

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1121

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

STAFF'S REPLY BRIEF

SUMMARY OF STAFF'S POSITION

After reviewing the opening briefs submitted by the Applicants and the intervening parties (intervenors), staff continues to recommend the Commission deny the Application.¹ The risks and harms accompanying the proposed acquisition outweigh its benefits. *See* ORS 757.511; PUC Order No. 01-778.

12 Staff presented its revised list of conditions (Conditions) under which the Commission
13 may find the Application satisfies ORS 757.511. *See* Staff Opening Brief, Attachment A. Staff
14 considered the Applicants' and the intervenors' criticisms, made in their opening briefs, of some
15 of its Conditions. Generally, the Applicants argue that various Conditions are too "strong,"
16 while selected intervenors assert certain Conditions are too weak (or are lacking entirely). After
17 careful review of the parties' assertions and suggestions, staff stands by its Conditions.

STRUCTURE OF STAFF'S REPLY BRIEF

19 In its Reply Brief, staff avoids repeating points and arguments presented in its Opening
20 Brief. Staff also incorporates its Opening Brief as its reply to any assertion not directly
21 addressed. Staff instead focuses on selected main topics which are either especially important or
22 are vigorously disputed. These topics include:

- (1) Net benefits under ORS 757.511;
 - (2) OEUC's rate credit;

²⁵ ¹ “Applicants” refers to Oregon Electric Utility Company (OEUC), TPG Partners III, L.P.; TPG
²⁶ Partners IV, L.P.; Managing Members Gerald Grinstein, Tom Walsh, Peter Kohler, M.D., Duane McDougall, and Robert Miller. *See* OEUC/22 (Application).

- (3) Disputed financial and “ring-fencing” conditions;
 - (4) Impact of transaction on PGE;
 - (5) Risks of inappropriate cost cutting;
 - (6) Risks of TPG ownership;
 - (7) The tax “savings” issue;
 - (8) Trojan decommissioning costs; and
 - (9) Other Matters.

Before addressing the main topics, to help simplify the issues for the Commission, the following lists OEUC's and staff's conditions that appear to use identical (or nearly so) language: Condition Nos. 1-15, 17², 19, 21, 23, 28, 29, 31-32, and 34. Conversely, OEUC and staff continue to disagree on the wording for the following conditions: Condition Nos. 18, 20, 22, 24, 30, 33, and 35-38.³ Staff's discussion of the topics will involve further discussion of the following conditions: Nos. 5, 20, 22-25, and 27.

NET BENEFITS UNDER ORS 757.511

Staff explained in its Opening Brief how the Commission has interpreted ORS 757.511, statute that governs the Application. *See* Staff Opening Brief at 2-4. In brief, the Applicants bear the burden to show the proposed acquisition would (1) provide a “net benefit” to the PGE’s customers, and (2) impose “no harm” to the public at large. *See* Order 01-778 at 8, 11. Enron’s (Enron) opening brief spends considerable energy arguing the Commission’s

² Staff stated in its opening brief that it was adopting OEUC's Condition 17 verbatim. See Opening Brief at 16. Unfortunately, staff's revised Condition 17 is incorrectly worded. See Opening Brief at 16, Attachment A at 5. Staff's Condition 17 should read:

Oregon Electric agrees that the customers of PGE shall be held harmless if PGE's return on common equity and other costs of capital, viewed on a stand-alone basis, rise as a result of Oregon Electric's ownership of PGE. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.

³ Staff first proposed its Conditions 35-38 in its Opening Brief after reviewing testimony filed by certain intervenors. As such, staff does not really know whether the Applicants find any, or all, of these conditions objectionable.

1 Order 01-778 is incorrect. Enron asserts there is no “net benefit” standard under ORS 757.511,
2 only one of “no harm.” Enron Opening Brief at 6-10.

3 Staff does not see a need to respond to Enron’s suggested interpretation of ORS 757.511.
4 The Commission issued its Order 01-778 after a through investigation of the issues and
5 arguments similar to those again raised by Enron (indeed, Enron’s wholly-owned subsidiary
6 PGE was a party to the proceeding leading to the Order). As Enron notes, no party has ever
7 challenged Order 01-778 in court and the Commission has not indicated it wants to re-visit its
8 conclusions in this docket.

9 In a related matter, certain intervenors request the Commission apply the net benefits test
10 to ensure the Applicants provide additional commitments for their various interests, such as
11 renewable resources or more support for low-income customers. *See* Renewable Northwest
12 Project’s Opening Brief; Strategic Energy LLC’s Opening Brief. Staff did not require the
13 Applicants to make such commitments.

14 The Commission did not explore in its Order 01-778 its intended scope of the net benefits
15 test. Staff’s position is ORS 757.511 does not include a requirement that a successful applicant
16 commit to providing additional improvements over the status quo for each and every matter or
17 interest advocated by an intervening party. However, the Commission may consider such a
18 “public interest” commitment as it weighs the benefits offered by a particular application.
19 Obviously, the further removed the requested improvement is from the utility’s primary mission
20 of providing safe and adequate service, the less relevant and appropriate the matter is under ORS
21 757.511.

22 **OEUC’S RATE CREDIT IS INSUFFICIENT**

23 Staff’s Opening Brief explains how staff arrived at its recommendation that OEUC
24 provide \$75 million in guaranteed rate credits to PGE’s customers. *See* Staff Opening Brief at
25 17-23. As stated, staff set its rate credit amount after careful consideration of all of the actual
26 and potential harms and risks to this transaction.

