

September 22, 2004

Via Federal Express

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:

Enclosed are an original and six (6) copies of the Surrebuttal Testimony of Susan Anderson on behalf of the City of Portland, Oregon in this proceeding.

Thank you for your assistance.

Very truly yours,

Benjamin Walters
Senior Deputy City Attorney

BEW:pd
Enclosures

c: UM 1121 Service List

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bc: Kathleen Gardipee
Susan Anderson
Michael Armstrong
Linda Meng

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1121

In the Matter of the Application of OREGON
ELECTRIC UTILITY COMPANY, LLC,
TPG PARTNERS III, L.P., TPG PARTNERS
IV, L.P., MANAGING MEMBER LLC, NEIL
GOLDSCHMIDT, GERALD GRINSTEIN,
and TOM WALSH for an Order Authorizing
Oregon Electric Utility Company LLC to
Acquire Portland General Electric Company

**SURREBUTTAL TESTIMONY OF
SUSAN ANDERSON
ON BEHALF OF
THE CITY OF PORTLAND, OREGON**

September 22, 2004

I. INTRODUCTION AND OVERVIEW

My name is Susan Anderson, and I am the Director of the City of Portland Office of Sustainable Development. I have previously testified in this proceeding. My qualifications are set forth in Exhibit 1 to my direct testimony on behalf of the City of Portland.

The City of Portland believes that Texas Pacific Group's proposal to acquire Portland General Electric (PGE) remains seriously flawed.¹ The current proposal, as modified by Texas Pacific's rebuttal testimony, continues to introduce substantial risk to ratepayers while providing inconsequential benefits. Texas Pacific's proposal does not come close to meeting its statutory burden of proving to the Oregon Public Utility Commission ("Commission") that this transaction would provide net benefits to PGE's customers. As a large customer and as the local government representative of 25 percent of PGE's customers, the City of Portland cannot support this application in its current form.

Texas Pacific's rebuttal testimony responds to several of the concerns raised in my direct testimony, but on no issue is its response adequate. The City of Portland is particularly concerned about the following issues:

1. PGE franchise with the City of Portland;
2. Commitment to environmental protection;
3. Assistance to low-income households;
4. Tax benefits enjoyed by Texas Pacific Group and not shared with ratepayers;
5. Lack of meaningful local input at PGE;
6. Risks of financial structure and debt burden at Oregon Electric; and

¹ Throughout this testimony, "Texas Pacific Group" refers to TPG Partners III, L.P., TPG Partners IV, L.P., Oregon Electric Utility Company, LLC, and Managing Member LLC, as the context may imply.

7. Duration of Texas Pacific Group ownership and its plans to dispose of PGE.

The first four items are relatively straightforward, and Texas Pacific Group can address Portland's concerns by agreeing to specific acquisition conditions. For each of these issues, the City of Portland proposes such a condition or a way to establish a condition.

For the fifth issue, the lack of meaningful local input to key PGE corporate decisions, the City of Portland does not propose a condition, but simply observes that it cannot be considered a substantive benefit, as Texas Pacific Group claims.

The remaining two items are more complex and difficult to remedy. While there may be possible ways for Texas Pacific Group to mitigate Portland's concerns with these issues, these remain serious, fundamental problems in the proposed acquisition.

My testimony will address each of these issues individually.

II. TEXAS PACIFIC MUST COMMIT TO ENTERING INTO A MODERN FRANCHISE TO OPERATE IN THE CITY OF PORTLAND TO ADDRESS THE SIGNIFICANT UNCERTAINTY OF PGE'S CURRENT STATUS.

As noted in my direct testimony, the validity of the franchise agreements under which PGE claims to operate in Portland is, at best, legally uncertain (COP/100, Anderson/2). Portland and PGE are currently in negotiations to develop a valid modern franchise and continue to make progress toward that end.

