation to the ratepayers in light of the increased risks to PGE ratepayers that will remain after the stock distribution and will provide a meaningful net benefit to PGE customers.

Q. Why should a rate credit for PGE be part of the new stock issuance plan?

A. For there to be a measurable public benefit from the stock distribution, a significant rate credit is needed. (See testimony Staff/800/Conway/9-14, COP/113.) A small rate credit was part of the TPG acquisition plan and this was rejected by the Commission as lacking sufficient certainty of net public benefit. The other three recent acquisition proposals reviewed by the Commission included significant rate credits. Without a significant rate credit as part of the new stock issuance plan, I do not believe the Commission's net benefit test can be met.

Q. Is there an alternative comparator that the Commission could use to establish a rate credit level?

A. Yes I believe there is. Earlier this year R. W. Beck conducted a number of analyses that supported the reasonable economic feasibility of a 10 percent reduction in rate levels for PGE customers arising from the City's purchase and operation of the PGE system. A summary of these analyses was prepared by City Staff and is included as Exhibit COP/114. In part these analyses support the

viability of rate credits for PGE ratepayers in excess of $100 million. I believe it would be appropriate for the Commission to use the municipal operation of PGE as a valid comparator in this proceeding.

Q. What would be the potential benefits of a rate credit action by the Commission in this proceeding?

A. By granting an immediate rate credit, a clear net benefit of the Commission's approval of the Application would be demonstrated. In addition, this would set a new baseline upon which PGE's future rate reviews could be based. PGE would need to independently demonstrate in its upcoming rate case the merits of rate increases to cover legitimate liabilities and higher costs. The burden of proof related to any rate increase would shift to PGE to show the Commission that future rate increases are necessary. Additionally, the Commission's declaration that no Enron-related costs will be borne by PGE ratepayers in future rate proceedings will assign the liability for these costs to Enron creditors where it rightfully belongs. This liability would be factored into and discounted appropriately in PGE's stock price. This would potentially reduce any possibility of an over-valuation of the stock price that does not address these liabilities. As the liabilities are resolved, the PGE stock price will adjust to reflect this information while at the same time PGE ratepayers will benefit from the protections they were promised in the Enron acquisition of PGE.

Q. How would this remedy address the net benefit issue in this proceeding?

A. As Commission staff has testified in UM 1121, "Immediate rate relief via rate credits would be the most straightforward way of demonstrating net benefits." (Staff/100,Conway/16, lines 9-10, Exhibit COP/102.) In addition, by formalizing

the Commission's position regarding the exclusion of all Enron-related costs from subsequent rate proceedings, the Commission ensures that the PGE ratepayers will be afforded protections consistent with conditions agreed to in the 1997 merger of Enron and PGE. (See Condition 10 of Enron/PGE merger.) Further, since I believe there has not been any indication of meaningful net benefits to PGE ratepayers related to the local control or other factors, PGE should be required to demonstrate net benefits in some other area. A significant rate credit is the one clear condition that would demonstrate net benefit of the new PGE stock issuance and would justify the Commission granting approval of the Application.

Q. Does this conclude your prefiled testimony?

A. Yes.

Record of Testimony
Submitted by
Richard W. Cuthbert

Utility	Proceeding	Subject of Testimony	Before	Client	Date
1. Fairbanks Sewer and Water, Inc.	Docket Nos. U-05-43 and U-05-44	Water and wastewater utility cost of service analysis, rate design, and proposed rates	Regulatory Commission of Alaska	Fairbanks Sewer and Water, Inc.	8/05
2. Georgia Power Company and Savannah Electric and Power Company	Docket No. 19225-U	Notice of Proposed Rulemaking Related to Existing Rules for Conducting Request for Proposals for Supply-Side Power Supply Options	Georgia Public Service Commission	NewSouth Energy LLC	7/05
3. Golden Valley Electric Association	Docket No. U-04-033	Revenue requirement filing under Alaska Simplified Rate Filing (SRF) statutes	Regulatory Commission of Alaska	Golden Valley Electric Association	3/04
4. Sierra Pacific Resources and Nevada Power Company	Docket No. ER03-1328-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Mirant Americas Energy Marketing, L. P.	3/04
5. Aurora Energy, LLC	Docket No. U-02-060	Revenue Requirements and Cost of Service	Regulatory Commission of Alaska	Golden Valley Electric Association	1/03
6. Homer Electric Association, Inc.	Docket Nos. U-03-66 U-00-18	Revenue Requirements and Cost of Service	Regulatory Commission of Alaska	Homer Electric Association, Inc.	8/03
7. Chugach Electric Association, Inc.	Docket No. U-01-108	Appropriate Rate of Return and Equity Ratio for Electric Cooperative	Regulatory Commission of Alaska	Homer Electric Association, Inc.	7/02

Utility	Proceeding	Subject of Testimony	Before	Client	Date
8. Alaska Electric Generation and Transmission Cooperative, Inc.	Docket No. U-00-18	Revenue Requirements and Rate Design Study	Regulatory Commission of Alaska	Alaska Electric Generation and Transmission Cooperative, Inc. and Homer Electric Association, Inc.	4/02
9. Golden Valley Electric Association	Docket No. U-00-93	Revenue Requirements and Cost-of-Service Study	Regulatory Commission of Alaska	Golden Valley Electric Association	8/01
10. Pacific Gas and Electric Company	Docket No. ER99-4323-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Sacramento Municipal Utility District	2/00
11. Southern California Edison Company	Docket Nos. ER97-2355-000 / ER98-1261-000 / EL98-1685-000	Appropriate Rate of Return on Equity (Affidavit)	Federal Energy Regulatory Commission	Sacramento Municipal Utility District	10/99
12. Boston Edison Company	Docket Nos. ER99-978-000 / EL99-31-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Braintree Electric and Reading Municipal Light Departments	4/99
13. Pacific Gas and Electric Company	Docket Nos. ER98-2351-000 / ER97-2358-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Sacramento Municipal Utility District	9/98
14. Anchorage Municipal Light and Power	Docket No. U-96-36	Projected Utility Power Requirements	State of Alaska, Public Utilities Commission	Anchorage Municipal Light and Power	7/98
15. Niagara Mohawk Power Corporation	Docket No. OA96-194-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Sithe/Independent Power Partners, L.P.	7/97
16. Public Service Company of New Mexico	Docket Nos. ER95-1800-000, et al.	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Plains Electric Generation and Transmission Cooperative	9/96

Utility	Proceeding	Subject of Testimony	Before	Client	Date
17. Western Resources, Inc. and Kansas Gas & Electric Company	Docket Nos. ER93-523-000 and ER93-533-000	Rate of Return and Appropriate Capital Structure	Federal Energy Regulatory Commission	Board of Public Utilities, Kansas City, Kansas	7/94
18. Chugach Electric Association, Inc.	Docket No. U-92-10	Appropriate Amortization of Refinancing Gain	State of Alaska, Public Utilities Commission	Alaska Electric Generation and Transmission Cooperative and Homer Electric Association	4/92
19. Anchorage Municipal Light and Power	TA No. 175-121	Rate of Return and Appropriate Capital Structure	State of Alaska, Public Utilities Commission	Anchorage Municipal Light and Power	3/92
20. Homer Electric Association, Inc.	TA No. 126-32	Economic Evaluation of Soldotna Generating Unit	State of Alaska, Public Utilities Commission	Alaska Electric Generation and Transmission Cooperative and Homer Electric Association	4/91
21. Pacific Power and Light Company	Case No. CVF89-020-MDC	Condemnation: Feasibility and Business Severance	U.S. District Court, Eastern District, California	City of Alturas, California	2/89
22. Puget Sound Power and Light Company	Cause No. U-81-41 – Reopening	Phase-in of Generation Plant; Effect of Automatic Adjustment Clause on Rate of Return	Washington Utilities and Transportation Commission	Commission Staff	7/88
23. Chugach Electric Association, Inc.	Docket No. U-87-35	Appropriate Rate of Return, Equity Ratio for REA Cooperative	State of Alaska, Public Utilities Commission	Matanuska Electric Association and Homer Electric Association	12/87
24. Pacific Gas and Electric Company	Case No. 85CV030	Condemnation: Property Valuation and Business Severance	State of California, Superior Court – Trinity County	Hayfork Valley Public Utility District	11/87
25. Chugach Electric Association, Inc.	Docket No. U-86-29	Appropriate Rate of Return for an REA Cooperative	State of Alaska Public Utilities Commission	Matanuska Electric Association and Homer Electric Association	10/86

Utility	Proceeding	Subject of Testimony	Before	Client	Date
26. El Paso Electric Company	Docket No. ER86-368	Rate of Return and Capital Structure	Federal Energy Regulatory Commission	Imperial Irrigation District	8/86
27. Anchorage Municipal Light and Power	Docket No. U-86-20	Rate of Return and Capital Structure	State of Alaska Public Utilities Commission	Anchorage Municipal Light and Power	8/86
28. New Orleans Public Service Inc.	Docket No. CD-85-1	Rate of Return and Capital Structure	New Orleans City Council	City of New Orleans	2/86
29. Puget Sound Power and Light Co.	Cause No. U-85-53	Financial Impacts of Plant Phase-In	Washington Utilities and Transportation Commission	Commission Staff	1/86
30. Enstar Natural Gas Co.	Docket No. U-84-59	Rate of Return	State of Alaska Public Utilities Commission	U.S. Department of Defense	10/85
31. Jamaica Water Supply Company	Case No. 29071	Rate of Return and Price Elasticity	State of New York Public Utilities Commission	City of New York	9/85
32. Utah Power and Light Company	Docket Nos. ER84-571/572	Financial Analysis of Wholesale Rates	Federal Energy Regulatory Commission	Colorado River Energy Distributors Association	4/85
33. Jamaica Water Supply Company	Case No. 28828	Rate of Return	State of New York Public Service Commission	City of New York	10/84
34. Jamaica Water Supply Company	Case No. 28563	Rate of Return	State of New York Public Service Commission	City of New York	10/83

Q. WHAT IS THE STAFF'S ROLE IN THIS DOCKET?

A. Staff's role in this docket is to review OEUC's application to determine if it meets the requirements of ORS 757.511. This statute requires the applicant to "bear the burden of showing that granting the application is in the public interest."

Q. WHAT DOES IT MEAN FOR THE APPLICATION TO BE IN THE PUBLIC INTEREST?

A. This Commission addressed the legal interpretation of the meaning of "will serve the public utility's customers in the public interest" in Order Number 01-778.[1] The key issue the Commission addressed is whether this language means the transaction must hold customers harmless or result in net benefits. The Commission interpreted the meaning of "will serve the public utility's customers in the public interest" directive to require a two-step assessment of whether the Proposed Transaction will (1) provide a net benefit to the utility's customers, and (2) impose "no harm" to the public at large.

Q. HOW WAS THE ISSUE OF NET BENEFITS ADDRESSED IN PRIOR ACQUISITIONS?

A. Prior to Order Number 01-778, the Commission did not need to address the issue in the last three acquisition dockets. In the Enron acquisition of PGE, the ScottishPower acquisition of PacifiCorp, and the Sierra Pacific acquisition of PGE the issue of defining what is "in the public interest" was

Davis/Page 9 of 26, footnote 2.) It appears that OEUC's intention is that this mechanism would shift risks due to hydro variability to customers.