1 In contrast, OEUC offers a \$43 million rate credit. *See* OEUC Opening Brief at 13, 16;
2 and Oregon Electric/501, Davis/5 (Condition 20). While staff has first-hand experience with
3 how difficult it is to determine the amount of the rate credit, staff observes that OEUC fails to
4 provide *any* explanation as to how it derived its rate credit amount. As such, it is hard to assess
5 what OEUC has done in this regard.

6 Further, as noted by some intervenors, OEUC's rate credit differs from staff's in several
7 important respects. First, there is the obvious \$32 million difference between staff's and
8 OEUC's recommended amounts. Second, staff's credit would commence in January, 2006,
9 while OEUC's credit would not start until a year later, in 2007. Third, despite its claim to the
10 contrary, OEUC's rate credit is not "guaranteed." The annual \$8.6 million rate credit (calculated
11 on a yearly basis for five years) is subject to an offset for any "savings" OEUC is able to
12 demonstrate to the Commission's satisfaction in PGE's future general rate cases. Further, as the
13 Industrial Customers of Northwest Utilities (ICNU) point out, it is unclear how PGE would make
14 its "savings" showing in its rate case. *See* ICNU Opening Brief at 33-34. There are no
15 guidelines as to how PGE will show "cost savings" and what responsive showing staff or other
16 parties opposed to a proposed offset would have to make. Therefore, including offsets for cost
17 savings in the rate credit formula adds risk for ratepayers that is not present with staff's proposal.

18 Staff's well-reasoned, truly guaranteed rate credit is superior to OEUC's proposal.

19 **DISPUTED FINANCIAL AND RING-FENCING CONDITIONS**

20 Staff compared and contrasted its financial and ring-fencing conditions to OEUC's at
21 length in its opening brief. Accordingly, staff will address only selected issues concerning three
22 conditions in reply to assertions OEUC makes in its opening brief.

23 **1. Condition 16 (Minimum PGE Equity Ratio)**

24 Condition 16 addresses the risk that OEUC would cause PGE to make distributions
25 (dividend payments) to OEUC that would, or could reasonably be expected to, cause PGE's
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1 equity ratio to fall below 48%. *See generally* Staff Opening Brief at 11-16.⁴ OEUC argues that
2 any concerns staff may have with PGE’s use of its revolving lines of credit (“revolvers”) is
3 resolved by OEUC’s agreement to include in the definition of long-term debt “the rolling
4 12-month average of committed and drawn balances” under PGE’s unsecured lines of credit, in
5 excess of \$250 million. *See* OEUC Opening Brief at 32. This commitment is meaningless
6 because the revolver is determined by its “capacity.” “Capacity” refers to the “maximum
7 amount of revolving debt...of the instrument.” PGE/400, Piro/4. Since PGE cannot exceed the
8 \$250 million capacity of its revolver, OEUC’s “rolling average” modifier allows OEUC to
9 effectively exclude all amounts of PGE’s unsecured revolver from the definition of long-term
10 debt in Condition 16.

11 **2. Condition 25 (Cash Sweep)**

12 Staff previously explained that Condition 25 is intended to address the risk that OEUC
13 would not use money received from PGE to pay down OEUC’s sizable debt arising from this
14 acquisition. *See* Staff Opening Brief at 26-28. OEUC disputes staff’s requirement that it must
15 use the PGE distributions for debt retirement for a period of five years. OEUC calls such a time
16 restriction “arbitrary” and “unsupportable.” *See* OEUC Opening Brief at 37.

17 Staff recommends that its cash sweep condition continue for five years to better protect
18 PGE’s ratepayers against problems with OEUC’s ownership. The five-year period lasts through
19 the time when PGE will be under the most financial pressure due to the maturing of millions of
20 dollar in debt and the need to finance the Port Westward project. As stated, PGE’s credit rating
21 for its unsecured debt is likely to fall because of this transaction. *See* Staff Opening Brief at 20.
22 Condition 25 will help PGE strengthen and improve its credit rating by first helping to pay down
23 OEUC’s debt and then, to the extent that debt is paid off, building up an “equity cushion.” This

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25 ⁴ Staff would like to clarify what could be a possible “gap” in Condition 16’s scope. While
26 Condition 16 prevents a PGE distribution that would, or could, bring its equity ratio below 48%,
staff intends Condition 16 to also prevent PGE from making a distribution to OEUC at any time
when PGE’s equity ratio is already below 48%.

1 equity cushion would help protect PGE's customers against possible, and perhaps unforeseen,
2 risks of OEUC's ownership and exogenous events. The five-year period also coincides with the
3 likely time TPG will own PGE through OEUC.

4 ***3. Condition 27 (Re-leveraging of debt)***

5 Staff's Condition 27 works in conjunction with Condition 25. Condition 27 prevents
6 OEUC from incurring additional debt if it would, or could reasonably be expected to, bring
7 OEUC's consolidated capital structure below 40% common equity. *See* Staff Opening Brief at
8 28-29.

9 OEUC argues that the common equity level should be 30% rather than staff's 40%.
10 However, OEUC still fails to explain how it arrived at its 30% equity figure, and why that
11 reduced level is superior to staff's 40% requirement. *See* OEUC Opening Brief at 37-38.