PGE witness Piro acknowledges that PGE is engaged in this process "because it is good business to do so" but declines to make a commitment to concluding a franchise, "since the Commission need not and should not insert itself in the middle of these normal utility business affairs" (PGE/100, Piro/30). Similarly, Texas Pacific Group witness Davis indicates that Texas Pacific Group "supports the development of a modern utility franchise agreement between PGE

and the City” (Oregon Electric/100, Davis/51). However, Mr. Davis also rejects making a commitment in this proceeding.

The City of Portland appreciates both Mr. Piro’s and Mr. Davis’s positive statements about the current franchise negotiations and the importance of concluding a modern franchise. Given these statements, PGE’s and Texas Pacific Group’s unwillingness to agree to a condition to formalize their intent is puzzling. This issue presents a clear opportunity to provide assurances to Portland and other parties of Texas Pacific Group’s intent to take a prudent and collaborative approach to running PGE. However, Texas Pacific Group appears unwilling to make even a gesture toward such a basic commitment.

To address this concern, the City of Portland proposes that Texas Pacific Group agree to the following condition:

Oregon Electric and the City of Portland commit to make all reasonable efforts to develop and obtain approval of a modern utility franchise between PGE and the City of Portland within twelve months following the completion of the acquisition.

This condition has a direct precedent in Sierra Pacific Resources’ application to acquire PGE. In that proceeding, a stipulation among parties included a condition with comparable language, and the Commission’s final order acknowledged that the commitments in the stipulation were in the public interest (Order 00-702, at p. 8). This precedent counters the testimony of Mr. Piro and Mr. Davis that this item is outside of the Commission’s legitimate concerns. Refusing to provide a tangible commitment on this type of issue, otherwise easily resolvable, sets the tone for how Texas Pacific Group has failed to follow through on more complex and more difficult matters.

III. TEXAS PACIFIC GROUP APPEARS UNWILLING TO MAKE ANY SUBSTANTIVE COMMITMENT TO ENVIRONMENTAL PROTECTION.

My direct testimony identified three concerns with Texas Pacific Group's proposal for increasing PGE's use of renewable resources:

- 1) Its target is based on an inappropriate measure;
- 2) It does not include interim targets; and
- 3) It is so heavily qualified that PGE could meet the commitment without producing a single additional kilowatt-hour of renewable energy (COP/100, Anderson/15).

Texas Pacific Group's rebuttal testimony tangentially addressed the third of these issues in its discussion of the meaning of "economic" but made no additional commitments (Oregon Electric/100, Davis/48). Texas Pacific Group continues to indicate that it would "vigorously pursue" a renewables target of 10% of 1:2 peak capacity by 2012, if economic (id.).

As I noted in my direct testimony, Texas Pacific Group can meet its proposed commitment without generating a single kilowatt-hour of renewable power. Its proposal lacks sufficient detail and certainty to be considered a benefit and does nothing to establish how Texas Pacific Group's new ownership would improve PGE's current practices with respect to renewables and energy efficiency. In short, Texas Pacific Group's pledge to "enhanc[e] PGE's performance in environmental, energy efficiency, and renewable resource areas" and related testimony simply cannot be considered a benefit, despite Applicants' claims to that effect. See, *Application*, p. 21.

To provide a substantive, measurable benefit in the form of a commitment to renewable energy, Texas Pacific Group should commit to the following condition:

Oregon Electric commits to supplying a minimum of 7 percent of PGE's retail MWh sales with new renewable resources (as defined

in OAR 860-038-0005) by 2007, 8 percent by 2010, and 10 percent by 2014.

More generally, Texas Pacific Group's rebuttal testimony resists agreeing to even a symbolic commitment to supporting the public purpose concepts embodied in Senate Bill 1149, even while stating clearly, "Oregon Electric strongly endorses the policy objectives that underlie SB 1149 and expects to support those objectives well into the future" (Oregon Electric/100, Davis/46). The City of Portland welcomes this comment and asks only why Texas Pacific Group is seemingly unwilling to formalize this sentiment as an explicit condition of this acquisition. The continued success of the public purpose fee is critical to the long-term economic and environmental health of Oregon, and making an explicit pledge consistent with Mr. Davis's testimony would provide reassurances of Texas Pacific Group's future intent.