Q. DOES STAFF BELIEVE THIS IS A FRUITFUL APPROACH TO DEMONSTRATING NET BENEFITS TO CUSTOMERS?

A. No. This approach is fraught with complications and uncertainty. Staff encourages OEUC to look for other methods of providing rate commitments to PGE customers besides "sharing excesses."

Q. WHAT DO YOU RECOMMEND?

A. Immediate rate relief via rate credits would be the most straightforward way of demonstrating net benefits.

Q. PLEASE EXPLAIN YOUR USE OF THE TERM "NET BENEFITS."

A. Any merger or acquisition is likely to produce a combination of results that are positive (benefits) and negative (risks and/or costs) for customers. Staff must be sure that the positive results outweigh the negative results so that, overall, the merger or acquisition produces net benefits for customers (i.e., the benefits outweigh the risks and costs). (*See* Order 01-778.)

Q. ARE RATE CREDITS A REQUIREMENT FOR APPROVAL?

A. No. However, I believe it is exceedingly difficult to demonstrate sufficient benefits to offset the risks of the transaction without meaningful rate credits.

Q. WHAT DO YOU MEAN BY RISKS?

Mr. Finklea, I'll turn it to you first.

MR. FINKLEA: In light of the discussion that I had on the record with Mr. Conway, I have no cross of this witness.

ALJ LOGAN: Thank you.

Mr. Morgan, on behalf of Enron.

MR. MORGAN: Thank you.

CROSS-EXAMINATION

BY MR. MIKE MORGAN:

Q Mr. Morgan, since you and I have the same name we'll have to ask the court reporter to be somewhat careful about which Mr. Morgan is asking and answering.

I will address you as "Mr. Morgan." You may address me as "Mike," if you would like, in order to just make the distinctions clear.

A I will do that.

Q Would you please turn to your exhibit, Staff 900, page 24.

Do you have that in front of you?

A Yes, sir.

Q You're addressing generally what you refer to at line 16 as an estimate of PGE's increased debt expense related to Enron. Is that a fair characterization?

A That's correct.

Q And you use the -- you reference at line 17, five to seven million dollars. Do you see that?

A Correct.

Q Is it accurate to say that PGE's rates do not currently include any of that five to seven million dollars or any number that relates to your testimony here?

A I think that's -- that's correct.

Q And would it be accurate to say that in order for PGE's customers to bear any of the costs, if any, that you're discussing here, the Commission would have to allow those costs into PGE's rates in a formal proceeding?

A That's correct.

Q Is it also accurate to say that you have -- you are not able to say when PGE might file its next general rate case?

A That's correct.

Q And also fair to say that you don't know what will happen to PGE's financing between now and the next general rate case?

A That's correct.

Q And also fair to say that you don't know what amount of these costs, if any, PGE might request in rates?

A That's correct.

Q And also fair to say that you have no idea what decision the Commission would make if they requested these

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

FORM 10-K

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2004
OR
[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition period from _____ to _____

Commission File Number 1-5532-99

PORTLAND GENERAL ELECTRIC COMPANY

(Exact name of registrant as specified in its charter)

Oregon	**93-0256820**
(State or other jurisdiction of incorporation or organization)	(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**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
None	

Securities registered pursuant to Section 12(g) of the Act:

Title of each class
Portland General Electric Company 7.75% Series, Cumulative Preferred Stock, no par value

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 _X_ No ___.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $0.

Number of shares of Common Stock outstanding as of February 28, 2005: 42,758,877 shares of common stock, $3.75 par value. (All shares are owned by Enron Corp.)

Note 13 - Related Party Transactions

The tables below detail the Company's related party balances and transactions (in millions):

	December 31, 2004	December 31, 2003
Receivables from affiliated companies		
Enron Corp and other Enron Subsidiaries in Bankruptcy:		
Merger Receivable	$ -	$ 73
Allowance for Uncollectible - Merger Receivable	-	(73)
Accounts Receivable[a]	-	3
Other Allowance for Uncollectible Accounts[a]	-	(3)
Other Enron Subsidiaries:		
Portland General Holdings, Inc. - in Bankruptcy		
Accounts Receivable[a]	5	5
Other Allowance for Uncollectible Accounts [a]	(1)	(2)
PGH II and its subsidiaries - not in Bankruptcy		
Accounts Receivable[a]	1	2
Other Allowance for Uncollectible Accounts[a]	(1)	-
Note Receivable[a]	-	1
Payables to affiliated companies		
Enron Corp:		
Accounts Payable[b]	4	6
Income Taxes Payable[c]	21	36

[a] Included in Accounts and notes receivable on the Consolidated Balance Sheets
[b] Included in Accounts payable and other accruals on the Consolidated Balance Sheets
[c] Included in Accrued taxes on the Consolidated Balance Sheets

For the Years Ended December 31	2004	2003	2002
Revenues from affiliated companies			
Other Enron subsidiaries:			
Sales of electricity and transmission[a]	$ -	$ -	$ 1
Expenses billed to affiliated companies			
Portland General Holdings, Inc. - in Bankruptcy:			
Intercompany services[b]	-	-	1
PGH II and its subsidiaries - not in Bankruptcy:			
Intercompany services[b]	1	1	1
Expenses billed from affiliated companies			
Enron Corp:			
Intercompany services[b]	28	34	32
Interest, net from affiliated companies			
Enron Corp:			
Interest income (expense)[c]	-	(8)	7
PGH II and its subsidiaries:			
Interest income[c]	-	-	3

[a] Included in Operating Revenues on the Consolidated Statements of Income
[b] Included in Administrative and other on the Consolidated Statements of Income
[c] Included in Other Income (Deductions) on the Consolidated Statements of Income

Distributions to Enron - On October 15, 2002, PGE submitted proofs of claim to the Bankruptcy Court for amounts representing intercompany obligations between PGE and Enron and its bankrupt subsidiaries arising prior to the commencement of the bankruptcy case. In December 2004, PGE made a distribution of all pre-petition amounts owed by Enron and its affiliates, and related proofs of claim, except for those related to Portland General Holdings, Inc. The distribution was made in an effort to eliminate these pre-petition intercompany balances from PGE's books in order to remove the uncertainties regarding the value of the proofs of claim. The specific types of claims distributed (and their related amounts) are discussed below.

Merger Receivable - In 1997, Enron acquired PGE through a merger between Enron and PGC, the former parent corporation of PGE. Under terms of the 1997 merger agreement, Enron and PGE agreed to provide $105 million of benefits to PGE's customers through price reductions payable over an eight-year period. Although the remaining liability to customers was reduced to zero under terms of a 2000 settlement agreement related to PGE's recovery of its investment in Trojan, Enron remained obligated to PGE for the approximate $80 million remaining balance and continued to make monthly payments, as provided under the merger agreement.

Enron suspended its monthly payments to PGE in September 2001, pursuant to its Stock Purchase Agreement with NW Natural, under which NW Natural was to have assumed Enron's merger payment obligation upon its purchase of PGE. The Stock Purchase Agreement was terminated in May 2002. At the time of Enron's bankruptcy filing on December 2, 2001, Enron owed PGE approximately $73 million (including accrued interest) for the Merger Receivable. Due to the uncertainty of the realization of the Merger Receivable, PGE established a reserve for the full amount of this receivable in December 2001. PGE accrued interest on the Merger Receivable and recorded an offsetting reserve from the December 2001 Enron bankruptcy filing until December 2003. Both the interest and the related reserve accrued in Enron's post-petition bankruptcy period were reversed in December 2003 to reflect PGE's proofs of claim filing. In December 2004, in conjunction with the distribution of pre-petition amounts to Enron (as discussed above), PGE reversed the $73 million Merger Receivable and related reserve. For further information, see Note 15, Enron Bankruptcy.

Income Taxes Receivable and Payable - As a member of Enron's consolidated income tax return, PGE made income tax payments to Enron for PGE's income tax liabilities. PGE and its subsidiaries ceased to be a member of Enron's consolidated tax group on May 7, 2001. On December 24, 2002, PGE and its subsidiaries again became a member of Enron's consolidated tax group. The $21 million income taxes payable to Enron at December 31, 2004 represents a net current income taxes payable for the fourth quarter of 2004 that were paid to Enron in January 2005. During 2004, PGE paid $83 million to Enron for income taxes payable, of which $21 million was for the period from December 24, 2002 to December 31, 2003. Income tax payments for those periods were withheld until PGE's December 24, 2002 reconsolidation with Enron was agreed to by the IRS on February 2, 2004. The remaining $62 million tax payment to Enron represented $55 million for the first nine months of 2004 and $7 million net taxes payable (net of receivables) for the period up to May 7, 2001 (pre-petition) which was part of the December 2004 distribution of pre-petition amounts discussed above. The $36 million income taxes payable to Enron at December 31, 2003 represented $29 million related to income taxes owed for the period December 24, 2002 through December 31, 2003 and $7 million for income taxes owed up to May 7, 2001 (pre-petition liability included as an offset in PGE's proofs of claim filing). For further information, see Note 15, Enron Bankruptcy.

Intercompany Receivables and Payable - As part of its continuing operations, PGE bills affiliates for various services provided by the Company. These include services provided by PGE employees, as well as other corporate services. In addition, Enron passes through PGE's share of costs related to

employee benefits and certain insurance coverage. Transactions with affiliates are subject either to approval of, or confirmation filing requirements with, the OPUC and, as long as PGE is a subsidiary of a registered holding company under PUHCA, the SEC. Under OPUC regulations, services provided to affiliates by PGE are charged at the higher of cost or market, while affiliated services received by PGE are charged at the lower of cost or market. Under SEC regulations, both services provided to, and received from, affiliates are charged at cost. Services will be provided at cost unless there is a conflict between OPUC and SEC regulations, in which case PGE and Enron have agreed not to provide the services until the matter can be resolved.

Enron - In 2004, Enron passed through to PGE approximately $25 million for medical/dental benefits and retirement savings plan matching and $3 million for insurance coverage. Beginning in 2004, Enron no longer bills PGE for corporate overhead costs. In 2003, Enron passed through to PGE approximately $20 million for medical/dental benefits and retirement savings plan matching, $1 million for insurance coverage, and billed $13 million for corporate overhead costs. In 2002, Enron passed through to PGE approximately $19 million for retirement savings plan matching and medical/dental benefits and billed $13 million for corporate overhead costs. Effective January 1, 2005, administration of the medical/dental benefit and retirement savings plans was returned to PGE from Enron; as a result, Enron no longer bills PGE for these services.

Intercompany payables to Enron were paid by PGE until Enron filed for bankruptcy in early December 2001, except for payments for employee benefit plans. In reaching an agreement with Enron regarding the allocation of corporate overheads in the post-bankruptcy period, PGE resumed payments for corporate overhead costs from March 2003 through December 2003. During 2004, PGE paid $30 million to Enron, consisting of $23 million for employee benefits, $3 million for insurance premiums, and $4 million for pre-petition period corporate overheads and restricted stock costs. The payment of the pre-petition period amounts was part of PGE's December 2004 distribution of pre-petition amounts to Enron. At December 31, 2004, PGE had $4 million payable to Enron for employee benefits. During 2003, PGE paid $47 million to Enron, consisting of $27 million for corporate overhead costs and $20 million for employee benefits. The $6 million payable to Enron at December 31, 2003 consisted of $4 million for corporate overheads and $2 million for employee benefits.