12 Staff's 40% equity floor for incurring new debt strengthens PGE's financial stability, thus
13 leading to higher credit ratings for PGE and ultimately a lower cost of capital for the company.
14 The following charts show how staff's 40% equity requirement serves to increase PGE's
15 financial stability by increasing its equity cushion.⁵

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⁵ The information in the charts is derived from Staff/202, Morgan/408.

Consolidated Company – Balance Sheet Information (\$ millions)				
	<u>Pre-Transaction</u>	<u>At Closing</u>		
	December 2004			
Cash	\$248		\$10	
Existing Debt	\$1,011		\$1,011	
Bank Debt	\$0		\$593	
Senior Notes	\$0		\$125	
Preferred Stock	\$22		\$22	
Common Equity	\$1,292	50.23%	\$525	22.97%
TOTAL	\$2,573.00		\$2,286.00	

Assuming 30% Consolidated Minimum Equity Ratio				
Existing & New Debt	\$1,729	76%	\$1,571.20	69%
Preferred Stock	\$22	1%	\$22	1%
Common Equity	\$525	23.1%	\$683	30%
TOTAL	\$2,276.00		\$2,276.20	100.00%

Growth of Equity is a nominal amount of only \$158 million (16.7 percent).

Assuming 40% Consolidated Minimum Equity Ratio				
Existing & New Debt	\$1,729	76%	\$1,343.60	59%
Preferred Stock	\$22	1%	\$22	1%
Common Equity	\$525	23.1%	\$910	40%
TOTAL	\$2,276.00		\$2,275.60	100.00%

Total Equity build-up is still less than double the initial post-transaction amount, growing only \$385 million (73 percent).

Thus, under this example, with staff's 40% equity requirement, OEUC would have \$227 million more in equity than under OEUC's 30% requirement (i.e. 910 -683). Even so, under this example, there is still significantly less equity than existed at PGE prior to the transaction ($1,292 - 910 = \$382$ million "worse off").

IMPACT OF TRANSACTION ON PGE

1. TPG's Model Runs

OEUC discusses the model runs it conducted to determine how much debt it could place at OEUC. OEUC Opening Brief at 22-24. OEUC describes the purpose of the models as showing that "PGE would have the liquidity necessary to fund its budgeted expenditures while

1 funding sufficient dividends to allow Oregon Electric to service and pay down its debt.” *Id.* at
2 23. OEUC further states the staff witness Morgan “confirmed” the “efficacy” of its modeling.
3 *Id.* at 8.

4 Staff disagrees with the impression created by OEUC’s characterization of Mr. Morgan’s
5 assessment of its modeling. It is true that Mr. Morgan found TPG’s models to be of high quality.
6 Staff/200, Morgan/34-35. However, models are only forecasts and all forecasts are, to some
7 degree, wrong. Staff’s concerns about the highly leveraged nature of the proposed transaction
8 remain, despite its comfort with TPG’s models. The models do not, and cannot, eliminate the
9 pressures the high degree of debt places on PGE to perform efficiently to service OEUC’s debt.
10 Should PGE’s performance suffer, it may have to borrow on its revolvers to continue making
11 payments to OEUC so that OEUC may reduce its debt level. Ultimately, PGE’s credit rating
12 could be reduced, harming the company, and its customers, by increasing PGE’s cost of debt.

13 ***2. Impact on PGE’s credit rating***

14 As stated under several topics, the highly-leveraged nature of this transaction carries with
15 it risks for PGE, and in turn, its customers. To summarize, OEUC would take on approximately
16 \$707 million in debt to fund this transaction. This level of debt, by itself, has caused S&P credit
17 agency to say it would downgrade PGE’s senior unsecured credit rating “one notch” to BBB-
18 upon closing of the transaction. Further, OEUC intends to pay down its sizable debt with
19 distributions taken from PGE. This in turn causes pressure on PGE to adequately perform to
20 generate the revenue necessary to fund the distributions OEUC expects it to make. If PGE is
21 unable to generate the necessary revenue, it may have to borrow to pay the dividends, further
22 eroding its credit rating. Staff will highlight a couple of concerns arising from this scenario.

23 First, staff showed how the effect of the Enron “overhang” and this transaction results in
24 a credit rating reduction from “A” for PGE as a stand-alone company to BBB- under this
25 transaction. *See* Staff Opening Brief at 21. The resulting impact could be an increase of \$5 to
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1 \$7 million a year in debt costs for PGE’s ratepayers.⁶ However, in its opening brief, OEUC
2 suggests there would be only a “25 basis point” reduction to the credit level at which it could
3 acquire debt, with a corresponding \$250,000 per year increase in debt costs. OEUC Opening
4 Brief at 26. The problem with OEUC’s statement is it ignores the premise for staff’s calculation:
5 the combined effect of the “Enron overhang” and this transaction. OEUC’s “25 basis point”
6 figure is calculated based only upon the expected effect of this transaction on PGE’s current
7 credit rating.

8 Second, PGE and OEUC discuss how short-term borrowing rates may affect customer
9 rates. See PGE Opening Brief at 4-6; OEUC Opening Brief at 26. PGE asserts that the use of
10 short-term debt to fund construction costs, such as Port Westward, “can only serve to benefit
11 customers by lowering the applicable interest rate for the AFUDC account.” *Id.* at 4-5.