The City of Portland encourages Texas Pacific Group to work with the Joint Public Interest Parties to draft a condition along the lines of the following:

OEUC and PGE commit to supporting the intent and direction of SB 1149, including a public purpose fee of at least three percent. OEUC and PGE commit to confer and work in good faith with the SB 1149 stakeholders, including the Commission, CUB, ICNU, AOI, City of Portland, and FCEC to further implement and refine the energy policies reflected in SB 1149, including the investments in energy efficiency and renewables through the Energy Trust of Oregon.

If Texas Pacific Group is unwilling to agree to a condition of this nature, including substantive, verifiable standards, its commitments in this regard simply cannot be described as providing any benefit to PGE's ratepayers.

IV. TEXAS PACIFIC GROUP'S OFFER TO DOUBLE PGE'S EXISTING CASH ASSISTANCE TO LOW-INCOME HOUSEHOLDS WOULD PROVIDE TRIVIAL BENEFITS.

Mr. Davis's rebuttal testimony states that he "very much appreciated the testimony by CADO-OECA and Multnomah County," but he then simply repeats Texas Pacific Group's offer to double the cash portion of PGE's commitment to Oregon HEAT (Oregon Electric/100, Davis/49). This commitment amounts to \$50,000 per year for all low-income households served by PGE.

Currently, just over 100,000 PGE households are eligible for low-income bill-paying assistance through the Oregon Energy Assistance Program.² If Texas Pacific Group's \$50,000 commitment were shared equally with all qualifying households, Texas Pacific Group's proposal would provide just four cents per month for each eligible household.

For Texas Pacific Group to trumpet to its commitment of an additional \$50,000 in annual bill-paying assistance underscores the minimal nature of all of its claimed benefits. Individually or collectively, they simply do not add up to providing any meaningful benefits to PGE's ratepayers. Certainly this proposal cannot be described as providing any significant benefit to low-income ratepayers as a class.

The City of Portland urges Texas Pacific Group to work with CADO/OECA and Multnomah County to agree on one or more acquisition conditions that make a meaningful commitment to addressing the needs of low-income households.

² "Oregon Energy Assistance Program Evaluation." Prepared by Quantec for Oregon Housing and Community Services, January 2003. URL: www.ohcs.oregon.gov/OHCS/CRD/SOS/docs/OEA_Evaluation_011303_final.pdf.

V. TEXAS PACIFIC GROUP SHOULD OFFER A MECHANISM FOR SHARING THE SUBSTANTIAL TAX BENEFITS THAT IT WOULD ENJOY TO OFFSET THE CORRESPONDING RISKS THAT WOULD BE IMPOSED UPON PGE'S RATEPAYERS.

Several intervenors, including Portland, have suggested that Texas Pacific Group adopt a mechanism to share the tax benefits that arise from the interest deductions at Oregon Electric (COP/100, Anderson/21; CUB/100, Jenks-Brown/13; ICNU/200; Antonuk-Vickroy/41).

Commission Staff also express an interest in this issue, although also identifying several potential hurdles, including IRS regulations (Staff/500, Johnson). PGE's rebuttal testimony amplifies the complexities of changing the Commission's policy on how to treat utility tax obligations for ratemaking purposes (PGE/200, Tinker-Murray-Hager/8).

Nothing in PGE's response alters the underlying fact that the financial structure Texas Pacific Group has proposed generates tax benefits that improve Texas Pacific Group's return on its investment. Since it is the high levels of debt at Oregon Electric that lead both to these tax benefits and to significant new risks for ratepayers (discussed in Section VII below), it seems appropriate for Texas Pacific Group to provide some corresponding benefits to ratepayers. Instead, Texas Pacific Group has chosen to provide no meaningful, substantive response.

A corresponding benefit could be accomplished through at least two straightforward mechanisms, neither of which requires the Commission to modify its policy on tax treatment or runs afoul of IRS regulations. In the simplest approach, Texas Pacific Group could forecast the financial benefits of the interest deduction at Oregon Electric and add this amount to the guaranteed rate credit it has already offered.

