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J. Jeffrey Dudley
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December 3, 2004

Via Facsimile and U.S. Mail

Annette Taylor
Oregon Public Utility Commission
PO Box 2148
Salem OR 97308-2148

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

Dear Ms. Taylor:

Attached please find an original and five copies of PGE's Reply Brief for filing in the above-captioned docket.

Please stamp the extra copy of this letter and return it in the self-addressed envelope provided.

Thank you for your assistance in this matter. If you have any questions, please do not hesitate to call.

Sincerely,

JJD:am

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1121

In the Matter of the Application of OREGON ELECTRIC UTILITY COMPANY, LLC, et al., For Authorization to Acquire Portland General Electric Company	)))))))	**REPLY BRIEF OF PORTLAND GENERAL ELECTRIC COMPANY**

Portland General Electric Company ("PGE") submits this Reply Brief in support of the Oregon Electric Utility Company, LLC ("Oregon Electric"), Application to acquire all of the PGE common stock.

I. Introduction

The parties opposing this transaction filed testimony rich in argument and sparse in evidence. This "testimony" all claimed problems or "risks" with the transaction.

As the Opening Briefs show, the other parties have stuck to their initial arguments notwithstanding contrary evidence in the record. In the end, their arguments are just that - arguments. The Commission must base its decision on the evidence in the record, not argument. The evidence shows that the risk of harm to PGE is minimal at most and PGE's customers are protected from any harm through conditions or the Commission's existing authority or both. Moreover, the evidence shows that customers will receive both certain benefits and other favorable outcomes. The Commission should approve Oregon Electric's Application.

In this Reply Brief, we focus on the evidence in the record, particularly the evidence PGE presented which none of the other parties has disputed. Section II will focus on concerns expressed regarding PGE's finances and the erroneous assumptions that support them. The

evidence shows that Oregon Electric's debt will not place undue pressure on PGE, should not increase PGE's cost of capital, and will not increase PGE's rates. Section III addresses the adequacy of the conditions Oregon Electric offers in light of the success of the Enron merger conditions. PGE successfully operated under these conditions during Enron's bankruptcy. Section IV addresses claims that the Commission's regulatory framework is inadequate to regulate PGE under Oregon Electric ownership. Section V addresses EWEB/BPA claims regarding Trojan decommissioning costs and URP's arguments regarding the Commission's general ratemaking policy for tax expenses of a utility.

II. The Parties' Opening Briefs Reflect Misunderstandings about PGE's Finances

A. The Need to Service Oregon Electric's Debt Will Not Place Undue Pressure on PGE

Several parties claim that Oregon Electric's need to pay interest and principal on its debt will place unusual pressure on PGE and its finances. City of Portland Opening Brief at 3; Staff Opening Brief at 20. Some even argue that "the amount of debt surrounding this deal places great pressure on PGE to perform at a high level of efficiency to serve it." Staff Opening Brief at 20. This is wrong.

The record evidence demonstrates that Oregon Electric will be able to service its debt even if PGE significantly underperforms for a number of subsequent years. Even if PGE earned a net income of between $50 million and $65 million a year, a return on equity of between 5% and 6.5% each year for 5 years, Oregon Electric could service its debt obligations. PGE/100, Piro/4.

This was the stress testing that Staff put the transaction through. Staff had Oregon Electric run its financial models with PGE's earnings dropping by 30% from authorized levels for 5 straight years. *Id.* This reflects a prolonged period of dismal earnings, $32 million less

than PGE is authorized to earn, or 500 basis points below PGE's allowed return on equity of 10.5%. *Id.* Mr. Piro called such a worst-case scenario "highly improbable." *Id.*/5. Even Staff's witness acknowledged that this rigorous stress testing reflected extreme conditions that were "highly unlikely." Staff/900, Morgan/13. During the last 14 years PGE's utility earnings dipped below this level in only one year and approached it in one other year. PGE/100, Piro/5. And these instances were 12 years apart. *Id.* But the point is Oregon Electric's debt service can be met even under a highly unlikely stress test.

Oregon Electric's debt-service cost does not require PGE to constantly perform at or above its allowed rate of return. Oregon Electric, like any investor, will expect PGE to earn its allowed rate of return. But the parties produce no evidence that Oregon Electric's debt-service needs put undue pressure on PGE's financial performance.

B. PGE's Borrowing Cost Should Not Increase

Other parties express concern that PGE's cost of capital may increase because of the transaction. *See, e.g.,* ICNU Opening Brief at 26. Mistaken assumptions and misunderstandings regarding PGE's finances are the source of these concerns. For example, many of the parties fail to distinguish between PGE's long-term and short-term debt. The distinction is critical in this context. This transaction is not expected to affect PGE's credit rating for secured long-term debt or the interest rates PGE pays for secured long-term debt. PGE/400, Piro/11. Staff witness Morgan concurs with this conclusion. Staff/900, Morgan/12.