12 In response, PGE’s assertion, while seemingly correct, somewhat misses the point.
13 Clearly, the cost for PGE’s revolver(s), which PGE witness Piro asserts is treated as short-term
14 debt under GAAP, would be higher under this acquisition than without it (because of the
15 reduction in PGE’s credit rating for unsecured debt). Staff expects OEUC to hold customers
16 harmless under Conditions 17 and 18 for any additional costs to customers due to increased costs
17 of debt arising from this transaction – be it either short-term debt, long-term debt or AFUDC.

18 **RISKS OF INAPPROPRIATE COST-CUTTING**

19 Staff disagrees with those intervenors that suggest that the length of ownership is itself a
20 risk of the transaction because it is “short term.” In this case, the length of ownership is intended
21 to be 12 years or less. What constitutes “short term:” 12, 20, 30 years? Typically, a proposed
22 acquisition under ORS 757.511 would not detail the intended length of ownership. The fact that
23 we know - today - the potential length of ownership is unique to this transaction and the

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25 ⁶ Staff notes that, if PGE were to come in for a rate case within the next four years after this
acquisition, the \$5 to \$7 million figure totals up to a \$28 million “loss” for PGE’s ratepayers.
26 From one perspective, staff’s \$75 million recommended rate credit, less the \$28 million loss, [i.e.
\$47 million] is close to OEUC’s offer of \$43 million in rate credits.

1 Applicant's business model. While staff does not view ownership for up to twelve years as a risk
2 of a "short term" owner, it does have concerns regarding inappropriate cost-cutting and adequate
3 and prudent capital expenditures.

4 Staff's Conditions include four conditions (Conditions 5, 22, 23, and 24) that are aimed
5 directly at the risk that the transaction will result in inappropriate levels of cost-cutting and
6 adequate capital expenditures. *See* Staff Opening Brief at 23-25. OEUC has also proposed three
7 conditions related to cost-cutting and capital expenditures. *See* Oregon Electric/501, Davis 6-7.

8 These specific Conditions, along with staff's recommended package of Conditions and in
9 conjunction with existing regulatory tools, should adequately mitigate the risk of inappropriate
10 levels of cost-cutting and imprudent capital expenditure and allows staff to recommend approval.
11 As outlined in staff's Opening Brief, staff's Condition 22 and 24 are stronger than OEUC's
12 comparable conditions because they add more substance and meaning than those proposed by
13 OEUC. *See* Staff Opening Brief at 23-26.

14 Staff disagrees with intervenors that staff's proposed cost-cutting Conditions are
15 inadequate. In fact, staff's Conditions are stronger than OEUC's and, staff's package of
16 Conditions allows staff to recommend approval of the transaction. While staff does not view its
17 Conditions as providing complete protection from all risk, staff's expects its package of
18 Conditions, including rate credits and ring-fencing Conditions, to sufficiently protect PGE's
19 customers and the public at large.

20 ***1. Staff Condition 22***

21 Staff's Condition 22 requires OEUC and PGE to submit a final transition plan to the
22 Commission within one year of closing. The Condition further requires that the plan detail,
23 through benchmarking review and other analysis the areas where efficiencies and cost-cutting
24 efforts could occur, identify process improvement plans, and provide annual estimates of
25 expected savings. *See* Staff/1000, Durrenberger/3; Staff Opening Brief at 23-24.

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1 Staff's Condition 22 is a result of concerns with the level of potential cost-cutting.
2 OEUC has produced due diligence reports that describe the types and possible levels of cost-
3 cutting. In response, OEUC provided testimony that asserts that the due diligence reports are
4 only preliminary in nature and not the basis of cost-cutting plans. Instead, OEUC states that
5 cost-cutting plans will only be implemented post-closing, with significant involvement from
6 management. *See* Oregon Electric/100, Davis/17-18. Staff's Condition 22 is aimed directly at
7 identifying these cost-cutting plans.

8 Staff's Condition helps mitigate against inappropriate levels of cost-cutting by requiring
9 OEUC and PGE to submit a transition plan, after closing, which details many facets, including
10 the levels, of cost-cutting that may occur. The final transition plan will assist staff by allowing it
11 to focus audit efforts and resources on areas where cost reductions at PGE are planned or have
12 been made to ensure that they do not negatively affect PGE's customer service, safety, and
13 reliability. *See* Staff/1000, Durrenberger/3.

14 **2. Staff Condition 23**

15 Staff Condition 23, which is also proposed by OEUC, provides that PGE will provide a
16 non-fuel operations and maintenance ("O&M") expense and capital expenditures report ("OMCE
17 Update"). Condition 23 provides that the OMCE Update, using delineated accounts, will
18 compare the actual O&M and capital expenditures for the most recent past year with the current
19 year's budgeted O&M and capital expenditures and the average of the preceding three calendar
20 years' actual O&M and capital expenditures. The OMCE Update will also compare actual O&M
21 costs by functional area for the most recent past year to the last approved test year revenue
22 requirement. PGE is required to include a written narrative description describing the reasons
23 for major variances between the compared accounts and present the major findings to the
24 Commission, upon request. *See* Staff Opening Brief at 25.

25 Although OEUC testified that it does not intend to cut costs at PGE irresponsibly and that
26 it intends to invest prudently in PGE's infrastructure, staff was still concerned that OEUC's

1 statements were not contained in a specific, written plan. *See* Staff/1000, Durrenberger/4. In
2 order to add substance to OEUC's claims, staff proposes Condition 23, which requires PGE to
3 make the annual OMCE Update, described above. The OMCE Update will give staff and the
4 Commission additional information about PGE's O&M expenses and capital expenditures and
5 allow them to focus on areas of concern.