In a more complicated option, Texas Pacific Group could agree to a condition along the lines of the following:

Oregon Electric and PGE agree to adjust the amount of the rate credit to be distributed to PGE's customers in any given fiscal year by adding to the rate credit the amount of any local, state or federal taxes paid by PGE to Oregon Electric due to the companies' combined tax status during the prior fiscal year that are absorbed or retained by Oregon Electric rather than paid forward to the respective assessing government body.

VI. LOCAL INVOLVEMENT ON PGE BOARD WOULD PROVIDE NO SUBSTANTIVE BENEFITS TO PGE'S RATEPAYERS.

Texas Pacific Group continues to claim that the participation of Oregon residents on PGE's board is a major benefit of the transaction, despite the consent rights held by Texas Pacific Group (Oregon Electric/100, Davis 58). In its rebuttal testimony, Texas Pacific Group's chief defense of this position is presented by witness Jackson, who asserts that "PGE's best interests are largely coextensive with the best interests of PGE's customers and the community" (Oregon Electric/300, Jackson/3). Mr. Jackson concludes by stating, "I am personally satisfied that TPG shares my philosophy and goal of achieving a balanced approach with respect to actions that affect both the company's customers and its investors" (Oregon Electric/300, Jackson/9).

With all due respect to Mr. Jackson's personal assessment of Texas Pacific Group, as a PGE board member, Mr. Jackson's fiduciary obligation is to advance the interests of the shareholder, not the customer. Moreover, all major decisions of the PGE board are subject to Texas Pacific Group's consent, so even if Mr. Jackson is correct that the interests of PGE and its customers overlap, the ultimate decision maker is Texas Pacific Group, not PGE.

Portland does not object to the composition of the board proposed by Texas Pacific Group, either in general terms or with respect to the candidates who have been identified, but it cannot be considered a substantive benefit.

VII. THE PROPOSED TRANSACTION WOULD IMPOSE SIGNIFICANT RISKS UPON PGE'S RATEPAYERS, WITHOUT PROVIDING SIGNIFICANT, OFFSETTING BENEFITS.

The City of Portland remains seriously concerned about the risks the proposed transaction introduces for PGE and its customers. The City of Portland's concerns are rooted in two issues:

- 1) Texas Pacific Group's investment objectives and the double-leverage structure significantly increase the pressure on PGE to reduce costs.
- 2) The significant level of debt at Oregon Electric increases the risk of a credit downgrade at PGE, raising PGE's cost of capital.

Texas Pacific Group's rebuttal testimony insists that Commission staff and intervenor concerns about risk are "unfounded" (Oregon Electric/200, Wheeler/5). Ms. Wheeler testifies, for example, that Oregon Electric's debt and resulting negative pressure on PGE's credit rating would only affect PGE's senior unsecured debt (Oregon Electric/200, Wheeler/15). Apparently this is to be viewed as a minor issue, since PGE is unlikely to issue new unsecured debt until 2010 (Id.).

Mr. Davis, on the other hand, notes that as Oregon Electric pays down its debt over time, PGE's credit rating would improve (Oregon Electric/100, Davis/3). Texas Pacific Group appears to deny a meaningful link between the credit rating at Oregon Electric and PGE when it would result in a downgrade at PGE but take credit for the same link when it could conceivably benefit PGE.

By presenting arguments on both sides of the credit risk issue, Texas Pacific Group's testimony is not reassuring. It appears to confirm that the double-leverage structure and exceptionally high consolidated debt levels do, in fact, present a risk to PGE's cost of capital.

Texas Pacific Group's testimony is similarly contradictory in denying any specific intentions of reducing costs at PGE. In a section of his testimony subtitled, "The Limited Application of Due Diligence Reports," Mr. Davis describes at length how the benchmarking reports Texas Pacific Group completed as part of its due diligence cannot be construed as blueprints for reducing costs at PGE (Oregon Electric/100, Davis/14). He also observes, however, that reducing costs is a desirable outcome and implies that this would lead to lowered rates (see, e.g., Oregon Electric/100, Davis/3 and 8).