In December 2004, in conjunction with the distribution of pre-petition amounts discussed above, PGE reversed the $1 million account receivable from Enron and the related reserve for pre-petition employee benefits. At December 31, 2004, PGE has no remaining pre-petition intercompany balances with Enron.

Other Enron Subsidiaries in Bankruptcy - PGE purchased electricity from, and sold electricity to, Enron Power Marketing, Inc. (EPMI) during 2001. PGE also provided transmission services to EPMI under a transmission contract that was guaranteed by Enron. PGE has not purchased electricity from, or sold electricity to, EPMI since December 2001, and EPMI has not paid for transmission services since September 2002.

PGE was owed a net $2 million by EPMI for power sales and transmission services of $1 million in 2001 and 2002. EPMI is part of Enron's bankruptcy proceedings. Due to uncertainties associated with the realization of this receivable from EPMI, a $2 million reserve was established. PGE included amounts owed by EPMI for power sales and transmission services in the proofs of claim filed with the Bankruptcy Court.

In April 2003, PGE entered into a settlement agreement with EPMI and Enron to terminate the transmission contract. The settlement agreement was approved by the Bankruptcy Court and accepted

by the FERC. Under the settlement, PGE retained a $200,000 deposit from EPMI related to the transmission contract and Enron's guaranty was terminated. PGE amended its proofs of claim in the Enron bankruptcy to include a pre-petition unsecured claim against EPMI and a pre-petition guaranty claim against Enron for $1 million owed PGE for transmission services. In December 2004, as part of the distribution of pre-petition amounts discussed above, PGE reversed the $2 million account receivable from EPMI and the related reserve. As of December 31, 2004, PGE has no remaining account receivable or payable balances with EPMI. For further information, see Note 15, Enron Bankruptcy.

Portland General Holdings, Inc. - in Bankruptcy - On June 27, 2003, PGH, a wholly owned subsidiary of Enron located in Portland, filed to initiate bankruptcy proceedings under the federal Bankruptcy Code. The PGH filing has been procedurally consolidated with the Enron bankruptcy proceeding. No PGH subsidiaries are included in the bankruptcy filing. At December 31, 2004 and 2003, PGE had outstanding accounts receivable from PGH of $5 million, comprised of $4 million related to employee benefit plans and $1 million for employee and other corporate governance services provided by PGE to PGH in 2002. During 2003, PGE submitted proofs of claim to the Bankruptcy Court for approximately $5 million for employee benefit and corporate governance services. Based on management's assessment of the realizability of the receivable from PGH, a reserve of $2 million was established in December 2002. In June 2004, PGE reduced the reserve by $1 million based on management's current assessment. PGE will continue to assess the collectibility of this receivable.

In 1999, PGE transferred $21 million of corporate owned life insurance policies to PGH, creating a receivable balance owed by PGH to PGE. PGH transferred these policies to a trust to pay certain non-qualified benefit plan obligations owed by PGH, leaving with PGH the receivable balance due PGE. Later in 1999, PGH recorded a capital transaction with its wholly owned subsidiary PGH II, Inc. (PGH II), reflecting an assumption by PGH II of the obligation to pay the $21 million owed to PGE. PGH retained the residual interest in the trust owned life insurance policies. The transfer to PGH II was the result of negotiations between Enron and Sierra Pacific Resources related to the proposed sale of PGE and PGH II to Sierra (the sale of which was later terminated in April 2001). In the proposed sale of PGE and PGH II to NW Natural, the obligation to pay the intercompany payable to PGE would have been assumed by NW Natural. In June 2002, due to the termination of the sale agreement with NW Natural, the PGE intercompany payable was transferred back to PGH. Due to the effects of both the termination of the sale agreement with NW Natural and the complexities of the Enron bankruptcy on the period of time required to collect this receivable balance from PGH, PGE's board of directors on July 25, 2002 approved the transfer of the intercompany receivable at PGE to Enron in the form of a non-cash dividend. In July 2002, the balance due PGE from PGH of $27 million, including accrued interest, was transferred to Enron as a non-cash dividend.

PGH II and its Subsidiaries - not in Bankruptcy - PGH II, a wholly owned subsidiary of PGH, is the parent company of various subsidiaries that receive services from PGE. PGH II and its subsidiaries are not part of Enron's or PGH's bankruptcy proceedings. PGH II subsidiaries include Portland General Distribution, LLC (PGDC), a telecommunications company, Microclimates, Inc., a project management company, and Portland Energy Solutions Company, LLC (PES), which provided cooling services to buildings in downtown Portland, Oregon.

During 2004, 2003 and 2002, PGE billed PGH II and its subsidiaries $1 million annually, for employee and other corporate governance services. As of December 31, 2004, PGE had outstanding accounts receivable from PGDC of $1 million for employee and other corporate governance services, offset by an approximate $0.9 million uncollectible reserve. At December 31, 2003, PGE had outstanding accounts and notes receivable from PGH II and its subsidiaries of $3 million, comprised

of $2 million for employee and other corporate governance services ($1 million each owed by PGDC and PES) and a $1 million secured loan to PES.

PGE and PES had entered into a revolving credit agreement under which PGE had agreed to advance funds to PES to complete a district cooling system project. Advances accrued interest at 16% per annum. Interest paid by PES to PGE in excess of PGE's authorized cost of capital (9.083%) was deferred for future refund to PGE's customers. In April 2004, PES sold substantially all of its assets to an unrelated third party. The proceeds from the sale were used to repay all amounts PES owed to PGE, including trade payables and amounts due under the loan.

In September 2004, PGDC sold substantially all of its assets to an unrelated third party. The proceeds from the sale are expected to repay the unreserved amounts that PGDC owes to PGE.

On November 8, 2004, PGH II sold all of the common stock of Microclimates, Inc. to an unrelated third party. Prior to the sale, PGE received payment for all amounts owed by Microclimates

Other Subsidiaries - PGE also provides services to its consolidated subsidiaries, including funding under a cash management agreement and the sublease of office space in the Company's headquarter complex. Intercompany balances and transactions have been eliminated in consolidation.

PGE maintains no compensating balances and provides no guarantees for related parties.

Interest Income and Expense - Interest on the Enron Merger Receivable balance and the related reserve accrued in Enron's post-petition bankruptcy period were reversed in December 2003, as previously discussed. Accounts receivable balances from PGH II and its subsidiaries accrue interest at 9.5%. Receivable balances from PGH also accrued interest at 9.5% until PGH filed bankruptcy and the interest accrual was discontinued. Prior to 2001, interest was accrued at 9.5% on other outstanding receivable and payable balances with Enron and its other subsidiaries.

Note 14 - Receivables and Refunds on Wholesale Market Transactions

Receivables - California Wholesale Market

As of December 31, 2004, PGE has net accounts receivable balances totaling approximately $63 million from the California Independent System Operator (ISO) and the California Power Exchange (PX) for wholesale electricity sales made from November 2000 through February 2001. The Company estimates that the majority of this amount was for sales by the ISO and PX to Southern California Edison Company and Pacific Gas & Electric Company (PG&E).

In March 2001, the PX filed for bankruptcy and in April 2001, PG&E filed a voluntary petition for relief under the provisions of Chapter 11 of the federal Bankruptcy Code. PGE filed a proof of claim in each of the proceedings for all past due amounts. Although both entities have emerged from their bankruptcy proceedings as reorganized debtors, not all claims filed in the proceedings, including those filed by PGE, have been resolved. PGE is continuing to pursue collection of these claims.

Management continues to assess PGE's exposure relative to these receivables. Based upon FERC orders regarding the methodology to be used to calculate refunds and the FERC's indication that potential refunds related to California wholesale sales (see "Refunds on Wholesale Transactions" below) can be offset with accounts receivable related to such sales, PGE has established reserves totaling $40 million related to this receivable amount. The Company is examining numerous options, including legal, regulatory, and other means, to pursue collection of any amounts ultimately not received through the bankruptcy process.

Refunds on Wholesale Transactions

California

On July 25, 2001, the FERC issued an order establishing the scope of and methodology for calculating refunds for federally-mandated wholesale sales transactions made between October 2, 2000 and June 20, 2001 in the spot markets operated by the ISO and PX. The order established evidentiary hearings to develop a factual record to provide the basis for the refund calculation. Several additional orders clarifying and further defining the methodology have since been issued by the FERC. Appeals of the FERC orders were filed and in August 2002 the U.S. Ninth Circuit Court of Appeals issued an order requiring the FERC to reopen the record to allow the parties to present additional evidence of market manipulation.

Also in August 2002, the FERC Staff issued a report that included a recommendation that natural gas prices used in the methodology to calculate potential refunds be reduced significantly, which could result in a material increase in PGE's potential refund obligation.

In December 2002, a FERC administrative law judge issued a certification of facts to the FERC regarding the refunds, based on the methodology established in the 2001 FERC order rather than the August 2002 FERC Staff recommendation. On March 26, 2003, the FERC issued an order in the California refund case (Docket No. EL00-95) adopting in large part the certification of facts of the FERC administrative law judge but adopting the August 2002 FERC Staff recommendation on the methodology for the pricing of natural gas in calculating the amount of potential refunds. PGE estimates its potential liability under the modified methodology at between $40 million and $50 million, of which $40 million has been established as a reserve, as discussed above.

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The Oregonian

Sten demands PGE rate cut

Among the major parties, the Portland commissioner stands almost alone in opposing Enron's transfer plan

Monday, September 12, 2005

GAIL KINSEY HILL
The Oregonian

Portland City Commissioner Erik Sten has a beef with bankrupt Enron's latest plan to divest itself of Portland General Electric: Where's the rate cut?

It's a familiar complaint. Sten called for rate relief for PGE's 765,000 customers in his attack on a buyout bid from investment firm Texas Pacific Group, then in his defense of a city-led acquisition. Both deals collapsed.

Now, Sten is taking aim at Enron's fallback plan, which would transfer ownership of PGE to Enron creditors through a distribution of utility stock. The city will submit its formal opposition to the plan to state regulators on Friday.

Regulators, Sten says, "ought to demand a rate cut. That's all there is to it."

To his dismay, they are not -- not yet, anyway. The Portland Utility Commission staff, Enron and influential ratepayer groups once allied with Sten have agreed on a stock spinoff plan that includes various negotiated requirements but no upfront rate reductions.

The move has split Sten from his one-time allies and made his cry for rate cuts a long shot. The last time around, when regulators were trying to decide whether to approve Texas Pacific's $2.35 billion bid for PGE, the city of Portland and ratepayer groups marched in a united block of opposition. This time, Sten is leading a parade with few followers.

The three-member PUC will decide whether to approve the stock plan in the next few months. But the PUC staff and ratepayer groups concur that the plan, along with 17 conditions in the recent agreement, adequately protects the utility and its customers from financial harm and helps ensure a smooth transition to a publicly traded company. Under the plan, PGE shares would be listed on a major stock exchange and publicly traded.

"In our judgment, there's just no credible argument for rate credits," says Bob Jenks, executive director of the Citizens' Utility Board, which represents residential ratepayers. "It makes a good sound bite, but does it make a good case, on the record, to the commission?"