6 ***3. Staff Condition 24***

7 Staff Condition 24 provides that PGE agrees to conduct an audit, if directed by the
8 Commission, within the first seven years of closing, and that the shareholders would bear the
9 expense of the audit up to \$400,000. Furthermore, Condition 24 provides examples of areas the
10 audit may cover. *See* Staff Opening Brief at 25-26.

11 This Condition protects customers from potential risk that may occur if, and when,
12 OEUC implements cost-cutting measures by providing that the Commission may direct OEUC to
13 hire an independent company to examine certain areas of PGE's operations. Under the
14 Condition, PGE's shareholders would bear the audit expense up to \$400,000.

15 ***4. Stipulated Condition 5***

16 Stipulated Condition 5 provides that PGE will continue to perform under the Service
17 Quality Measures ("SQM"), as set forth in Stipulations for PGE Service Quality Measures
18 UM 814/UM 1121 dated July 13, 2004, for a period of ten full calendar years after the date the
19 current SQM is scheduled to retire. *See* Staff/801, Conway/3. Stipulated Condition 5 also helps
20 mitigate the risk that inappropriate cost-cutting will harm customers.

21 Specifically, the SQM provides that the Commission may reduce PGE's revenue
22 requirement for substandard service quality performance under certain conditions of the SQM.
23 *See* Staff/602, Murray-Sipler/7. Thus, if cost-cutting creates substandard service quality
24 performance the Commission has the ability to reduce PGE's revenue requirement. The
25 Commission's ability to reduce PGE's revenue requirement creates an incentive for PGE to be
26 cognizant that cost-cutting efforts should not negatively affect service quality performance.

1 Stipulated Condition 5, in which OEUC and PGE agree to the SQMs, provides additional
2 mitigation against inappropriate cost-cutting.

3 ***6. Currently existing regulatory tools***

4 Staff's package of conditions is generally aimed at the specific potential harms of this
5 transaction and does not restate current Commission regulatory tools. While existing regulatory
6 tools are insufficient for the specific potential harms of this transaction (thus staff's package of
7 proposed Conditions), the existing regulatory tools are significant and do provide protection to
8 PGE's customers and the public generally. For example, the Commission has its existing
9 ratemaking authority (*see* ORS 757.205 through 757.225) and broad supervisory and
10 investigatory authority - just to name a few of its existing regulatory tools. *See also* ORS
11 756.040; 756.515; 756.070.

12 While existing regulatory tools are by themselves insufficient to mitigate the specific
13 risks of this particular transaction, they are meaningful, and along with staff's package of
14 Conditions, meet the standard for approval in ORS 757.511 and allow the Commission to
15 approve this transaction. OEUC cost-cutting conditions do not go far enough. However, staff's
16 cost-cutting Conditions, when viewed in combination with staff's package of Conditions and
17 existing regulatory tools, would sufficiently mitigate the risk of inappropriate cost-cutting and, if
18 the Commission adopts staff's package of Conditions, allow the Commission to find that the
19 transaction would provide net benefits.

20 **RISKS OF TPG OWNERSHIP**

21 Some parties that oppose approval of this transaction argue that staff's package of
22 Conditions are inadequate because staff does not have the necessary access to information at the
23 TPG level.⁷ Staff's Conditions, however, provide the necessary access to TPG information
24 related to PGE.

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⁷ "TPG," as used in this section, refers to TPG Partners III, L.P. and TPG Partners IV, L.P.

1 ***1. TPG is an affiliate of OEUC and PGE***

2 In order to understand the access to TPG information regarding PGE, it is important to
3 note that TPG is an applicant. TPG is an applicant because it is an affiliated interest of OEUC
4 and PGE. ORS 757.511 provides, in relevant part, that:

- 5 (1) No person, directly or indirectly, shall acquire the power to exercise any
6 substantial influence over the policies and actions of a public utility which
7 provides heat, light or power without first securing from the Public Utility
8 Commission, upon application, an order authorizing such acquisition if such
9 person is, or by such acquisition would become, an affiliate interest with such
10 public utility as defined in ORS 757.015(1), (2), or (3).

11 Under ORS 757.511(1), the Commission exercises authority over purchasers that are, or
12 will become as a result of the purchase, an affiliated interest under ORS 757.015 (1), (2), or (3).

13 Under ORS 757.015(1) and affiliated interest is:

14 Every corporation and person owning or holding directly or indirectly five
15 percent or more of the voting securities of such public utility.

16 This language clearly applies to OEUC because in the proposed transaction it would own
17 all of the voting securities in PGE. In addition, ORS 757.015 (2) and (3) apply to purchasers
18 with less direct control than under subsection (1), but are legally treated the same as companies
19 that fit the definition of ORS 757.015(1). ORS 757.015(2) defines an affiliated interest as:

20 Every corporation and person in any chain of successive ownership of five
21 percent or more of voting securities of such public utility.

22 Under ORS 757.015(2), TPG is an affiliated interest because they own 5 percent of the
23 voting securities in OEUC, OEUC in turn owns not only 5 percent of the voting securities of
24 PGE, but all of them. TPG applied as applicants because they are an affiliated interest under
25 ORS 757.015(2).