PGE's short-term unsecured debt rating may decline as a result of this transaction. PGE/400, Piro/10-11; Oregon Electric/200, Wheeler/15. But the parties misunderstand the significance of this possibility on several levels. First, some parties get the facts wrong. They incorrectly state that PGE's credit rating has been downgraded. City of Portland Opening Brief

at 12. S&P issued an "advice statement" suggesting it may downgrade PGE's unsecured debt. PGE/400, Piro/10-11; Oregon Electric/200, Wheeler 15. It has not downgraded PGE's unsecured debt.

Second, others draw the wrong conclusion. They mistakenly suggest that customers would pay for higher short-term debt costs. ICNU Opening Brief at 2. This reflects a misunderstanding about how the Commission sets rates. When setting rates, the Commission uses the allowed cost of equity and long-term debt to establish the allowed rate of return. Short-term interest is not a factor in computing weighted cost of capital. PGE/100, Piro/21 ("This debt [short-term debt] however does not affect PGE's revenue requirement").

1. Concerns About Port Westward Financing and PGE's Retiring Debt Are Unfounded

Some parties argue that the transaction may increase Port Westward financing costs or PGE's long-term debt that will retire before 2010. Staff's Opening Brief is a good example:

> If PGE's credit rating is lowered as expected because of this transaction, PGE's costs to obtain additional debt would increase. Staff/200, Morgan/30, 50-51. An increased cost of debt is of special concern in light of PGE's plans to make significant new capital expenditures for Port Westward. Customers could face a $1 million tab in additional costs for the Port Westward project due to PGE's increased cost of debt arising from this transaction. Staff/900, Morgan/25. PGE's cost of debt is also important because PGE has significant amounts of debt that will be retiring by 2010. Staff/900, Morgan/15.

Staff Opening Brief at 20.

There are several problems with this argument. First, a credit downgrade for PGE's short-term unsecured debt will not necessarily lead to an increase in borrowing costs. Mr. Piro testified that a number of factors affect interest rates. PGE/100, Piro/19. The perceived regulatory risk, an investor's own due diligence, the type of security offered, the ratings, and the

general market conditions all may play a role in determining the interest rate. *Id.*/21 The relationship between a firm's credit rating and the interest rate it pays is attenuated by these factors. *Id.*

Second, replacement cost of the debt retiring before 2010 is unaffected by this transaction. PGE plans to replace the debt that is retiring before 2010 with long-term secured debt. As mentioned above, PGE and Staff agree that this transaction is not expected to adversely affect PGE's credit rating for secured debt or the interest rates PGE will pay for these instruments. PGE/400, Piro/10; Staff/900, Morgan/12.

Third, the claim that customers face $1 million in additional financing costs for Port Westward is not clearly supported by the record. This calculation assumes that the debt issued to fund Port Westward construction increases by 50 basis points because of Oregon Electric's acquisition. Staff/900, Morgan/25. But there is no record support for this assumption. Mr. Piro testified that PGE plans to use long-term debt to finance the debt portion of the Port Westward financing (PGE/400, Piro/11-12; Hearing Transcript at 26), and Oregon Electric's acquisition is not expected to affect such long-term financing. PGE/400, Piro/11-12; Staff/900, Morgan/12.

PGE may use short-term financing to fund the initial phase of Port Westward construction until PGE puts into place long-term financing. PGE/400, Piro/11-13. Even if PGE uses short-term financing to fund construction costs initially, it is speculative whether this transaction will increase Port Westward financing costs. This is because when PGE uses short-term debt to finance the initial phase of construction, it normally uses commercial paper as the source of short-term debt, and credit ratings have very little effect on commercial paper rates. As Mr. Piro testified, "typically the company doesn't draw against the revolver, we use the Commercial Paper Program, which doesn't really look at your overall ratings. . . . The revolver

is a backstop for our Commercial Paper Program, but the rates we get on commercial paper are independent, necessarily, of your ratings." Hearing Transcript at 30. In short, credit ratings are not expected to adversely impact the long-term financing which PGE intends to use for Port Westward, nor will they impact the Commercial Paper Program which may fund the initial phases of the Port Westward construction.[1]

Finally, this $1 million concern rests on another mistaken assumption, namely that if PGE's financing costs increase due to Oregon Electric's ownership, the "Commission [would] pass through the entire financing costs to customers." Staff/200, Morgan/25. This assumption has no basis. To the extent that an increase in financing costs is attributable to Oregon Electric's ownership, Oregon Electric has agreed to a hold-harmless condition that protects customers from paying for such increase. Moreover, as we explain in Section IV.A. below, the Commission's ratemaking authority allows it to apply statutory and constitutional standards in any ratemaking proceeding to determine whether including any particular cost in revenue requirement will result in just and reasonable rates.