At the heart of the debate is a "net benefits" standard that the PUC must apply in reviewing changes in utility ownership. Commissioners cannot OK an acquisition proposal unless they conclude that utility customers come out ahead.

For Sten, the standard provides clear-cut direction. "The PUC shouldn't approve anything without a rate cut," he says, "because that's how you compensate for risk."

Portland's testimony to the PUC, due Friday, will probably outline conditions that the city thinks would make the Enron plan acceptable, and a rate cut is certain to be on the list, Sten says.

Amount of cut undecided

The city hasn't yet settled on a rate-reduction amount. But it could be around 10 percent, Sten says, a reduction that mirrors the cut the city said it could have offered if a municipal purchase had succeeded.

"That's the kind of number we're looking for -- something that matters to people," Sten says.

Enron ended acquisition discussions with the city on July 20, citing an impasse in negotiations.

Consumer groups concede that rate cuts are a common condition in traditional acquisition settlements. But, Jenks says, the stock plan

is a "completely different kind of animal."

No outside buyer, such as Texas Pacific, is piling on debt or presenting risks that might warrant an offsetting rate credit, he said. Instead, Enron would issue 62.5 million shares of PGE stock and hand out the shares to creditors, as outlined in the restructuring plan approved by the U.S. Bankruptcy Court.

The process could take years to complete. And, at any point, Enron could entertain buyout offers. The scenario presents its own brand of risk, Jenks acknowledges. But he sees far greater uncertainty if the PUC rejects the plan.

Then, Jenks suggests, Enron could hold PGE up as buyout bait, hoping that a new federal energy act, which eases restrictions on utility acquisitions, would quickly draw lucrative offers.

Or, the company could try to ignore the state's regulatory authority and proceed with the stock spinoff, citing the federal Bankruptcy Court's approval of the stock plan. If it succeeded, the chance to impose conditions would be lost.

"This is an unusual case," Jenks says, "because the risks of saying no are greater than saying yes."

Sten calls Jenks' logic "tortured." To say the stock plan provides a benefit to customers because there's greater theoretical risk in rejection is "like someone coming up to you in the street and saying, 'I'm not going to hit you.' "

Sten agrees, however, that PGE is an attractive takeover target, and he predicts that Enron will announce a buyer before the stock plan is even initiated.

CFO defends plan

This brings up another of Sten's concerns: Creditors are going to make a lot of money off PGE, he predicts, as utility mergers become increasingly popular. That's all the more reason customers should get a rate cut now, he said.

PGE recently sent a $150 million cash dividend to Enron, money that Sten says proves the utility has extra equity it could channel to customers.

PGE's residential customers pay more than 8 cents a kilowatt hour for electricity and related costs each month -- among the highest rates in the Northwest.

Jim Piro, PGE's chief financial officer, says the stock plan offers a clear path to more stable conditions. PGE would become an independent, locally headquartered, publicly traded company, he said, just as it was before Enron bought it in 1997.

A suitor could emerge, he says, but that's a fact of life for any publicly traded company. PGE would continue to be regulated by the PUC, Piro says, and any buyout proposals would come before the commission.

Piro objected to Sten's call for rate cuts. "Because of the nature of the transaction," Piro says, "there aren't any rate cuts to discuss."

As for the cash dividend, Piro says, Enron shareholders -- at this point, the creditors -- "want a return on capital." PGE stopped paying dividends in 2001 as Enron descended into bankruptcy, and the payment was overdue, he says.

Several groups sign on

Melinda Davison, an attorney for Industrial Customers of Northwest Utilities, signed on to the stock-plan agreement after it helped craft conditions, including one requiring improved service for large industrial customers.

Another condition requires PGE to set aside $40 million that can be tapped to offset any future rate increases linked to debt resulting from the Enron bankruptcy.

"I see it as similar to a rate credit," Davison says.

In addition to the industrial customers and the Citizens' Utility Board, two organizations representing low-income electricity consumers signed the pact: Community Action Directors of Oregon and Oregon Energy Coordinators Association.

Commissioners aren't allowed to discuss the pros and cons of the proposal while the proceedings are under way. Generally speaking, PUC Chairman Lee Beyer observes, "You can usually assume that if all major groups signed on, there's something there that makes sense."

Beyer says the commission will rule only after weighing all of the evidence and applying the proper legal tests.

"We have an obligation to keep an open mind," he says, "and we will."

although it does not have great value. We agree with ICNU witness Schoenbeck that these types of service quality assurances are activities that a "prudent, well-managed utility would already be providing to its customers." *See* ICNU/100, Schoenbeck/2.

4. Local Focus

Applicants claim that they will restore the local focus of PGE with a commitment to maintain at least five Oregonians on the PGE Board of Directors. An Oregonian will also serve as chair of the Board. Oregon Electric contends that this strong local presence will bring greater sensitivity to local issues, along with providing PGE with a higher degree of accountability to customers.

We find no benefit from this commitment. PGE currently has a local focus. Moreover, a local presence on the board of directors is common in the energy industry, especially here in the Pacific Northwest. As ICNU notes, Northwest Natural Gas Company, Avista Corporation, Puget Sound Energy, and PacifiCorp all have strong local representation on their board of directors. *See* ICNU/100, Schoenbeck/5.

5. TPG Assistance

TPG claims that its role in the ownership of PGE will benefit customers, due to its experience and expertise in helping companies through periods of transition. TPG claims it will be able to assist and guide the PGE Board regarding long-term strategy, capital investment decisions, and operational issues.

We are not persuaded by TPG's assertion for two reasons. First, TPG has no experience in the utility industry. Second, its argument presumes that this assistance cannot be obtained elsewhere. As stated by witnesses Antonuk and Vickroy, "These 'benefits' really do little more than restate what are fundamental, baseline obligations of utilities." *See* ICNU/200, Antonuk-Vickroy/12.

6. Commitment to Low-Income Customers

Oregon Electric will extend for 10 years PGE's in-kind donations to Oregon HEAT, along with increasing its shareholders' annual cash donation from $50,000 to $100,000. Additionally, Oregon Electric agrees to participate in a group led by PGE to work on additional programs for low-income customers.

This is a tangible benefit to customers of this transaction. However, the benefit is limited to a particular group of customers, and is an extremely small amount, approximately .01 percent, of PGE's retail revenue. *See* ICNU/100, Schoenbeck/12.

7. End of Enron Ownership.

Applicants contend that this transaction will immediately end Enron ownership, resulting in stable and known ownership by Oregon Electric. According to Applicants, this certainty will benefit PGE as it can focus on providing excellent service rather than facing ongoing distractions caused by continued Enron ownership.

The end of Enron's ownership will occur without this transaction. The question is whether the *immediate* end of Enron's ownership is a customer benefit. PGE is not a distressed company, either financially or operationally. The utility has continued normal operations throughout the bankruptcy, and has continued to maintain and invest in its system. Because of the current stability of PGE, and the certainty of an eventual end of Enron ownership, we do not find the benefit asserted by Applicants.

V. CONCLUSIONS OF LAW

A. Net Benefits

As previously stated, the Commission must review the application, with the amendments and conditions agreed to by Applicants, to determine the harms and benefits of the transaction. If the benefits outweigh the harms, then the net benefit standard has been met and the application must be granted. The Commission has discretion to issue a conditional order approving the acquisition if certain requirements are met. If those hurdles cannot be overcome, then the application must be denied.

To take into account the transitional nature of PGE's ownership, we perform this analysis by comparing the benefits and harms of Applicants' proposal against a backdrop of PGE as a separate and distinct entity. In this analysis, we assume that PGE will function as it is currently, essentially as a stand-alone entity.

As discussed above, there are few benefits to Applicants' proposal. Of the seven benefits advocated by Applicants, three provide no value to PGE's ratepayers. On this record, we cannot conclude that Applicants' commitment to local focus, TPG's expertise, and the end of Enron ownership provide ratepayers any benefit they would not receive if PGE continues to operate as a stand-alone entity. The remaining four claimed benefits provide minimal value. At first glance, the $43 million rate credit and the indemnifications appear significant. Our examination above, however, casts doubt on whether these provisions would provide any value to ratepayers. Similarly, the extension of the SQM agreement and commitment to assist low-income customers provides little value to customers they would not have received without this transaction.

We identified several sources of harm in this application. The primary source stems from Applicants' proposal to finance the purchase of PGE with an excessive amount of debt. As discussed above, the high debt percentage in the consolidated capital

COVER STORY

THE NEW DEAL

If you thought the Texas Pacific deal for PGE was bad, get a load of this.

BY NIGEL JAQUISS

It really doesn't make sense.

Six months ago, the Oregon Public Utility Commission rejected the Texas Pacific Group's bid for Portland General Electric, saying, "The potential harms or risks to PGE customers from the deal outweigh the potential benefits."

Two weeks ago, Enron presented the PUC with a new plan to distribute PGE's stock to Enron's creditors. Utility watchers say the commission will almost certainly approve that plan.

Yet by almost any measure, the spinoff of PGE to the bankrupt energy giant's creditors is worse for the utility's 767,000 customers than the Texas Pacific deal.

Politicians and consumer advocates involved in the PGE saga, which began in 1997 when Enron bought the state's largest utility, are puzzled.

"I don't know why we'd give PGE's customers over to Enron yet another time-yet that's what this deal does," says state Sen. Ryan Deckert (D-Beaverton).

Dan Meek, a lawyer with the watchdog group Utility Reform Project, agrees. "This deal is worse in almost every respect than the Texas Pacific proposal," he says.

Most notably, the proposed deal contains not a penny in electricity rate cuts for ratepayers-something even Texas Pacific offered.

The absence of rate cuts violates guidelines that Gov. Ted Kulongoski established earlier this year for a new deal. In March, after the PUC rejected Texas Pacific, the governor-who appoints the commission's three members-said any future owner of PGE must "provide rate relief for PGE customers who have endured unpredictable and increasing energy costs. Any proposal under consideration should include a plan to lower rates."

Enron's proposal does not do that. Nonetheless, the plan enjoys Kulongoski's blessing. Confidential PGE documents obtained by *WW* last week make the situation even more inexplicable. Those documents show that the utility can easily afford rate cuts: PGE is financially stronger now than it has been for a long time and expects a 62 percent profit increase over the next two years.

"It's the height of hypocrisy for PGE to generate a forecast this good and say they can't afford a rate cut," says Portland financial advisor Bill Parish, who reviewed the confidential documents at *WW*'s request.

Rate cuts are not just an idle wish. Oregon law requires that when a regulated utility such as PGE changes ownership, the transaction must provide ratepayers a "net benefit." Usually, that means rate cuts.

When Enron bought PGE in 1997, it promised to cut rates $105 million over eight years. When Scottish Power bought Oregon's second-largest utility, PacifiCorp, in 1999, it cut $51 million over four years. Sierra Pacific, a Nevada utility that tried to buy PGE in 2001-the same year Enron declared bankruptcy-offered a $97 million cut over seven years. Even Texas Pacific offered $43 million in cuts over five years. The City of Portland, whose bid for PGE was rejected by Enron on July 21, promised cuts of more than $100 million *annually*.