26 ***2. TPG is an affiliated interest of OEUC and PGE; therefore, there is adequate access
to TPG information regarding PGE.***

27 The fact that TPG is an affiliate of OEUC and PGE reveals the adequacy of staff's

1 proposed Conditions for the purpose of access to TPG information regarding PGE. Staff's
2 proposed package of Conditions, along with existing affiliate statutes and rules, gives the
3 Commission necessary and adequate access to TPG information related to PGE.

4 Specifically, staff's Condition 7 provides that the Commission may audit TPG accounts
5 (as an affiliate of OEUC) that are the bases for charges to PGE to determine the reasonableness
6 of allocation factors used by OEUC to assign cost to PGE and amounts subject to allocation or
7 direct charges. Therefore, the Commission may audit TPG if it is the basis for charges to PGE.

8 Staff's Condition 8 provides that TPG (as an affiliate of OEUC) shall not allocate to or
9 directly charge to PGE expenses not authorized by the Commission to be so allocated or directly
10 charged. TPG cannot allocate or directly charge PGE expenses unless authorized by the
11 Commission.

12 Staff's Condition 12 provides that OEUC and PGE shall maintain and provide the
13 Commission with unrestricted access to all books and records of OEUC and PGE that are
14 reasonably calculated to lead to information relating to PGE. Thus, OEUC and PGE have an
15 obligation to maintain and provide access to information reasonably calculated to lead to
16 information relating to PGE.

17 Staff's Condition 14 provides that OEUC and PGE will provide the Commission access
18 to all books of account, as well as all documents, data and records of their affiliated interests
19 (TPG), which pertain to transactions between PGE and all its affiliated interest (TPG), unless
20 such transactions are exempt under applicable laws or the Master Services Agreement (which
21 also will need to be approved by the Commission if the transaction closes). Consequently,
22 OEUC and PGE must provide the Commission with access to records that pertain to transactions
23 between PGE and TPG, unless they are exempted under an approved Master Service Agreement.

24 In addition to these explicit conditions that provide access to TPG information regarding
25 PGE, the Commission also has statutes and rules that give it the ability to investigate records
26 concerning any transaction between TPG and PGE. *See* ORS 756.070-756.125 (Investigatory

1 Powers); ORS 757.490 (Approval needed for certain contracts); ORS 757.495 (Contracts
2 involving utilities and persons with affiliated interests); *see also* OAR 860-027-0040
3 (Application for Approval of Affiliated Interest Transactions); OAR 860-027-0041 (Affiliated
4 Interest Informational Filings); OAR 860-027-0100 (Reporting of Affiliated Interest
5 Transactions).

6 Staff's package of Conditions, along with existing regulatory tools provides for
7 reasonable access to TPG information related to PGE. While some intervenors claim the more
8 access to TPG the better, staff's Conditions appropriately balance the Commission's need for
9 ample TPG information related to PGE and TPG's ability to keep confidential information
10 unrelated to its equity ownership of PGE.

11 ***3. Possible Ramifications of PUHCA repeal***

12 Most of staff's Conditions apply to OEUC and not TPG because staff's recommendations
13 are based upon the structure as currently presented by the Applicants. The Applicants have
14 purposefully structured this transaction to avoid TPG regulation under PUHCA.

15 Some parties worry that if PUHCA is repealed, staff's package of Conditions will not be
16 adequate. The more appropriate question, however, is not what happens if PUHCA is repealed
17 but how TPG responds to a repeal of PUHCA.

18 For example, if TPG responds to the repeal of PUHCA by eliminating OEUC then the
19 removal of one of the Applicants, OEUC, that is an integral part of this transaction would trigger
20 a substantial change of influence, which would require an ORS 757.511 filing. In addition to the
21 Commission's authority under ORS 757.511, the Commission also has the authority to revisit
22 and amend its order if there is a change in circumstances. *See* ORS 756.568; *see also* ORS
23 756.040 ("Commission vested with powers and duties to protect customers and public
24 generally"); ORS 756.515 ("Commission authority to investigate.")

25 If PUHCA is repealed, future Commission action will depend on how TPG responds to
26 the repeal of PUHCA. In its Opening Brief, the Applicants state that if PUHCA is repealed

1 TPG's consent rights would be eliminated and the voting control of OEUC would be realigned to
2 reflect the respective equity interests, which would give TPG direct voting control over PGE.
3 See OEUC Opening Brief at 3, fn 9. Applicants further claim that this realignment of voting
4 control would not require additional Commission action under ORS 757.511. *See Id.* To
5 determine the plans of TPG upon the repeal of PUHCA, the Commission could ask TPG at oral
6 argument to explain, based upon the evidentiary record, what their plans are if PUHCA is
7 repealed. If necessary, the Commission could recognize and condition approval of the
8 transaction on revisiting conditions if PUHCA repealed.

9 **4. *If TPG sells its interest in OEUC, the purchaser would be required to file for***
10 ***approval under ORS 757.511.***

11 The Building Owners and Managers – Portland (“BOMA”) claim that TPG is not limited
12 in selling its investment interest in OEUC. *See* BOMA Opening Brief at 9. BOMA is mistaken.