2. Concerns About PGE Revolver Are Unjustified

Other cost of capital concerns simply reflect misunderstandings about how PGE uses its revolver and the ratemaking treatment of such short-term debt. ICNU expresses its concern as follows:

> Although Mr. Piro testified that it is not unusual for PGE to have $10 million in cash on hand, the alarming fact is that he also testified that "PGE uses its revolvers to manage all our working

[1] Aside from not affecting long-term debt or the Commercial Paper Program, the potential credit downgrade would not have the impact Mr. Morgan suggests. Credit Suisse First Boston indicated that the credit rating downgrade for unsecured debt is likely to result in only a 25 basis point difference, or 0.25%, in interest rates. Oregon Electric/200, Wheeler/16. Even assuming Mr. Morgan's belief is correct, the "over one million dollar" impact is questionable. A 50 basis point difference in interest rates would result in an annual increase of $750,000 in the cost of debt (assuming $150 million in debt), not over $1 million as Mr. Morgan asserts.

> cash-needs; and as long as we have access to … that revolver, that's the most efficient way to finance our ongoing needs." It appears that under Oregon Electric, access to that revolver may come on more expensive terms.

ICNU Opening Brief at 25. Revolvers are short-term lines of credit offered by a consortium of banks. PGE/400, Piro/4. PGE uses revolvers for three primary purposes: (1) to backstop commercial paper; (2) to support credit for power and fuel purchases and sales; and (3) to use as working cash. *Id.* Far from being "alarming," this is how PGE has always used its revolvers. It is the most efficient way for PGE to meet its ongoing short-term financing needs. Hearing Transcript at 24.

The cost of PGE's revolvers does not directly affect rates. The only impact is indirectly through the interest rate that applies to PGE's APUDC (Allowance for Funds Used During Construction) rate - the rate applied to the Construction Work in Progress (CWIP) account for financing costs before construction is completed. But this is unlikely because, as Mr. Piro testified, PGE does not usually use its revolvers directly. Hearing Transcript at 30 ("Typically the company doesn't draw against the revolver, we use the Commercial Paper Program").

C. Credit Ratings Will Not Adversely Impact PGE's Purchased Power Costs

AOI continues to claim that a credit downgrade will adversely affect the cost of purchased power. AOI Opening Brief at 18. Mr. Piro answered this unsupported concern. PGE/400, Piro/13. "The price at which a utility buys or sells power and fuel does not change as a result of that utility's credit rating." *Id.*

D. Staff's Condition 16 Should Be Rejected

1. Staff's "Over $150 Million" Treatment Is Unnecessary

Staff's proposed Condition 16 reflects a misguided concern about PGE's revolver. Staff proposed Condition 16 would redefine "long-term debt" to include short-term revolver draws

over $150 million for purposes of calculating PGE's minimum equity ratio. Staff Opening Brief at 14. Revolvers are short-term financing tools to bridge mismatches between revenues and expenses and to support commercial paper. Revolvers provide least-cost alternatives to meet PGE's working capital needs. PGE/400, Piro/3-4; Hearing Transcript at 24. No one has questioned that these are necessary financial tools.

Staff's only reason for including revolver balances above $150 million is the suspicion that PGE may misuse revolvers as a replacement for long-term debt.[2] But the $150 million threshold is needlessly low and will only serve to unnecessarily restrict PGE's legitimate need for financing flexibility. PGE's historic average capacity for revolvers is approximately *$250 million,* not *$150* million (PGE/400, Piro/4), and no one has suggested that PGE has inappropriately used revolvers in the past. PGE will need this financing flexibility with or without the transaction. Staff objects to Oregon Electric's proposal that revolver balances over $250 million be defined as long-term debt precisely because "based upon PGE's history with unsecured revolvers, it is extremely unlikely that PGE would ever exceed the $250 million rolling average threshold." Staff Opening Brief at 15. But this raises the fundamental question: Why should this condition potentially restrict PGE from using revolvers just as it has used them in the past? If the Commission wants to deter abuses (which is the only reason Staff has offered), it should adopt Oregon Electric's $250 million threshold.

Other than speculation about abuses of revolvers, which do not justify Staff's proposal, the parties offer no support for the new proposed expansion of the definition of long-term debt. None of the previous merger and acquisition orders has defined the minimum equity ratio in this way. Nothing about this transaction justifies a change in policy. No past abuse justifies a change in policy.

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[2] Staff Opening Brief at 15.

The effect of Staff's redefinition of long-term debt is to *de facto* increase PGE's minimum equity level by about 2% (adding about $100 million of long-term debt to PGE's balance sheet for purposes of calculating its equity ratio). *See* PGE Opening Brief, Exhibit 1, for illustration. Staff provides no evidence why this change is necessary or prudent. PGE/400, Piro/5. Mr. Piro concluded that no change in the equity ratio is needed or appropriate: "In my judgment, there is no reason why PGE should now have more equity than the 48% settled upon in the Enron merger docket." PGE/400, Piro/6. An increase in the minimum equity ratio for PGE would *extend* the already large difference between PGE's minimum equity ratio of 48% and PacifiCorp's minimum required equity ratio of 39%. *PacifiCorp*, UM 918, Order No. 99-616, Appendix-Stipulation 5 at page 6. Staff provides no reason for the disparate treatment of similar utilities, nor is there any explanation for *increasing* the unequal treatment.