As with Texas Pacific Group's multiple positions on credit ratings, so it embraces multiple positions on the merits and likelihood of reducing costs. The only reasonable conclusion is that Texas Pacific Group fully expects to reduce costs—most of its financial scenarios include such cost reductions, after all, and its presentation to the credit rating agencies about the proposed transaction similarly suggested reduced levels of capital investment—and the only question is to what extent the cuts would affect ratepayers (Oregon Electric/200, Wheeler/9; ICNU/100, Schoenbeck/20).

These risks are largely financial, and it would be appropriate for Texas Pacific Group to compensate ratepayers for these added risks by providing a meaningful rate credit.

In its rebuttal testimony, Texas Pacific Group proposes a rate credit of \$3 million per year for five years beginning in 2007 (Oregon Electric/100, Davis/32). According to Mr. Davis, the \$15 million figure represents 50% of what Texas Pacific Group forecasts PGE would earn above the currently authorized 10.5% return on equity (ROE) (Oregon Electric/100, Davis/32).

It is important to note that, should PGE consistently earn above its authorized ROE, it would be appropriate to hold a rate case to establish appropriate rates to reflect the company's

costs. Once rates are re-set, ratepayers would receive all financial benefits that would otherwise be above the authorized ROE, not merely half of them.

More generally, however, the current proposal of \$15 million in rate credits is a benefit, but it is a benefit that is wholly inadequate to compensate ratepayers for added risk of financial structure and uncertainty.

Contrary to Mr. Davis's claim that "this is an irrefutable net benefit," the proposed rate credit is an extraordinarily modest benefit that is offset many times over by financial and operational risks and uncertainties of Texas Pacific Group's short-term ownership and double-leveraged structure.

These other problems are so significant, in fact, that it would be inappropriate to estimate a credible rate credit figure that would provide adequate compensation to ratepayers for the risks of this transaction. Any discussion of rate credit must take place in tandem with acquisition conditions that can mitigate these financial and operational risks. At a minimum, these conditions should include:

Until Oregon Electric's bonds are investment grade and equally rated with PGE's bonds, any new PGE long term debt or preferred stock issuances will be reflected for ratemaking purposes at a cost rate at the time of issuance that is one step above the actual rating granted by the rating agencies.

Oregon Electric shall not allow, and shall hold PGE's customers harmless from, any increases in PGE's revenue requirements that may be directly attributed to Oregon Electric's ownership of or control over PGE.

VIII. DURATION OF TEXAS PACIFIC OWNERSHIP AND EXIT STRATEGY

The City of Portland remains concerned about the duration of Texas Pacific Group's ownership of PGE. Texas Pacific Group would hold PGE for a maximum of 12 years, a limitation that is problematic for two reasons:

- 1) It creates an investment horizon for Texas Pacific Group that conflicts with the investment horizon for ratepayers; and
- 2) It perpetuates PGE's "for sale" status, with Texas Pacific Group watching for the opportunity to sell or issue stock in PGE that would maximize its return on investment, regardless of whether that opportunity arrives in 2005 or 2015.

My direct testimony, as well as testimony of the Citizens' Utility Board, suggested one mechanism for addressing the uncertainty around PGE's future: grant an option to purchase PGE to a public entity, subject to certain conditions and process (COP/100, Anderson/12, CUB/100, Jenks-Brown/30).

Texas Pacific Group's rebuttal testimony claims that any "limits" placed on how it divests of PGE would be "unwise," since the future is unknown (Oregon Electric/100, Davis/56).

Granting an option to purchase to a public entity does not "limit" Texas Pacific Group's ability to later sell PGE. Rather, it provides a defined, certain structure as one element of the sale process. Moreover, designating a public entity as the holder of an option to purchase would represent a clear benefit of the current transaction. Publicly owned utilities consistently enjoy better rates and service and provide exemplary accountability and long-term stability. (See, generally, the direct testimony of City of Portland witness Richardson.)