The stock-distribution plan does offer a few new items, such as the opportunity for consumer advocates to meet periodically with PGE's board and management and greater access to the open market for industrial users. It also continues service-quality and financial protections that are already in place for customers. But such gestures are of questionable value to the average ratepayer. "This agreement is meaningless," Meek says. "The provisions almost entirely restate the commission's existing authority."

What the plan most certainly does not offer is a rate cut. The average PGE residential customer-who PUC stats show paid the utility $875 in 2004-has gotten abused for years.

Because of the lingering effects of Enron's market manipulations and because it has fewer and more costly generating facilities than other utilities, PGE's rates today are 31 percent higher than those charged by PacifiCorp. PGE's rates are higher than any investor-owned utility operating in Oregon or Washington (see chart at left).

Steep rates hurt homeowners and Oregon businesses. "Competitive electricity prices are important to any manufacturer that competes in a global marketplace," says CEO Mike Siebers of Blue Heron Paper in Oregon City. "There have been several rate comparisons done showing how PGE industrial rates stack up. Theirs are always on the high end."

No one understands PGE's importance better than the governor, who has made strengthening Oregon's economy his top priority. After keeping a low profile during state regulators' consideration of Texas Pacific's bid, Kulongoski moved aggressively this summer to shape PGE's future.

On July 20, he vetoed Senate Bill 671, which would have established a customer-owned entity to buy PGE. Two days later, he vetoed Senate Bill 1008, which Deckert sponsored and which would have allowed the state to buy the utility.

As he eliminated potential competitors to Enron's stock distribution, Kulongoski reiterated his earlier insistence on rate cuts. "I cannot support SB 671 because it violates the basic principles I set forth in March 2005," Kulongoski wrote in a letter to the Senate explaining his veto. "As I said at that time, any plan should provide rate relief."

Yet the governor supports the current stock-distribution plan even though it, too, offers no rate relief. His spokeswoman, Holly Armstrong, says Kulongoski now feels that "a desire to lower rates was just one of [his] guiding principles."

Kulongoski's about-face infuriates former PGE suitors. "It's unbelievable," says Jim Hansen, a Lake Oswego investor who was behind SB 671. "When the governor vetoed our deal, he promised a rate cut. Where is it?"

PGE can certainly afford reduced rates. According to documents filed with the SEC on June 30, for instance, the utility recently paid Enron a $150 million dividend and is still sitting on more than $500 million in retained earnings.

PGE expects its financial picture to grow even sunnier. Confidential PGE records obtained by *WW* show that the utility expects its profit to rise from $77 million in 2005 to $125 million in 2007.

(PGE gave its projections to the PUC on the condition that they be kept confidential. The utility claimed that making financial projections public "could be detrimental to PGE and its customers." The PUC agreed.)

Nonetheless, PGE Chief Financial Officer Jim Piro says customers are not entitled to relief. He argues that Enron's plan to distribute stock to creditors is not a takeover and should be judged differently. "Trying to compare this with other transactions is not fair," Piro says.

Piro is right that this deal is different. But the "net benefit" law makes no distinction between a takeover and a stock distribution. "It's impossible to find a benefit here," Meek says. "And that's what the law calls for."

Enron's stock distribution is less attractive than the Texas Pacific bid in other ways.

The Texans got Enron to agree to shield PGE from the costs of lawsuits stemming from Enron's misdeeds. But the current stock-distribution plan does not protect the Portland utility from many of those potential liabilities. That should concern ratepayers, who are the ultimate source of PGE's cash. They could suffer if the utility pays for damages relating to Enron's market manipulations, abuse of employee benefit plans and other offenses.

PGE's Piro argues the company faces fewer liabilities today and those that exist won't affect customers.

But Phillip Gildan, a Florida utility lawyer who has done work for the City of Portland, disagrees. "The stock-distribution plan offers little protection against Enron-related liabilities and doesn't fund them in any way," Gildan says.

No matter how loudly critics complain, however, PUC commissioners appear ready to accept Enron's terms. The PUC staff, which makes an independent recommendation, has already endorsed the plan.

"It's highly likely the commission will grant approval," says Ann Fisher, a lawyer who represents the Portland Building Owners and Managers Association in front of the PUC. (On BOMA's behalf, Fisher declined to sign on to the stock agreement).

Perhaps more importantly, the state's two biggest customer groups-Industrial Customers of Northwest Utilities, which represents big players such as Intel, and the Citizens' Utility Board of Oregon, which advocates for residential ratepayers-have also endorsed the

stock-distribution plan.

The dynamics are very different from the Texas Pacific case, when ICNU and CUB badgered the Texans for 16 months. Their rabid insistence that Texas Pacific meet the "net benefit" standard helped kill that deal.

There are several reasons the customer groups have mellowed. First, the stock distribution offers ICNU's members increased opportunity to buy power from producers other than PGE, and it gives both groups the opportunity to lobby PGE brass personally. Second, both groups are busy battling investor Warren Buffett's proposal to acquire PacifiCorp, which is currently before the PUC.

But the overwhelming reason both groups signed on to Enron's plan is that they see no other choice. Enron's bankruptcy plan calls for the company to either sell PGE or give it to creditors. After the PUC nixed Texas Pacific, Kulongoski vetoed the two legislative possibilities and Enron rejected the City of Portland's bid, only stock distribution remained as an option. "We had no leverage at all," says Jason Eisdorfer, a lawyer for the CUB. "In a normal utility transaction, you look at the alternative for comparison. In this case, there isn't one."

Eisdorfer might be right that the odyssey that began when Enron put PGE up for sale in 1999 will soon be over.

But one wild card remains. Buried in Oregon law is an obscure statute that allows cities to cut the rates of utilities operating within their jurisdictions.

Specifically, ORS 221.420(2)(c) permits cities to "prescribe by ordinance, or in any other lawful manner, the rates, charges or tolls to be paid to, or that may be collected by, any public utility."

Normally, the PUC sets utility rates, but this law seems to provide an exception. "It means that the City of Portland has statutory authority to set utility rates for PGE customers within the city," Meek claims.

No Oregon municipality has ever tried to lower a utility's rates unilaterally. And even if the Portland City Council were to do so, the statute allows the affected utility to appeal such a rate cut to the PUC.

The PUC then has 90 days to consider the matter. If the PUC agrees with the utility that rates should not be cut, the question is automatically referred to a vote of residents in the affected city. Such a move could complicate the stock distribution. Creditors might have qualms subjecting their investment to the whims of Portland or the other 50 cities PGE serves-and of course, a successful effort to lower rates would lessen the value of PGE stock.

Portland Mayor Tom Potter says the city is aware of the law. On Friday, a city attorney will give the PUC Portland's view of the Enron stock plan, which is unlikely to be favorable. But what comes afterward could be even more interesting. "When Enron broke off negotiations with us, we said we'd do whatever it takes to protect ratepayers in Portland and the region," Potter says. "We're looking at various options, including how to utilize Oregon law."

OUT OF THE FRYING PAN...

The only thing certain if the Public Utility Commission approves Enron's stock distribution plan is more uncertainty.

The plan would transfer ownership of 30 percent of Oregon's largest utility to Enron's creditors next April, with the rest to follow later. The stock is expected to trade on the New York Stock Exchange.

One problem: It is unclear exactly who Enron's creditors are. Neither the PUC nor PGE can identify them. "We do not know who they are," says PGE Chief Financial Officer Jim Piro.

The reason for the mystery is that Enron's IOUs trade freely in the secondary market. Anyone from investor Warren Buffett (who is already in the process of buying PacifiCorp) to the National Bank of Iraq can buy them, thus potentially becoming a part-owner of PGE.

Critics say Texas Pacific, whose identity, track record and goals were known, looks good by comparison with a nameless, faceless ownership.

The balance of the stock not distributed next April-70 percent of the company-will remain in Enron's hands. Enron CEO Stephen Cooper will retain control over this stock for a couple of years, until all bankruptcy claims are resolved. "Cooper will control [the company], and we have absolutely nothing to say about what he does with it," says Ann Fisher, a lawyer for the Portland Building Owners and Managers Association.

Before all the stock even gets distributed, experts say, a new investor is likely to grab a controlling stake in PGE, creating further uncertainty.

That likelihood increased last month, with congressional repeal of the Public Utility Holding Company Act, which strictly limited utility ownership. The PUC will still have authority over utility deals, but now anyone with a checkbook can own an electric company. "With no restrictions on ownership, it seems to me the chances of PGE staying an independent Oregon company are very slim," says Lynn Hargis, a utility lawyer with Public Citizen in Washington, D.C. *-NJ*

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MSNBC.com

Upbeat PGE prepares to go public again

By Wendy Culverwell
The Business Journal of Portland
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As Portland General Electric prepares to spin off from its bankrupt parent, Oregon will soon have a new publicly traded company.

In April, owner Enron Corp. will distribute the first round of PGE shares to its creditors in April. The company's shares will be traded on one of the major stock exchanges, signaling the company's revival as an independent company.

But whether PGE remains independent is anyone's guess.

In passing an energy bill earlier this summer, Congress repealed the Public Utilities Holding Company Act, a 1935 bill that regulates utility holding companies that is regarded by some as one of the most significant federal consumer protection acts ever passed.

By repealing it, Congress opened the way for a wave of utility takeovers. And despite its Enron taint, PGE is a solid, profit-generating entity that could attract a takeover bid.

Utility analysts and PGE watchers say Portland's homegrown electric company, serving 760,000 customers from Portland to Salem, is bound to attract just that sort of attention.

"I think it is likely we will see an applicant to purchase PGE sooner rather than later," said Ivan Gold, an attorney with Perkins Coie who specializes in energy issues. Gold did some work for a Lake Oswego-based group that had advocated that PGE be purchased and turned into a mutually owned entity.

Jeff Hammarlund, an adjunct associate professor at the Hatfield School of Government, teaches graduate courses on Northwest energy policy and has devoted numerous classes to PGE and its future.

He believes outside entities will be attracted, much as Enron was eight years ago.

Whether that's good or bad is debatable.

"That would depend on the quality of the suitor. I've had some concerns all along about ownership outside the region," he said, voicing a preference that the company's stock ultimately be owned by investors with a stake in the region.

In repealing the Public Utilities Holding Company Act, Congress vested more power in the Federal Energy Regulatory Commission to protect consumers, including the power to approve takeovers. It is a new role for the commission.

"We're in new territory here," Hammarlund said.

PGE could be a candidate for acquisition, agreed Paul Latta, director of research for McAdams

Wright Ragen Inc., a Seattle-based brokerage that follows Northwest-based companies.

Latta hasn't followed PGE and its tortured trek as a wholly owned subsidiary of Enron. But the firm will begin tracking it when it is again listed.

He doubts PGE would be targeted for a takeover immediately on being re-listed. More than 120 companies in the country could be takeover targets, so the odds of PGE being among the first to go are low.

To prepare itself for its return to the traded sector, PGE appointed a longtime financial officer, Bill Valach, to lead its investor relations department.

In his new position, which took effect Thursday, Valach is responsible for communicating with investors and analysts about the company and its mission.

He acknowledges there is a potential for a takeover, but characterizes it as remote.

"I wouldn't be interested in this job if we weren't going to be publicly traded," he said.