2. Staff's Proposed Treatment of Dividend Distributions Is Unsupported

The Commission Staff proposes a new test for determining whether a dividend distribution causes PGE's equity ratio to fall below 48%. Staff Opening Brief at 11. The new standard is whether the "distribution would, or could reasonably be expected to" cause PGE's equity ratio to fall below 48%. *Id.* This is a departure from the standard the Commission has applied in every other ORS 757.511 order. The traditional test is whether the dividend distribution "would cause" the equity ratio to fall below the prescribed level or "will reduce" the equity ratio below the minimum. *In the Matter of the Application of Enron,* UM 814, Order 97-196, Appendix A, at 2; *In the Matter of the Application of Sierra Pacific,* UM 967, Order No. 00-702, Appendix B, at 9; *In the Matter of the Application of Scottish Power,* UM 918, Order No. 99-616, Appendix Stipulation 5, at 6.

There is no reason for the Commission to change the standard here. Mr. Piro has testified that Staff's new language is subjective and has no standards. PGE/400, Piro/7. Utilities are able to issue dividends with confidence under a GAAP standard. "GAAP" stands for Generally Accepted Accounting Principles, which are commonly understood in the accounting industry. As Mr. Piro testifies, "businesses can access a wealth of prior examples and seek advice from accounting professionals for assistance in applying GAAP." PGE/400, Piro/8. GAAP guides utilities in accounting for assets, liabilities, expenses, revenues, gains, or losses. There are no standards available for deciding whether a dividend passes Staff's new test.

A concern that PGE might fall below 48% equity ratio appears to underlie Staff's proposal. Staff Opening Brief at 12. But there is no evidence that a temporary drop below the 48% equity ratio should be a cause for concern. Even in the unlikely event of a drop below the 48% equity ratio, PGE would remain below the minimum equity ratio for only a short time. PGE could not make a further dividend distribution until its retained earnings built the equity component of capital above the 48% equity ratio. There is no evidence that drops below the 48% equity ratio jeopardize a utility's operations or stability. PacifiCorp's minimum equity ratio is 39%. *PacifiCorp*,UM 918, Order No. 99-616, Appendix Stipulation 5 at page 6. PGE has been below the 48% equity ratio on many occasions before the Enron acquisition. PGE/100, Piro/11, PGE 102. PGE's dips below the 48% equity ratio have not impaired its access to capital. Indeed, PGE received its highest S&P rating of "A" during 1985-1990 with an average common equity ratio of 44.4%, well *below* the 48% threshold. PGE/100, Piro/12.

III. The Conditions Oregon Electric Offers Are More than Adequate to Protect Customers

Virtually all the parties agree on one thing: PGE is currently a stable, financially sound, and operationally solid utility. *See, e.g.,* ICNU Opening Brief at 2; AOI Opening Brief at 20-21.

As we demonstrated in opening briefs, this shows that the conditions Oregon Electric offers will be more than adequate to protect customers. AOI's Opening Brief is the best example of the customer groups' opinion of PGE today and the success of the Enron merger conditions:

> PGE is not a distressed company, financially or operationally. PGE is not in bankruptcy. PGE has operated normally during the Enron bankruptcy debacle. Conditions that the Commission put in place when Enron acquired PGE, and since, have provided significant protections to PGE and its customers. PGE has sufficient financial separation to prevent PGE from being consolidated into the Enron bankruptcy. PGE continues to serve its customers effectively and operate well. PGE has adequate liquidity and stable operating cash flow. Enron's bankruptcy has not impacted PGE's ability to access capital. PGE would be expected to operate over the foreseeable future without problems.

AOI Opening Brief at 20-21.

Oregon Electric has offered stronger and broader financial conditions than the Enron merger conditions that have kept PGE from becoming "a distressed" utility. This means that the Oregon Electric conditions are adequate to address the parties' concerns. Some parties are concerned about what would happen to PGE if Oregon Electric filed for bankruptcy. Staff/200, Morgan/29. But the UM 814 merger conditions ensured that "PGE has operated normally during the Enron bankruptcy . . . and the Enron bankruptcy has not impacted PGE's ability to access capital." AOI Opening Brief, at 20-21. Others are concerned that as a short-term owner Oregon Electric would not invest in PGE's infrastructure or might imprudently cut costs. CUB Opening Brief at 20-24; CUB/100, Jenks-Brown/8-12. But the UM 814 conditions erected "protections to PGE and its customers" and permitted to PGE to "continue to maintain and invest in the system" even though Enron has been trying to sell PGE for the last 5 years. AOI Opening Brief at 20-21. Finally, others are concerned about Oregon Electric's level of debt and its impact on PGE's access to capital. Staff Opening Brief at 20. But Enron had zero percent equity for the last 3

years, and the merger conditions have ensured that the troubles of the parent have had no "impact on PGE's ability to access capital." AOI Opening Brief at 20-21.