13 If TPG sells its interest in OEUC, the purchaser, by taking TPG’s interest that makes
14 TPG an affiliated interest, would become an affiliated interest also, and therefore, be subject to
15 ORS 757.511.⁸ If a purchaser buys TPG’s interest in OEUC, including the consent rights that
16 TPG has in connection with OEUC, the purchaser would have indirect control, even if it has less
17 than five percent control of the voting securities of PGE, and therefore, be an affiliate interest
18 subject to ORS 757.511.

19 If TPG does not sell its entire interest or sells its entire interest to several parties, ORS
20 757.511 would still apply to if the sale gives a purchaser five or more percent of the voting
21 securities of PGE. If a purchaser has less than five percent of the voting securities of PGE,
22 whether ORS 757.511 applies would depend on the indicia of control. For example, any
23 purchaser that has consent rights similar to TPG’s would have indirect control over all the voting
24 securities and be an affiliated interest that must file for approval under ORS 757.511.

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26 ⁸ In this context, "purchase" refers to an acquisition by private investors, not by consumer-owned
utilities like Public Utility Districts, municipalities or cooperatives.

If TPG sells its interest in OEUC, the purchaser would be required to file an ORS 757.511 application. If TPG sells part of its interest, or its entire interest to different purchasers, it may be required to file an ORS 757.511 application depending on the specifics of the transaction. Contrary to BOMA's claim, TPG is subject to the Commission's jurisdiction if it sells its interest, as described above, in OEUC.

**6 THE COMMISSION SHOULD CONTINUE ITS CURRENT POLICY OF VIEWING
PGE'S TAXES ON A STAND ALONE BASIS**

8 In both its testimony and opening brief, staff details why the Commission should
9 continue its practice of viewing PGE’s taxes, like every other utilities it regulates, on a stand-
10 alone basis. *See* Staff Opening Brief at 36; Staff/1200, Johnson/1-2; Staff/500, Johnson/2-3.
11 Nonetheless, some parties continue to express concern that PGE’s rates will include an estimate
12 of federal and state taxes, but that there is no guarantee that OEUC, if it files a consolidated tax
13 return, will pay such taxes to the Internal Revenue Service or to the Oregon Department of
14 Revenue.

15 In particular, the City of Portland (“COP”) argues that the Commission should require
16 TPG to share tax benefits that arise from the interest deductions at OEUC. *See* COP Opening
17 Brief at 31. The Citizen’s Utility Board (“CUB”) claims that customers will “overpay” on
18 PGE’s utility taxes. *See* CUB Opening Brief at 28. BOMA states that viewing taxes on a stand-
19 alone basis is against public policy. *See* BOMA Opening Brief at 9. The Utility Reform Project
20 (“URP”) declares that the Commission should not allow PGE to charge for taxes that are not
21 actually paid to the government. *See* URP Opening Brief at 6.

22 These parties do not rebut staff's principled rationale for viewing a utility's taxes on a
23 stand-alone basis but, instead, rely on rhetoric that does not survive scrutiny. At the outset, it
24 should be recognized that appropriate tax treatment for PGE – and the other utilities that the
25 Commission regulates - is a regulatory issue and is not related to the "net benefit" standard.
26 Staff's package of Conditions is not based upon the amount of money that TPG can afford to

1 pay, but rather on conditions necessary to demonstrate that the acquisitions' expected overall
2 benefits outweigh its expected risks and harms. *See generally* Staff Opening Brief at 2-4. The
3 Commission should recognize that taxes are not an issue in the docket.

4 The problem with the intervenors assertions is that they are not focusing on whether the
5 customer paid a fair price for the service. Instead, they are focused on tax law – law that allows
6 every business, from small mom and pop operations to large parent corporations, to offset gains
7 with losses – and equate this accepted and legal tax treatment into consumer harm specific to
8 utility regulation.

9 If the Commission did use the parent's cost, customers may be subjected to the risks
10 associated with the parent and all other companies in its corporate family. In addition, it may
11 logically have to use all of its costs, such as its return on equity, which is likely to be
12 substantially higher than the utility's. Utility taxes are paid based upon a myriad of issues,
13 including the consolidated capital structure and actual operations and profitability of the utility.
14 For example, assume that natural gas prices unexpectedly increase due to factors beyond the
15 control of the company. In this scenario, net operating income decreases significantly, which in
16 turn reduces the tax burden on the utility. The company would pay lower taxes than it would
17 have paid based upon normal operations. If this reduction in taxes were to be flowed through to
18 customers as some intervenors suggest, it would also seem logical to flow through the increased
19 gas costs that caused the reduction in taxes to customers. Otherwise, the utility would suffer
20 higher power costs and also be obligated to refund to customers the difference between actual
21 taxes paid and those calculated based upon normal operations.

22 The Commission should continue its policy of viewing taxes on a stand-alone basis
23 because the Commission's goal is to fairly reflect the costs that PGE incurs in providing service
24 to its customers, not the costs of the parent. The Commission policy to view utilities' taxes on a
25 stand-alone basis is based upon sound regulatory principle and is consistent with typical
26 regulatory treatment and should be continued.

TROJAN DECOMMISSIONING COSTS

2 The Eugene Water & Electric Board and the Bonneville Power Administration
3 (collectively, “EWEB”) ask the Commission to adopt a condition that would protect PGE’s
4 ratepayers against alleged financial harm arising from the effect of this acquisition on PGE’s
5 ability to fund the expenses associated with decommissioning the Trojan nuclear plant (Trojan
6 Expenses). EWEB says, “OEUC should be required to procure and maintain a bond or other
7 credit support instrument in a reasonable amount to be determined by the Commission to pay any
8 future PGE Trojan obligation not satisfied by the Decommissioning Trust Fund.” EWEB
9 Opening Brief at 4-5. EWEB sets forth its rather complicated condition on page 17 of its
10 opening brief.