The energy bill that repealed the Public Utilities Holding Company Act vested new approval authority in both FERC and state-level regulatory agencies such as Oregon's Public Utility Commission. Approval of any future takeover won't come easily, he said.

Even under the old rules, Oregon's process has proven to be a tall hurdle. After a lengthy and contentious review of Texas Pacific Group's deal to buy PGE for $2.35 billion, the Public Utility Commission unanimously said no.

Future buyers would have to prove their proposal offers a "net benefit" to customers -- the test Texas Pacific failed even after offering rate credits and other promises of local control.

In the interim, PGE is working its way through the myriad of tasks leading up to being listed either on the New York Stock Exchange (NYSE) or the National Association of Securities Dealers Exchange (Nasdaq).

First, the company's existing 42 million shares, all owned by the Enron estate, will be canceled. New shares will be issued. One figure mentioned is 62.5 million, but that is fluid.

About 30 percent of the new shares will be distributed to Enron creditors whose claims against the energy trading giant have been settled in bankruptcy.

At that time, the stock will be listed on one of the major stock exchanges, giving the creditors the opportunity to immediately sell their newly issued shares.

PGE is likely to be listed on the New York Stock Exchange, but is also talking to Nasdaq, Valach said. He has identified possible stock symbols, but declined to reveal the candidates. Hint: "PGE" is not in use.

The remaining 70 percent of the new shares that aren't immediately distributed will be placed in a reserved account for eventual distribution to creditors as their claims against Enron are settled. Those shares will be held by Stephen Forbes Cooper LLC, a company headed by acting Enron president Stephen Cooper. The company will have authority to cast votes.

Valach expects that about half of all PGE shares will be distributed by April 2007, and that as many

as 70 percent of the total outstanding shares will be in the hands of creditors by April 2008.

Aside from the mechanics of distributing shares and getting listed on a stock exchange, PGE has to reacquaint Wall Street with its story.

"Our stock hasn't been traded in a long time," he said.

Valach said one of his tasks is to take senior managers on a road show to discuss the company with analysts and investors. The company's story is strong, he said.

Senior managers, including CEO Peggy Fowler, have decades of experience with PGE. It has a stable base of demand, good growth potential, strong financial statements and good relationships with banks and bond rating agencies.

It recently secured a $400 million, five-year unsecured revolving line of credit, which ensures liquidity, and its bond ratings were boosted. This summer, it paid a $150 million dividend to its owner, Enron, for the years 2003 and 2004.

Valach said PGE will be a success if its stock trades at multiples consistent with comparable utilities, or price-to-earning ratios of 14 to 15. He'll look for sufficient trading volume to assure investors they can sell their PGE stock, as well as a good mix of institutional and retail investors and strong analyst coverage.

"I can't think of anything I'd rather do than take this company public again," he said.

URL: http://www.msnbc.msn.com/id/9214287/

ALERT Greenberg Traurig

August 2005

A Brave New World: Congress Repeals the Public Utility Holding Company Act of 1935

"The Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.) is repealed." Rarely does Congress do as much with so few words, and these, set forth in the Energy Policy Act of 2005, bring down the curtain on the 70 year reign of the most radical of the New Deal securities legislation. When the repeal of the Public Utility Holding Company Act of 1935, or PUHCA, becomes effective six months from now, Congress will have unleashed upon public utilities the deregulated market forces that have remade the airline, telecommunications and banking industries. Instead of the comprehensive system of holding company regulation administered under PUHCA, Congress has instead adopted a new Public Utility Holding Company Act of 2005 which has all but dismantled that system, taking the Securities and Exchange Commission ("SEC") out of the utility regulatory business and shifting a more limited regulatory prerogative to the Federal Energy Regulatory Commission ("FERC").

Adopted in the wake of corporate scandals which in their day rivaled those of recent years, PUHCA overhauled an industry that was rife with abuse and fraud. Unlike other major New Deal legislation such as the Securities Act and Securities Exchange Act, which were directed at disclosure, PUHCA authorized the SEC to restructure the gas and electric utility industries by forcing complex multi-state utility companies to dismantle their systems, spin off their subsidiaries and reorganize their capital structures so that they would be limited to a single, geographically integrated utility system that could be more easily regulated by state public utility commissions. Those companies that could not or would not pare themselves down, were required to register under PUHCA and were, as a result, subjected to intrusive regulatory scrutiny by the SEC of almost every significant corporate transaction. Moreover, registered holding companies were limited to business activities directly related to the conduct of their utility operations which discouraged non-utilities from becoming holding companies or acquiring significant interests in more than one utility. In addition, PUHCA forced utility holding companies to become single state holding company systems because so called "intrastate systems" were largely exempted from PUHCA. This exemption, however, required that a holding company and each of its material utility subsidiaries limit their activities to a single state.

> ***"...with the repeal of PUHCA, it appears that the world of public utilities is moving forward to the past, returning to a regulatory environment that should foster merger and consolidation activity that has been suppressed for nearly 70 years."***

In particular, PUHCA prohibited any utility company affiliate (an entity owning 5% or more of the voting securities of a utility or a utility holding company) from becoming an affiliate of another utility unless first obtaining SEC approval. That approval, usually involving a lengthy open ended process, was conditioned upon meeting a strict set of criteria, designed to

advance PUHCA's policy objectives (as they existed in 1935). This so called "two bite rule" acted as a legislative shark repellant, effectively discouraging utility acquisitions by other holding companies or any investor seeking to consolidate the industry. Only those combinations able to meet the prescribed standards of promoting geographically integrated and interconnected utility systems could be approved by the SEC.

Moreover, PUHCA effectively split the energy industry between electric utilities and gas utilities. Utility holding company systems in which both electric and gas utilities were combined were severely limited, if not prohibited, by PUHCA. Along with the intrusive regulation applicable to registered holding companies and the prohibition on registered companies engaging in non-utility businesses, PUHCA has largely shielded public utilities from the consolidation trends that have remade so many of our key industry sectors.

As with other industries that have seen the elimination of artificial checks on market forces, we should expect that PUHCA's repeal will trigger vigorous utility acquisition activity. By eliminating the need for an intrastate exemption, utility entities organized in one state will be able to acquire utilities in another. For the same reason, it will be possible for one utility company to also own utilities in multiple states. Industrial and financial services companies will also be able to acquire utilities in a variety of states without fear of PUHCA regulation and the loss of the ability to conduct non-utility businesses. Private equity firms will be able to participate in the market for utility properties just as they do for almost every other industry.

From the other direction, existing registered utility holding companies will be able to diversify into non-utility businesses, thus allowing them to leverage their substantial cash flows and capital resources to bid for and acquire a variety of non-utility enterprises. In addition, registered holding companies will be able to play more freely in the exempt wholesale generator and foreign utility company markets without the financial limitations imposed by PUHCA.

The bottom line is that electric and gas utilities will be newly vulnerable to acquisition, will have increased pressure to perform financially and will increasingly look to acquisitions as a means to grow and improve financial performance through the synergies derived from consolidation. Moreover, public utilities and their holding companies should draw the attention of national and multinational conglomerates seeking to tap into the steady cash flows and valuable assets offered by utilities. This means that utilities should be reviewing their anti-takeover protections while identifying targets of opportunity (both utility and non-utility).

This is not to suggest that we will see a totally unfettered utility merger market. The new legislation provides FERC with increased regulatory authority over utility mergers, including authority over mergers and acquisitions of generation facilities used for interstate wholesale sales of electricity. FERC can be expected to apply its merger guidelines rigorously to protect consumers from the anticompetitive effects of utility mergers and acquisitions that would permit the exercise of horizontal or vertical market power. In addition, holding companies will be subject to enhanced information reporting to both FERC and state utility regulators to facilitate rate regulation and protection of ratepayers from abusive affiliate company transactions. Of course, state utility commissions will continue to regulate local public utility activity, including mergers and acquisitions.

Despite its enhanced regulatory role, FERC's oversight should not be nearly as intrusive as was the SEC's under PUHCA. The new legislation, which will be implemented through FERC rulemaking, appears to limit the scope of FERC's review to antitrust-related and cross-subsidization issues rather than the wide-ranging review required by the SEC under PUHCA. Moreover, Congress has limited FERC's merger review process to 180 days (absent a showing of good cause) in striking contrast to the open-ended SEC process in which some utility mergers simply died from SEC inaction.

In sum, with the repeal of PUHCA, it appears that the world of public utilities is moving forward to the past, returning to a regulatory environment that should foster merger and consolidation activity that has been suppressed for nearly 70 years.

Greenberg Traurig's Energy and Natural Resources Group brings together integrated, multidisciplinary teams from across the firm's many practice areas to advise energy companies, utilities, project developers, investors, and other energy industry participants in all aspects of their business. Our considerable experience in many segments of the energy industry, coupled with our attorneys' extensive regulatory work, gives us a strong position from which to facilitate energy and natural resources-related business solutions not only in the U.S., but in international energy markets as well.

ALERT Greenberg Traurig

PRACTICE AREAS

- ADA, Accessibility, Building and Life Safety Codes
- Antitrust and Trade Regulation
- Appellate
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- Business Immigration
- Corporate and Securities
- Energy and Natural Resources
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- Real Estate Investment Trusts
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- Reorganization, Bankruptcy and Restructuring
- Retail Industry Group
- Structured Finance and Derivatives
- Tax
- Technology, Media and Telecommunications
- Trusts and Estates