Under Texas Pacific Group's current proposal, its ownership of PGE is merely a transitional phase from a state of instability to one of uncertainty: PGE continues to be for sale, and uncertainty about PGE's long-term future is unchanged from Enron's current, short-term ownership. With a public option to purchase in place, by contrast, Texas Pacific Group's ownership of PGE serves as the same transitional phase, but one in which at least one credible, secure, accountable buyer is clearly identified.

The City of Portland has explored public ownership of PGE at considerable length over the past two years. While any technical analyses and documents Portland may have developed about a potential acquisition of PGE are subject to a confidentiality agreement with Enron, *The Oregonian* reported at some length on Portland's efforts in a front-page story on July 23, 2004 (Attached as Exhibit 200). Portland's interest in public ownership of PGE was reaffirmed in a June 23, 2004 letter from the Mayor and three City Commissioners to the Public Utility Commission (attached as Exhibit 201). This letter concluded, "The City of Portland remains willing and able to pursue public ownership of PGE." There have been no public alterations or modifications to this position since this letter was written.

Public discussions about how a public utility could be owned, operated, and managed took place in a variety of venues in 2003, including four meetings of regional leaders. General concepts from these meetings were distilled into a discussion draft of a "governance framework," which identified a potential structure for managing and operating the utility, including the concept of an initial purchase by the City of Portland with subsequent transfer to a regional body.

The City of Portland has consistently indicated a willingness to transfer ownership of PGE to a regional entity such as a Chapter 190 organization. The draft governance framework, for example, explicitly stated, "If a transfer to regional ownership is found to be in the public interest, the City of Portland will work with the Board, other governmental jurisdictions, and key stakeholders to ensure an efficient and equitable transition."³

³ "Governance Framework for a Publicly Owned Electric Utility" is available at www.portlandonline.com/shared/cfm/image.cfm?id=49532. Portland Mayor Vera Katz and City Commissioner Erik Sten also emphasized Portland's openness to transferring ownership of PGE to a regional body at a series of meetings of regional leaders in 2003. See, for example, "Future of PGE Roundtable, October 15, 2003 Meeting Summary and Notes," pg. 5 (www.portlandonline.com/shared/cfm/image.cfm?id=31902).

While public ownership is one of several possible scenarios for PGE’s next owner, it differs importantly from all others in that it would remove the seemingly permanent “for sale” sign dangling from PGE. Public ownership would provide the company and ratepayers the stability and accountability that Texas Pacific Group’s proposal only pretends to offer. Without this option, Texas Pacific Group’s acquisition simply delays the transition to long-term stability while introducing significant risk, as described above.

Granting an option to purchase to a public entity does not eliminate Portland’s other concerns with this proposed transaction, but it increases the likelihood that Texas Pacific Group’s ownership could serve as a transition to a stable, regionally accountable utility for the long term.

IX. CONCLUSION

In his summary of Texas Pacific Group’s proposal, Mr. Davis identifies 17 “benefits” of the transaction (Oregon Electric/100, Davis/58). Of these, only three can be remotely characterized as providing any “benefits” to ratepayers. The others are either illusory, as certainly arising in any baseline scenario, or vague assurances lacking any quantifiable aspects of accountability or verification. The following table summarizes these various “benefits” and the categories into which they fall:

Claimed benefit	Category
“Strong local representation and leadership on PGE’s Board”	Vague
“First-class Board of Directors”	Vague
“Reinvigorated Board-level strategic direction”	Vague
“Capital reinvestment in PGE”	Vague
“Guaranteed rate credit of \$15 million”	Benefit
PGE is indemnified against certain Enron-related liabilities	Basecase
PGE is potentially indemnified against certain other Enron-related	Basecase