11 Staff did not recommend a condition concerning PGE's Trojan Expenses. While staff did
12 not provide written testimony on this topic, staff witness Conway explained staff's reasoning
13 during cross examination at the oral evidentiary hearings. EWEB incorrectly summarizes Mr.
14 Conway's testimony as a "hope that PGE's Trojan liabilities can all be addressed through the
15 Decommissioning Trust Fund" and then asserts "total reliance on the fund to address these
16 significant uncertainties is not prudent in the face of the highly leveraged acquisition structure."

17 *Id.* at 11.
18 Mr. Conway actually testified to something quite different than is represented in EWEB's
19 brief. Mr. Conway testified that:

1. The Commission has traditionally included the cost for the Trojan Expenses in customers' rates (Transcript, Vol 1 at 67);
 2. EWEB's concern "is best addressed through an ongoing review of the Trojan decommissioning costs and the rates customers are paying" (*Id.* at 69); and
 3. The Commission's Order No. 95-322 sets out the ongoing process the Commission will use for reviewing Trojan Expenses (quoting from Order 95-322): "The plan and its funding mechanism should then be a subject of regular and ongoing review by the Commission and staff. Necessary changes in authority granted to PGE by the Commission can be made in future dockets." (*Id.* at 70).

1 Thus, staff is not merely “hoping,” as EWEB claims, the existing Decommissioning Trust
2 Fund will continue to be sufficient to cover all future Trojan Expenses. Instead, consistent with
3 Order 95-322, the Commission will engage in an ongoing review of such expenses and enter
4 corrective orders as required. EWEB’s concerns can be adequately addressed through the
5 Commission’s ratemaking, and other related processes. As such, staff is not convinced of the
6 need for EWEB’s proposed bonding condition.

OTHER MATTERS

8 1. OEUC's General Provision "B"

OEUC offers three “General Provisions” for its 34 conditions. *See* Oregon Electric/501, Davis/9. Its General Provision B provides: “Conditions 25, 27, 31, 32 become inapplicable after an Initial Public Offering of Oregon Electric or PGE.” *Id.* Staff has a concern about this general provision and urges the Commission to reject it.

The provision is overly vague and uncertain because it fails to identify what action would constitute an “Initial Public Offering” (IPO). An IPO could encompass a sale of either 1% or 100% of OEUC or PGE, or both. Clearly, the Commission should not eliminate the named conditions simply because an insignificant equity ownership of OEUC or PGE is placed as an IPO. Further, the general provision as written arguably would allow the deletion of the named conditions if an IPO is offered but fails. Again, it would not be appropriate to remove the conditions under these circumstances. Further, while certain conditions should likely be removed upon a complete sale of PGE, this is not necessarily true for a sale of OEUC. Finally, any sale may be subject to ORS 757.511, depending upon the specifics of the sale, and it would be premature to try to determine today which conditions should remain, and which should be eliminated, without knowing the circumstances of the particular IPO or sale.

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1 **2. OEUC's General Provision "C"**

2 OEUC's General Provision C provides: "Nothing in this settlement shall be construed to
3 result in disallowance of costs from PGE's revenue requirement unless expressly stated." *Id.*

4 Staff recommends the Commission not adopt this general provision.

5 Preliminarily, the provision is flawed because of its reference to a "settlement." As such,
6 the provision does not seem appropriate, since settlement discussions were unsuccessful.

7 Further, even in the context of settlement discussions, staff is not at all clear how the provision
8 would work. If OEUC intends to pursue adoption of this provision, it should clarify its meaning
9 (perhaps at oral argument), especially since OEUC intends to have it apply to each of its 34 other
10 conditions.

11 **3. Bankruptcy and the Golden Share**

12 In discussing the adequacy of the Commission's ring-fencing conditions ordered when
13 Enron acquired PGE, Enron states: "The evidence shows that the prior ring-fencing conditions
14 adequately protected PGE and its customers from adverse effects of Enron's bankruptcy." Enron
15 Opening Brief at 15. While staff would like to think the conditions it recommended for the
16 Enron merger were all that were necessary to protect PGE once Enron filed for bankruptcy, such
17 is not the case. An important protective mechanism for PGE against the Enron bankruptcy, that
18 was not part of the original Enron conditions, is PGE's "golden share."

19 Briefly, a "golden share" is a single share of preferred stock that has special voting rights
20 that allow PGE to not file for voluntary bankruptcy regardless of the desires of its parent
21 company. *See* Oregon Electric/800, Bussel/8; ICNU/200, Antonuk-Vickroy/14. PGE's golden
22 share was created and issued after the Enron conditions were in place in order to prevent Enron
23 from dragging PGE into its own bankruptcy. This important bankruptcy protection for PGE
24 would be lost should the Commission approve this Application.

25 / / /

26 / / /

CONCLUSION

2 For the reasons stated, staff asks the Commission deny Applicants' Application. Should
3 the Commission decide to grant the Application, staff asks the Commission to adopt its
4 Conditions.

DATED this ____ day of December 2004.

Respectfully submitted,

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