0784-0805-NAT-GTFIRM

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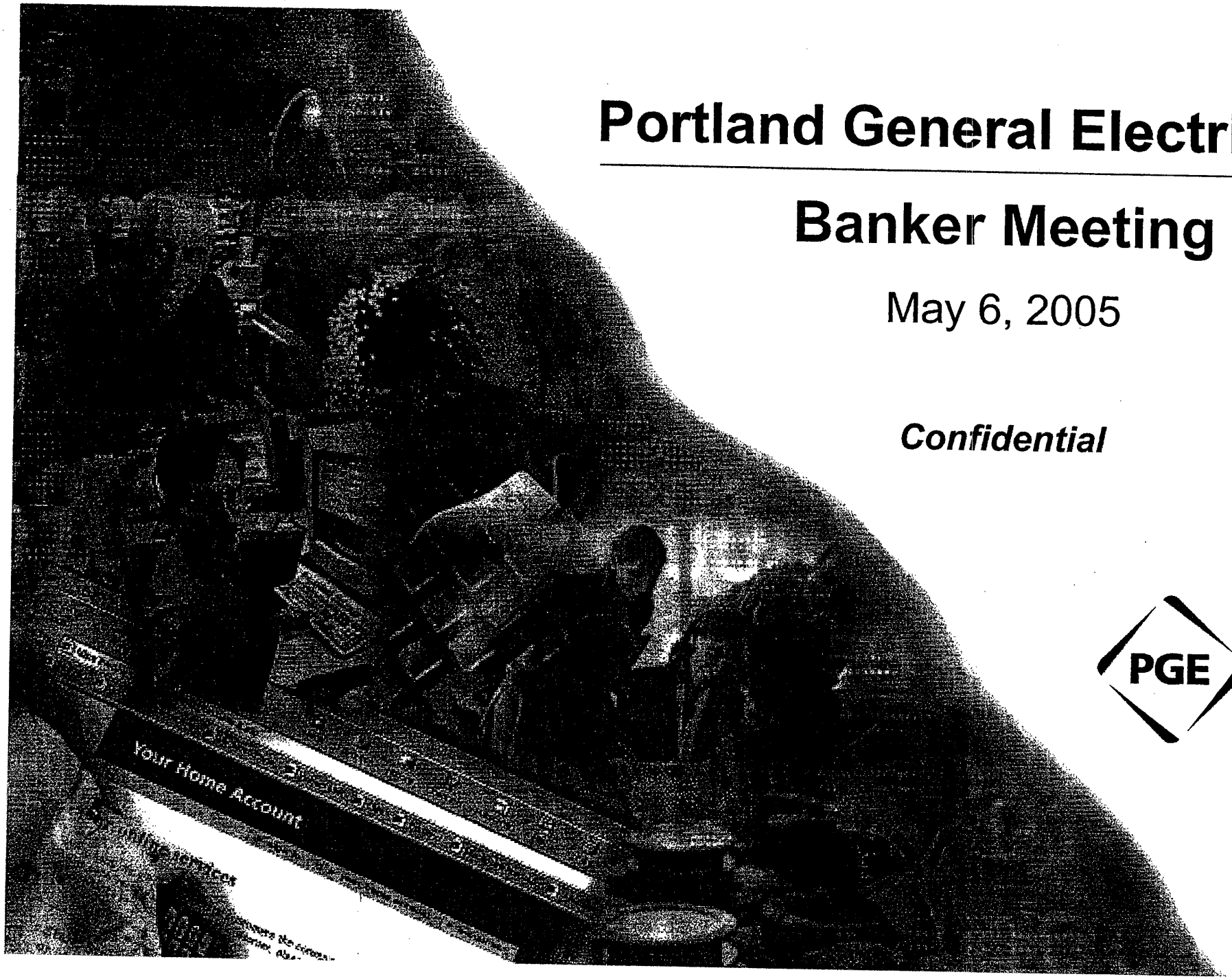


Portland General Electric

Banker Meeting

May 6, 2005

Confidential

PGE

COP/110
Cuthbert/1

2004 - 2007 Cash and Liquidity ($'s in millions)

	Actual	Forecast		
	12/31/2004	12/31/2005	12/31/2006	12/31/2007
Beginning Cash Balance	$109	$204	$5	$5
Net Cash from Operations	340	287	275	291
Net Cash used in Investing	(184)	(314)	(315)	(241)
Net Cash from Financing				
Issuance of Long-Term Debt	0	0	75	100
Repayment of Long-Term Debt	(58)	(28)	(9)	(50)
Increase (Decrease) in Short-Term Debt	0	9	37	(24)
Preferred Stock	(3)	(3)	(3)	(16)
Dividends	0	(150)	(60)	(60)
Total Net Cash from Financing	(61)	(172)	40	(50)
Ending Cash Balance (A)	$204	$5	$5	$5
Total Revolving Credit (B)	$150	$350	$350	$350
Short-Term Debt	0	9	46	22
Collateral : Letters of Credit Provided by PGE (1)	2	23	23	18
Cash Deposits to PGE from Counterparties (2)	14	14	14	14
Total Short-Term Debt, L/C's and Cash Deposits (C)	16	46	83	54
Total Excess Liquidity: A+B-C	$338	$309	$272	$301
Net Income	$92	$77	$99	$125

(1) L/C's provided by PGE on 5/6/05 were comprised of trading floor, $14MM and Port Westward, $9MM. L/C's are held constant for 2005 and 2006 and reduced in 2007 by $5MM for Port Westward.

(2) Cash deposits to PGE held constant at the 2004 level of $14MM.

I:\invest\xlsdata\2005 Finance Plan/2005 Finance Plan Cash Analysis2.xls

PGE

shareholders, none of the exposure that is a result of PGE's involvement with Enron should accrue directly or indirectly to PGE customers.

Conditions that protect PGE's customers from any Enron-related liabilities would provide a clear benefit to PGE's customers. Additionally, a complete description and potential valuation of each liability could be provided by TPG in order to assist Staff in determining the potential impact on PGE.

Q. CAN YOU DESCRIBE THE LIABILITIES ASSOCIATED WITH ENRON'S BANKRUPTCY AND PROVIDE THEIR POTENTIAL MAGNITUDE?

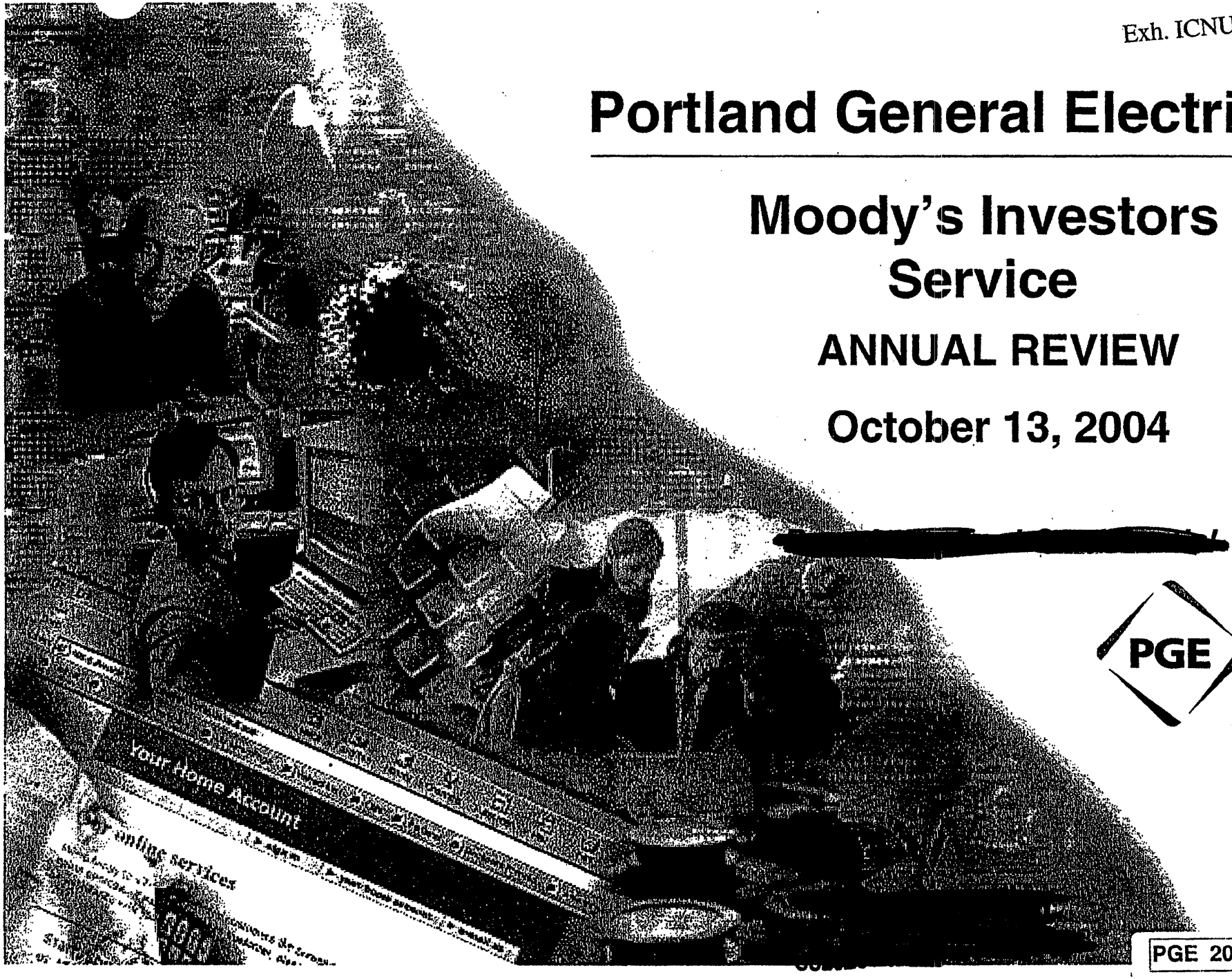
A. Although there are a few categories where the value of individual liabilities can be estimated with a reasonable range of accuracy, some liabilities could potentially be very large. The degree to which the final impact might affect PGE is not known with certainty. The following details a listing of liabilities for which PGE might face financial exposure. The listing may not be complete, and Staff invites the Applicants to provide complete details or a listing of all potential liabilities in its rebuttal testimony. Staff has recently requested any estimates available to TPG of the valuation of these liabilities.

Q. WHAT ARE THE POTENTIAL CONCERNS ABOUT THE LIABILITIES?

A. The ultimate liability exposure to PGE could be large enough to drain PGE's financial capacity. Additionally, PGE might attempt to recover these costs from its customers. If the impact of these liabilities drains PGE below a reasonable amount of equity, PGE's credit strength could erode.

Until the bankruptcy court has made a final decision, there is a potential for PGE to maintain liabilities within its own capital structure that may be viewed

Exh. ICNU/806N.C.



Portland General Electric

Moody's Investors Service

ANNUAL REVIEW

October 13, 2004

PGE

COP/112
Cuthbert/1

PGE 205861

Legal Issues (continued)

- California Refund:
  - As of June 30, 2004, PGE had net receivable balances from the California Independent System Operator and the California Power Exchange of $60 million.
  - In 2002 FERC ordered refunds for certain non federally-mandated transactions between October 2, 2000 and June 20, 2001.
  - The FERC methodology for calculating refunds was revised in March 2003. PGE has taken reserves of $40 million.
  - In September 2004, the Court of Appeals for the Ninth Circuit ruled in favor of the State of California and ordered that FERC look at moving the start date of the refund period back to May 1, 2000.

[redacted]

PGE

PGE 205874

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Cuthbert/2

it delineates an agreed upon procedure to enforce conditions of the acquisition. (See Staff/801, Condition 10.)

Q. PLEASE SUMMARIZE CONDITION 15 LISTED IN STAFF/801 AND EXPLAIN WHY IT IS NECESSARY.

A. This condition establishes a procedure to revolve disputes between Commission Staff and Oregon Electric and/or PGE regarding Staff requests made pursuant to the Acquisition Conditions. The condition is important because it creates a procedure for handling disputes that involve information requested pursuant to the Acquisition Conditions and helps to ensure Staff has adequate access to information at PGE and Oregon Electric. (See Staff/801, Condition 15.)

Rate Credits

Q. WHAT IS STAFF'S RECOMMENDED RATE CREDIT?

A. Staff recommends a rate credit of $15 million per year for the first five years after closing of the transaction. The monies are to be deposited in a balancing account at January 1, 2005 (or within 10 business days of the closing of the transaction if it closes after December 31, 2004) for the first year and at the first of each year thereafter. The balancing account will accrue interest at a rate consistent with Commission policy. The current policy would have the interest accrue at PGE's authorized rate of return.

Q. WHY IS STAFF RECOMMENDING OREGON ELECTRIC'S ACQUISITION OF PGE INCLUDE RATE CREDITS FOR THE BENEFIT OF PGE'S CUSTOMERS?

A. Staff recommends rate credits to offset the net risks and harms present in this transaction and produce net benefits for customers.