The success of the Enron merger conditions contradicts one of the fundamental assumptions offered against Oregon Electric's acquisition. Namely, that the conditions offered by Oregon Electric will not protect PGE from Oregon Electric's capital structure and TPG's investment horizon. PGE's success over the last three years is proof positive that this theory is wrong. The merger conditions have worked to protect PGE and its customers from the most significant negative impacts of the Enron bankruptcy.

IV. The Commission's Broad Regulatory Authority Is Sufficient to Protect Customers

In order to justify their positions, the parties opposing this transaction need three things to be true: (1) Oregon Electric's capital structure must harm PGE (increase PGE's cost of borrowing or capital, lead to imprudent cost reductions); (2) the conditions Oregon Electric offers must be insufficient to protect customers; and (3) existing Oregon utility law cannot protect customers. We have seen why assumptions (1) and (2) are wrong. The record evidence shows that Oregon Electric's capital structure should not materially affect PGE's cost of debt, that Oregon Electric's debt will not place undue pressure on PGE, and that the conditions Oregon Electric offers are stronger and broader than those that successfully protected PGE from the effects of the Enron bankruptcy. The failure of these first two assumptions alone is fatal to the opponents' arguments against Oregon Electric's acquisition. We now turn to the third faulty assumption: the mistaken assertion that the Commission's powers under the Oregon utility statutes cannot protect customers.

When the opponents of this transaction try to identify actual harms to customers, they simply ignore the existence of the statutes and the Commission's role in administering them.

They claim that higher debt at Oregon Electric *will* cause higher rates or otherwise *will be* the responsibility of ratepayers. *See, e.g.*, ICNU Opening Brief at 9 ("ratepayers ultimately bear the burden of acquisition-related risks"); *id.* at 2 ("the substantial debt associated with the proposed transaction will place significant financial pressure on PGE, which *undoubtedly will lead to rate increases")* (emphasis added). It is as if the Commission does not exist, and rates can increase automatically without Commission approval. This is wrong. PGE cannot increase rates without Commission approval. The Commission will continue to have broad powers to regulate PGE and to protect customers after Oregon Electric acquires PGE.

CUB, AOI, and Staff all recognize the Commission's broad authority to protect customers:

- "The OPUC has full authority to keep any inappropriate costs that are not the responsibility of customers from being included in customers' rates, directly or indirectly." AOI Opening Brief at 27;
- "The Commission always retains the right to deny PGE recovery in rates of the costs incurred from any of the liabilities. The Commission may decide to disallow, or allow, such costs depending upon the circumstances giving rise to any particular debt PGE incurs." Staff Opening Brief at 22;
- "The utility statutes in general reflect a legislative scheme in which the PUC exercises 'broad powers to protect consumer interests.'" CUB Opening Brief at 7.

These admissions make their arguments about customer harm even more inexplicable.

The Commission's powers include the authority to protect customers from unreasonable exactions under its general powers (ORS 757.040), to ensure that rates are just and reasonable (ORS 757.020 and ORS 757.210), to make sure customers receive "adequate and safe service"

(ORS 757.020), to guarantee that affiliate transactions are fair, reasonable and not contrary to the public interest (ORS 757.490(2) and ORS 757.495(3)), to review and approve sales of utility property (ORS 757.480), to approve the issuances of securities (ORS 757.405 et seq.), to compel the production of books and records (ORS 756.090 and ORS 756.105), to enter and inspect utility property (ORS 756.075), to compel the attendance of witnesses (ORS 756.555), and to initiate investigations (ORS 756.515). Oregon Electric's acquisition will not limit or interfere with the Commission's broad oversight authority. A clear understanding of the Commission's powers and authority answers a number of claims in the Opening Briefs.

A. The Commission Will Decide in Setting PGE's Rates Whether To Allow Any Increased Interest Cost Proven To Be Caused by Enron's Bankruptcy

Oregon law grants the Commission broad authority to determine just and reasonable rates for PGE's retail sales of electricity. Subject to Constitutional, statutory, and evidentiary limitations, the Commission has broad discretion regarding the costs it recognizes for purposes of determining a utility's cost of service. *See, e.g., American Can C. v. Lobdell*, 55 Or App 451, 463, 638 P2d 1152 (1982); *Pacific Northwest Bell Telephone Co. v. Sabin*, 21 Or App 200-224, 534 P2d 984 (1975). This authority applies to ratemaking decisions regardless of whether a 757.511 merger or acquisition condition exists.

Because of this, any risk of harm to customers alleged to arise from the termination of the UM 814 conditions upon the end of Enron's ownership is misplaced. The fact that customers "forgo the ring fencing provision that protects customers from any increase in the cost of capital as a result of Enron's acquisition" as a result of Oregon Electric's acquisition does not create a harm. As Staff's witness agreed, PGE's rates have not, and do not now, reflect any increases in the cost of debt alleged to relate to Enron's bankruptcy. This issue will be ripe when and if PGE files a general rate case that includes the cost of any debt issued since 2001, the time of PGE's

last rate case. At that time, Staff or another party can challenge whether the interest costs qualify for ratemaking recognition and PGE will have an opportunity to rebut any such evidence presented. But the issue is not ripe now, and this concern is not a customer harm from this transaction.