Claimed benefit	Category
liabilities up to \$1.25 billion	
“A commitment to reinforcing high-quality service”	Vague
“10-year extension of the commitment to service quality measures”	Benefit
“Oregon Electric will be an Oregon taxpayer”	Basecase
“An immediate end to Enron’s ownership of PGE, ensuring stability and unified ownership”	Basecase
“PGE’s headquarters will stay in Portland”	Basecase
“Commitment to work vigorously to have 10% of PGE’s resources to meet peak capacity to be from renewable resources, if economical”	Vague
“Appointment of a manager within PGE. . . to work with the advocacy groups for renewable energy sources, sustainability, energy efficiency, and environmental matters”	Vague
“10-year extension of PGE’s cash and in-kind donations to Oregon HEAT and a doubling of the cash portion”	Benefit
“Periodic access to PGE’s Board of Directors for various customer and environmental advocacy groups”	Vague
“Commitment to work on additional programs for low income assistance”	Vague

Of these, only three have any ascertainable substance and merit: the \$15 million in rate credits; the \$50,000 contribution toward low-income bill-paying assistance; and the extension of service-quality measures. In addition, Texas Pacific Group has agreed to certain financial ringfencing provisions that extend the current provisions to address the unique characteristics of Texas Pacific Group’s financial and ownership structure (Oregon Electric/100, Davis/42-44).

As noted above, the rate credit and commitment to provide an additional \$50,000 to low-income customers are exceedingly modest benefits, as is the extension of service-quality measures. The ringfencing provisions are welcome, but they only serve to protect PGE and ratepayers from Oregon Electric problems, rather than generating any positive benefit.

These modest benefits must be weighed against the risks and uncertainties introduced by the proposed acquisition, and in this case these risks are extensive. Major concerns include:

- 1) PGE’s credit rating has already been placed on negative outlook as a result of the proposed transaction, and the significant level of debt at Oregon Electric constrains PGE’s ability to address future financial strains.

- 2) Texas Pacific Group's investment expectations suggest strong pressure to reduce costs at PGE
- 3) The duration of Texas Pacific Group's ownership introduces the possibility that key investment decisions would be made with Texas Pacific Group's investment horizon in mind, rather than the long-term perspective of ratepayers.

No one can be certain which of these risks would prove most costly—or catastrophic—for PGE, but collectively they represent a degree of risk that is simply unacceptable. Against these risks, Texas Pacific Group offers extremely modest financial compensation and a long list of supposed benefits for which the new owners cannot be held accountable or which would accrue to PGE and its ratepayers under any conceivable ownership scenario.

The City of Portland recognizes the PUC's order clarifying that the PUC does "not intend to reduce the net benefit standard to economic considerations" (PUC Order 01-778, p. 11). In this case, the problem with Texas Pacific Group's claimed benefits is not that they are non-monetary; it is that they are so vague, constrained, and otherwise limited that they cannot legitimately be considered as providing benefits to PGE's ratepayers.

Acceptance of the conditions proposed throughout this surrebuttal testimony would take a significant step toward mitigating the risks inherent in Texas Pacific Group's proposed acquisition, though demonstrating unequivocal net benefits would likely still require substantial rate credits. Without these conditions, Texas Pacific Group's proposal compares poorly against transactions the Commission has previously approved. Those transactions included rate credits an order of magnitude larger than the credits Texas Pacific Group has proposed. Enron's acquisition of PGE resulted in \$141 million in monetary compensation for ratepayers, for example, and the Commission order approving the Sierra Pacific Resources acquisition, though ultimately not executed, included \$95 million in rate credits (Order No. 97-196 and Order No.

00-702). These previous transactions establish a yardstick against which to measure the current proposal.

Given the magnitude of the risks and the *de minimis* nature of its identified benefits, Texas Pacific Group falls far short of its statutory obligation of demonstrating net benefits. The City of Portland cannot support this transaction in its current proposed form.

Attachments:

- Exhibit 200: Jeff Manning and Gail Kinsey Hill, "Files Shed Light on City's Bid for PGE," *The Oregonian*, Friday, July 23, 2004
- Exhibit 201: Letter from Mayor Vera Katz, Commissioner Randy Leonard, Commissioner Dan Saltzman and Commissioner Erik Sten to the Oregon Public Utility Commission (June 23, 2004).