Q. HAVE RATE CREDITS BEEN A PROMINENT PART OF OTHER RECENT ACQUISITIONS APPROVED BY THE COMMISSION?

A. Yes. All three of the recent Commission orders contained rate credits. I will briefly describe the conditions and rate commitments made in each of these past three acquisitions.

Enron purchase of PGE (1997)
Order 97-196

- $36 million in rate credits spread out over four years
- $105 million to purchase PGE's trading floor
- Limitations on dividends, minimum equity requirements and other financial ring fencing
- Commitment that rates and cost of capital would not be higher due to the acquisition
- Service quality commitments

Scottish Power purchase of PP&L (1999)
Order 99-616

- $52 million in rate credits spread out over four years
- Limitations on dividends, minimum equity requirements and other financial ring fencing
- Commitment that rates would not be higher due to the acquisition
- Commitment of $6 million a year on conservation programs for three years
- Commitment to develop 50 additional megawatts of renewable energy within five years
- Service quality commitments (Improvements over those approved in the Enron-PGE merger)

- Agreement to pay customers $50 if it missed any of eight customer guarantees

Sierra Pacific proposed purchase of PGE (2000)
Order 00-702

- $95 million in rate credits spread out over seven years
- Rate freeze and other rate commitments such as rates no higher than without the acquisition
- Limitations on dividends, minimum equity requirements and other financial ring fencing
- Separation of generating and transmission costs to protect Oregon customers from higher Nevada rates and a ban on joint ventures
- Service quality commitments (Matched those implemented in the Scottish Power merger).

Q. HOW WERE THE RATE CREDITS IN THESE CASES DETERMINED?

A. The rate credits resulted from settlement discussions among Staff, intervenors and the applicants. From Staff's perspective, rate credits were necessary to conclude that the transaction provides net benefits to consumers. From the company's perspective, it would be natural to asses whether the purchase of the utility makes business sense in light of the rate credits proposed in settlement.

Q. DOES STAFF'S RATE CREDIT CONDITION IN THIS CASE RECOGNIZE THE SAME COMPETING PERSPECTIVES (NET BENEFITS FOR STAFF, COMPANY PROFITS FOR OREGON ELECTRIC) AS EXISTED IN PRIOR MERGER PROCEEDINGS?

A. Yes. Mr. Davis bases his rate credit offer on a projection of excess profits (*See* Oregon Electric/100, Davis/Page 32 of 60), while Staff testified that

rate credits are used to offset harms. (See Staff/100, Conway/17, lines 5-8.)

Q. HOW DOES THE STAFF PROPOSED RATE CREDIT COMPARE TO YOUR ANALYSIS CONCERNING THE POTENTIAL RETURNS TO INVESTORS IN OEUC?

A. In addition to the approximately $15 million a year in additional tax savings, (*See* Staff/1200, Johnson/4 line 18.) Oregon Electric's due diligence points to approximately [/**CONFIDENTIAL**] [redacted] [**CONFIDENTIAL**] in potential annual savings just in Operations and Maintenance (O&M) and Capital expenditures alone. Specific assumptions about these savings include base case savings in O&M of approximately [/**CONFIDENTIAL**] [redacted] [**CONFIDENTIAL**] in reductions related to capital expenditures. (*See* Staff/300, Durrenberger/2 line 20 through Durrenberger/3 line 6.) Finally, Oregon Electric's "downside case" projects a gain from Oregon Electric's purchase of PGE of [/**CONFIDENTIAL**] [redacted] [**CONFIDENTIAL**] over five years while Oregon Electric's "PUHCA Repeal Case" projects over [/**CONFIDENTIAL**] [redacted] [**CONFIDENTIAL**] in gains. (*See* Staff/202, Morgan/59.)

Q. DO YOU HAVE ANYTHING ELSE TO ADD ON RATE CREDITS?

A. Yes. The rate credits are intended to offset risks and harms present in this transaction as discussed by Staff in its testimony. In addition, even where conditions have been agreed to or recommended that address risks

or harms of the transaction, these conditions serve to mitigate rather than eliminate risk. Staff witness Thomas Morgan notes an example of a harm of this transaction in the testimony. Specifically, as a result of this acquisition, Staff believes the Commission will forego the opportunity to make a cost of debt adjustment due to increases in PGE's cost of debt attributable to Enron's bankruptcy. (*See* Staff/900, Morgan/24, lines 19-21.)

Q. DID YOU REVIEW MR. DAVIS' TESTIMONY REGARDING RATE CREDITS?

A. Yes. He states that his rate credit offer is guaranteed and that it represents an "irrefutable net benefit." He then cites my testimony on page 9. Mr. Davis' offer is not an irrefutable "net" benefit. Staff's definition of net benefit is based on a global view of the transaction—both the change in risks and benefits. This includes both positives (benefits) and negatives (risks and/or costs) for customers. In order to find net benefits, the positive results must outweigh the negative results so that, overall, the acquisition produces net benefits for customers (i.e., the benefits outweigh the risks and costs). (*See* Order 01-778.)

Q. DOES STAFF PLAN ON ADDRESSING THE ISSUE OF RATE CREDITS WITH THE PARTIES IN THE UPCOMING SETTLEMENT CONFERENCES?

A. Yes. In other acquisition dockets, rate credits have been one of many issues explored in settlement discussions. Other parties and Oregon

Electric will likely have views and concerns regarding rate credits that they wish to share with all parties. Other dockets included discussions of the timing or shape of rate credits and the possibility of allowing some portion of the rate credit to be offset in the future by a demonstration that savings, due to the transaction, have been incorporated in rates. Staff expects similar discussion may occur in this docket as well.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Pro Forma Assessment
Results of Operations Under City Ownership
Fiscal Year Ending June 30th

ITEM	2006	2007	2008	2009	2010
Gross Revenues					
Total Retail Revenues	1,383,051,375	1,443,927,498	1,466,642,404	1,528,956,619	1,601,723,130
Savings from City Ownership Passed on to Customers (10%)	138,305,138	144,392,750	146,664,240	152,895,662	160,172,313
Total Adjusted Retail Revenues	1,244,746,238	1,299,534,748	1,319,978,164	1,376,060,957	1,441,550,817
Wholesale Revenues	454,010,886	415,391,672	392,504,133	383,999,552	396,687,368
Other Operating Revenues	77,799,090	77,799,090	77,799,090	77,799,090	77,799,090
Total Gross Revenues	1,776,556,214	1,792,725,510	1,790,281,387	1,837,859,599	1,916,037,275
Operating Expenses					
Total Steam Production O&M Expenses	87,712,249	88,036,220	88,887,171	89,267,878	89,129,230
Hydraulic Production O&M Expenses	8,373,064	8,602,217	8,837,641	9,079,507	9,327,994
Other Production O&M Expenses	247,841,332	320,882,726	348,929,525	350,164,129	350,883,701
Other Power Supply Expenses (Purchased Power)	684,536,932	571,108,019	523,159,539	551,590,613	610,396,078
Transmission O&M Expenses	69,854,498	71,766,262	73,730,347	75,748,184	77,821,246
Distribution O&M Expenses	53,439,400	54,901,919	56,404,464	57,948,130	59,534,043
Customer Accts., Customer Svc., and Sales Expenses	63,249,180	64,980,171	66,758,536	68,585,570	70,462,607
Administration and General Expenses	93,827,678	96,395,536	99,033,670	101,744,004	104,528,514
Decommissioning Expense	14,041,000	14,041,000	14,041,000	14,041,000	14,041,000
Taxes Other than Income Taxes:					
Payroll Taxes	11,637,527	12,032,261	12,361,558	12,699,866	13,047,434
Miscellaneous Taxes and License Fees	1,114,476	1,114,476	1,144,977	1,176,312	1,208,505
Total Utility Operating Expenses	1,335,627,336	1,303,860,807	1,293,288,428	1,332,045,193	1,400,380,352
Net Revenues for Debt Service Coverage	440,928,878	488,864,703	496,992,959	505,814,406	515,656,923
Debt Service Coverage					
Acquisition Debt Service (Taxable)	196,349,130	188,001,731	178,463,100	168,314,601	158,014,092
Capital Expenditure Debt Service (Tax-Exempt)	12,451,240	43,150,259	57,149,303	71,788,538	87,100,665
Total Debt Service	208,800,370	231,151,990	235,612,403	240,103,139	245,114,757
Debt Service Coverage	2.11	2.11	2.11	2.11	2.10
Subordinated Tax Payments					
Property Taxes	35,480,260	35,727,400	31,481,463	31,935,311	32,424,755
Franchise Fees	31,598,320	33,406,602	30,054,758	30,927,026	32,335,460
Payment in Lieu of Taxes (State and Local)	13,279,045	15,149,044	15,326,166	15,566,954	15,852,789
Total Subordinated Tax Payments	80,357,625	84,283,046	76,862,387	78,429,291	80,613,004
Net Revenues After Debt Service & Subordinated Tax Payments	151,770,882	173,429,667	184,518,169	187,281,976	189,929,162
Cashflow Calculations					
Sources of Cash:					
Net Revenues After Debt Services	151,770,882	173,429,667	184,518,169	187,281,976	189,929,162
Capital Expenditure Bond Proceeds	202,816,857	500,052,905	228,028,868	238,456,857	249,417,543
Total Sources of Cash	354,587,739	673,482,572	412,547,037	425,738,833	439,346,705
Uses of Cash:					
Additional Principal Reduction on Acquisition Bonds	151,770,882	173,429,668	184,518,170	187,281,976	189,929,163
Ongoing Utility Capital Expenditures	202,816,857	500,052,905	228,028,868	238,456,857	249,417,543
Total Uses of Cash	354,587,739	673,482,573	412,547,038	425,738,833	439,346,706
Capitalization					
Acquisition Revenue Bonds (1)	2,853,688,220	2,662,521,060	2,447,528,319	2,219,161,107	1,985,618,391
Interest Rate on Acquisition Bonds	5.50%	5.50%	5.50%	5.50%	5.50%
Interest Paid	156,952,852	146,438,658	134,614,058	122,053,861	109,209,012
Scheduled Principal Reduction	39,396,278	41,563,073	43,849,042	46,260,740	48,805,080
Additional Principal Reduction	151,770,882	173,429,668	184,518,170	187,281,976	189,929,163
Net Acquisition Revenue Bonds	2,662,521,060	2,447,528,319	2,219,161,107	1,985,618,391	1,746,884,148
Capital Expenditure Revenue Bonds	202,816,857	500,052,905	228,028,868	238,456,857	249,417,543
Capital Expenditure Debt Outstanding	202,816,857	699,545,281	915,534,579	1,137,328,374	1,364,872,569
Debt Service on Capital Expenditure Revenue Bonds	12,451,240	43,150,259	57,149,303	71,788,538	87,100,665
Total Debt Outstanding	2,865,337,917	3,147,073,600	3,134,695,686	3,122,946,765	3,111,756,717

Notes:

(1) Acquisition cost assumptions:

Value of equity	2,000,000,000
plus Long Term Debt (at 12/31/05)	862,314,000
plus LTD due within one year (at 12/31/05)	9,047,000
less Cash (at 12/31/05)	(155,000,000)
Acquisition cost	2,716,361,000
Transaction costs (2% of purchase price)	54,327,220
Premium to retire PGE Long Term Debt	83,000,000
Acquisition cost	2,853,688,220