B. The Commission Is Fully Able to Handle Affiliate Issues

A number of parties are confused about whom the Commission will regulate (AOI Opening Brief at 11) and the scope of the Commission's affiliate statutes (CUB Opening Brief at 35). These parties mistakenly claim that the Commission will have to "follow the dollars up a chain of ownership through the OEUC holding company and back to the true controlling entities," and suggest that the Commission should be concerned about agreements between TPG and Oregon Electric. AOI Opening Brief at 13; CUB Opening Brief at 35.

The Commission regulates PGE and other "public utilities" as ORS 757.005 defines that term. The Commission does not regulate owners of public utilities except under the affiliate statutes and regulations. Under the affiliate statutes and rules, the utility must file with the Commission contracts between the utility and an affiliate that the utility seeks to have recovered in rates. ORS 757.490 and ORS 757.495. Under the affiliate regulations, all contracts between the public utility and an affiliate for services provided by the utility must be disclosed to the Commission unless the services are provided under an approved, generally applicable tariff schedule. OAR 860-027-0040 et seq. The Oregon Electric acquisition will do nothing to alter or subvert these rules, which apply to all public utilities. Nor have other parties offered any explanation for why contracts between TPG and Oregon Electric should be of concern to the Commission when PGE is not a party to such agreements, and these agreements cannot affect PGE's rates.

BOMA mistakenly believes that TPG can steal PGE's assets. BOMA Opening Brief at 7-8. This is wrong. Any transfer of utility assets of over $100,000 in value must be approved by the Commission (ORS 757.480), and the affiliate statutes and regulations apply to TPG as they do to all public utility affiliates.

C. The Identity or Motive of the Decision Maker Is Irrelevant for Ratemaking Actions

A number of parties express concern that, because of Oregon Electric's ownership structure and the fact that certain decisions require TPG's consent, the Commission "may not know who actually is making decisions for PGE." ICNU Opening Brief at 21. They go so far as to say that the Commission will "be unaware if TPG is making decisions that conflict with PGE's long-term interests" and suggest that this undermines the Commission's regulatory authority. ICNU Opening Brief at 17. BOMA even suggests that the Commission must regulate the exercise of TPG's consent rights. BOMA Opening Brief at 6.

These concerns misunderstand the nature of ratemaking and the Commission's regulatory authority. The Commission exercises its authority with respect to PGE's decisions under the objective standards set forth in the applicable statute. To obtain a rate change, the utility has the burden of proof to demonstrate its decisions produce just and reasonable rates. Utility property sale decisions must not be contrary to the public interest (ORS 757.480), and affiliate contracts that affect rates must be fair, reasonable, and not contrary to the public interest (ORS 757.490 and ORS 757.495). The Commission reviews decisions, not who is making them. A utility decision meets the applicable statutory standard or it does not. To name just some of the most recent PGE dockets, the Commission applied the applicable standards to PGE's decisions presented to the Commission in our last general rate case (UE 115), the proposed sale of PGE's interest in the Colstrip power plant (UP 158), PGE's annual RVM filings (UE 139, UE 149, and

UE 161), a distribution decoupling proposal (UE 126), and PGE's proposed hydro deferral (UM 1071). PGE's ownership was not relevant to the Commission decision in those matters.

Under Oregon Electric, the Commission will determine whether the decisions PGE is proposing for Commission action are in the long-term interest of PGE and its customers by reviewing them. This is how regulation has always worked in Oregon, and Oregon Electric's acquisition will not impair the Commission's regulatory authority.

D. AOI's Value Theory Violates Oregon Regulation

AOI's belief that ratepayers should receive a share of any increase in utility value is wrong. AOI Opening Brief at 16. The Commission sets rates based upon embedded and forecasted costs. The market value of the enterprise - for publicly traded companies, the number of shares outstanding times the current market price of the shares - is not a cost of service element. This Commission has routinely approved conditions that explicitly *prevented* a utility from including in rates the extent to which enterprise value exceeds rate base. PGE is aware of no Oregon case in which customers have reimbursed shareholders for a decline in enterprise value either. AOI's attempt to create a customer interest in the positive side of enterprise value should be rejected.

E. Claims that Oregon Regulation Requires Long-Term Ownership Are Wrong

Some parties argue that Oregon Electric's investment horizon creates "a new regulatory paradigm" (City of Portland Opening Brief at 2) and will interfere with the Commission's regulatory authority. CUB goes so far as to say that "utility regulation is based on the premise that a utility owner is around for a long time." CUB Opening Brief at 24. Oregon utility law does not support this claim. The Commission's authority under Oregon statutes is undiminished

by a change in utility ownership. The length of ownership does not affect or interfere with the Commission's powers.

PGE's ownership has changed over the last twenty years from a stand-alone publicly traded company to a subsidiary of the Portland General Corporation holding company and then to a subsidiary of Enron. PGE/100, Piro/10-11. None of these ownership structures "changed" the regulatory paradigm, and neither does Oregon Electric's acquisition.

F. CUB's List of Essential Attributes for Utility Ownership Is Ill-Founded

CUB contends that utility owners should possess a variety of attributes which it claims Oregon Electric lacks. CUB creates an "ideal utility" straw man and then proceeds to knock it over with the belief that PGE won't be "ideal" if owned by Oregon Electric. CUB Opening Brief at 25-26.

These attributes include: being satisfied with returns so long as "over time the ups and downs even out"; over-investing in the utility; creating relationships with regulators and customers; and having an interest in long-term energy policy. The first two attributes are likely true of no utility. The second two attributes are true not only of Oregon Electric, but also of PGE's management and employees. Oregon Electric/100, Davis/7, 10-12; PGE/100, Piro/3.

Utility investors expect what ORS 757.040 states: "a return to the equity holder that is: (a) Commensurate with the return on investments in other enterprises having corresponding risks; and (b) sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital." This statutory standard, which simply restates the Constitutional standard, does not include the "over time the ups and downs even out" clause.

We don't understand what CUB means by "over-investing" in a utility. If CUB means the ideal utility owner should be foolish and knowingly invest in assets to serve customers with

the understanding the Commission will disallow the investment - no owner will meet CUB's standards.

Oregon Electric's testimony - from Kelvin Davis, Jerry Jackson, the Local Applicants - amply demonstrates a deep interest in forming relationships with PGE's customers and regulators and in the energy policy issues facing PGE and the region. Oregon Electric/100, Davis 7, 45; Oregon Electric/300, Jackson/3-5. Moreover, PGE's management and employees have been, are, and will remain, vitally involved in these matters.

V. The Commission Should Reject the Arguments of EWEB/BPA and URP

A. Trojan Decommissioning Costs

EWEB/BPA attempt to interject speculation about Trojan decommissioning costs into this docket. EWEB/BPA Opening Brief at 4. The Commission should reject this effort. This docket concerns Oregon Electric's acquisition of PGE. It is not a general investigation or a ratemaking docket in which Trojan decommissioning costs are at issue. If Trojan decommissioning costs unexpectedly increase in the future (as BPA and EWEB suggest), the Commission can address the issue when it arises in a ratemaking proceeding. There is no reason to speculate today about what might happen tomorrow, particularly when Oregon Electric's acquisition has no effect whatsoever on Trojan decommissioning costs and the solution parties propose (insurance requirements and a bond) will increase costs.

EWEB and BPA express concern that Oregon Electric's acquisition *might* render PGE less able to meet its financial obligations that *might* arise if Trojan decommissioning costs unexpectedly increase. *Id.* at 2-3. What evidence do EWEB and BPA provide that "unexpected" increases in Trojan decommissioning costs will in fact occur? None. They offer one paragraph that is devoid of facts and full of conjecture:

> PGE *may* incur unexpected costs associated with Trojan *if the* NRC [Nuclear Regulatory Commission] amends the regulations applicable to nuclear facility decommissioning or spent fuel management. An unexpected incident involving spent fuel stored at the site *may* also increase Trojan costs to the extent not covered by insurance. PGE *may* also incur additional unexpected costs *if a* permanent spent fuel repository is not completed and available by 2018 as contemplated by the PGE decommissioning plan.

Id. at 4 (italics added); EWEB/100, Beeson/6.

There is no evidence that any of these unexpected events will occur or are likely to occur. NRC may amend its regulation, but there is no evidence it will, what amendments it might enact, or what the impact on decommissioning costs would be. An unexpected incident might occur with spent fuel, but it might not. EWEB/BPA provides no evidence upon which to judge which is more likely, much less the cost associated with an incident. And a permanent spent fuel repository might not be completed by 2018 as contemplated, but EWEB and BPA offer no evidence it will not be. And if these contingencies occur: "[T]he funds currently collected through PGE rates *may* not be adequate to cover unexpected Trojan decommissioning costs incurred in the future." *Id.* (italics added). In short, it is speculation whether the decommissioning fund might be insufficient even if one or more of the "unexpected" events occur.

In any event, EWEB/BPA's specific claims about this transaction are ill-founded. EWEB/BPA claim that the transaction will create a thinly financed utility *(id.* at 8) with "depleted" cash reserves. *Id.* at 14. Both of these claims are wrong. After the transaction, PGE's equity ratio will be above 48%, which is conservative compared with PGE's average equity ratio over the past 20 years. PGE/100, Piro/11. Moreover, the Oregon Electric acquisition will not "deplete PGE's cash reserves." Because PGE has not paid a dividend to Enron since 2001 when Enron filed for bankruptcy, PGE has accumulated cash of about $200

million as of the end of the second quarter 2004. Hearing Transcript at 18, 20. Oregon Electric's acquisition will not cause the reduction in cash. The catch-up dividend will. And it will be paid whether or not the Oregon Electric acquisition occurs. PGE/400, Piro/5; Hearing Transcript at 18. There is no basis for EWEB/BPA's claim that PGE will be cash poor at closing. When the transaction closes, PGE will have about $10 million in cash and a revolver of $250 million to take care of its short-term financing needs. Hearing Transcript at 23-24; PGE/400, Piro/5. This amount of liquidity is above, not below, the $5 million PGE normally maintains. Hearing Transcript at 23-24.

EWEB and BPA try to use this docket to leverage more favorable business terms among the owners of the Trojan facility. If they wanted more favorable terms, they should have negotiated for them in the agreement between the owners. These are business issues between the owners of Trojan. They have no place in this proceeding.[3]

B. Taxes

We agree with Staff's position that the Commission should continue to set rates using forecasts of a utility's stand-alone tax liability. *See* Staff Opening Brief at 36. Under this approach, the Commission uses one consistent forecast to estimate revenues and costs, including the cost of capital.

The Parties opposing this position have the facts wrong. They claim that, because customers are allegedly liable for Oregon Electric's debt, it is only fair that customers should

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[3] The City of Portland expresses concerns about Trojan decommissioning costs as well. City of Portland Opening Brief at 21. But the City's complaint rests on a misunderstanding regarding corporate law. The City objects that "limited liability corporations provide a financial shield for the parent/owner if an accident, equipment failure, safety upgrade, or unanticipated maintenance need creates a large, unanticipated cost." *Id.* Like shareholders in any corporation or limited liability company, investors in PGE are shielded from liability claims against PGE except in very specific and extraordinary situations. This investor protection is a hallmark of a corporation, and happens independently of this transaction.

receive the benefits of the interest deduction associated with that debt. City of Portland Opening Brief at 25 ("As the record clearly shows, this new debt will have negative effects upon PGE. Customers will be burdened with at least some, if not all, of the risk associated with this debt."); *see also* CUB Opening Brief at 36. In fact, PGE is not liable for Oregon Electric's debt. And the cost of Oregon Electric's debt will not be included in PGE's rates. PGE/400, Piro/15.

Indeed, one of the benefits of the stand-alone approach is that it protects the utility and its customers from the business risks and costs of the parent company. A leading utility accounting publication explained why:

> There is a well-reasoned, and widely recognized, postulate that taxes follow the events they give rise to. Thus, if ratepayers are held responsible for costs, they are entitled to the tax benefits associated with the costs. If ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs.

PGE/200, Tinker-Murray-Hager/14-15 (quoting "Accounting for Public Utilities," Publication 16, Release 19, November 2002).

The alternative - consolidating the utility and holding company for ratemaking purposes - is fraught with risk for customers. If rates include the interest deduction for holding company debt, rates would have to reflect the debt and the cost of the debt that gave rise to the interest deduction. The Commission would then set rates based upon the parent company's revenues and liabilities, including those unrelated to utility operations. This would include the consolidated capital structure at Oregon Electric, including its cost of debt and equity. This would reflect a considerably higher rate of return than the utility's rate of return. PGE/200, Tinker-Murray-Hager/6.

The deductibility of interest payments and the ability of corporations to file consolidated tax returns are fundamental tenets of the United States' tax code. These are matters of federal

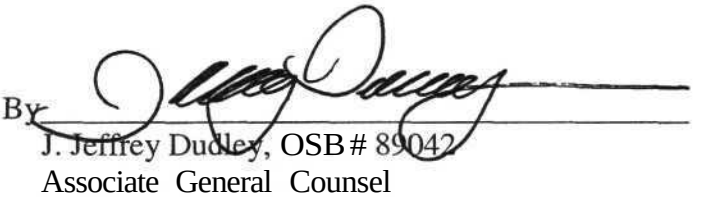
and state tax law and policy, not matters for the Commission. The issues are doubly irrelevant here. This transaction will not affect how the Commission calculates PGE's tax expense for rate-setting purposes. Whether PGE is part of Enron's consolidated tax group, Oregon Electric's consolidated tax group, or a stand-alone company, the Commission will use a forecast of PGE's stand-alone taxes, consistent with all other test-year assumptions, to set rates. Nor does Oregon Electric seek special treatment. The Commission uses the stand-alone approach to set rates for all utilities that are part of a consolidated tax group, including PacifiCorp. And this is how virtually every state Commission computes a utility's tax expense to set rates. The Commission should not depart from its longstanding approach of using the utility's stand-alone tax expense to set rates.

VI. Conclusion

For the reasons set forth above, in the Reply Briefs of Oregon Electric and Enron, and in the Opening Briefs of PGE, Oregon Electric, and Enron, the Commission should approve Oregon Electric's Application.

DATED this 3rd day of December, 2004.

PORTLAND GENERAL ELECTRIC COMPANY

By 

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CERTIFICATE OF SERVICE

I certify that I have caused to be served the foregoing Reply Brief of Portland General Electric Company in OPUC Docket No. UM 1121 by First Class U.S. Mail, postage prepaid and properly addressed for mailing, to the persons on the attached list, and by electronic mail to those persons on the electronic service list maintained by the OPUC.

Dated this 3rd day of December, 2004.

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