Files shed light on city's bid for PGE

Documents reveal how close Enron came to selling the utility to Portland officials -- and how apart the sides were in principle

Friday, July 23, 2004

JEFF MANNING and GAIL KINSEY HILL

Portland city officials told Enron last year that they were willing to pay at least \$2.33 billion for Portland General Electric, and the two sides came "within spitting distance" of agreeing on an acquisition price before talks cooled, according to confidential documents obtained by The Oregonian.

The city's offer, cloaked by secrecy agreements, until now has remained hidden. Last fall, Enron announced it would accept a similar price -- \$2.35 billion -- from Texas Pacific Group, a private buyout firm.

The documents offer an inside view of the financial hurdles and the cultural differences that separated city leaders from Enron's executives just as Mayor Vera Katz and city commissioners have reaffirmed their interest in acquiring PGE and renewed claims that a city-owned utility could slash electricity rates by 10 percent.

Texas Pacific argues that the city's pledge to cut rates is an empty promise based on bogus financial assumptions. But in a development that could lend political momentum to the city's case, state regulatory staff on Wednesday recommended rejecting Texas Pacific's offer, primarily because it failed to guarantee rate cuts.

The documents also establish the pivotal role played by Ater Wynne, the Portland law firm hired by the city to pursue the PGE transaction last year. By late 2003, the firm switched sides to represent Texas Pacific, prompting a preliminary investigation by the Oregon State Bar into whether Ater Wynne violated state ethical rules.

It's clear from the documents that Enron felt the city's offer fell short on financial detail and failed to adequately insulate Enron from potential legal claims. But Erik Sten, the Portland commissioner who has led the city's effort to buy PGE, maintains that Enron executives never had any intention of selling PGE to the city regardless of its offer.

"We needed a willing seller and Enron wasn't," he said.

Enron declined to comment for this story. In bankruptcy documents filed early this year, the company acknowledged numerous meetings with city officials, but emphasized that Portland "never provided debtors with a formal offer . . . and never provided a purchase agreement, whether a markup of Enron's form or otherwise."

Pursuit began in 2002

The city's run at buying PGE began in August 2002, nine months after Enron, which had acquired the utility in 1997, collapsed in a financial scandal and after PGE had implemented painful double-digit rate increases in the wake of the Western energy crisis.

Citing the value of local control, the Portland City Council in August 2002 approved a proposal from Katz and Sten to explore a purchase. Portland officials felt they had two significant advantages over other private-sector bidders: The city has access to low-interest debt financing, and a municipally owned utility would not have to pay federal income taxes.

In ensuing months, the city hired investment banker Goldman Sachs, engineering firm R.W. Beck, and Ater Wynne to help structure a deal, work out a financing plan and negotiate with Enron. The city would end up spending almost \$800,000 on the acquisition effort.

Stephen Cooper, appointed Enron's new chief executive officer after the company's December 2001 bankruptcy, had repeatedly made clear that his overriding goal was to maximize the payout to Enron creditors, who were owed billions of dollars. As Enron's most valuable asset, PGE's disposition became critical.

By the winter of 2003, Cooper and his team were contemplating two options for PGE -- distributing PGE stock among Enron's creditors or selling it. By January 2003, Enron was seeking buyers for the utility.

On Feb. 26, 2003, the city submitted to Enron a term sheet, which outlined a proposed purchase, including price and conditions. The nonbinding document offered \$2.1 billion for PGE -- \$1 billion in cash, \$1.1 billion in assumed debt.

The Oregon Constitution prohibits the city from purchasing company stock, a potentially serious obstacle to the deal. But the city, with advice from Ater Wynne, had found a way around the rule. A new, city-formed

nonprofit corporation -- dubbed "Newco" for the purposes of negotiation -- would buy the stock then sell the assets of PGE to the city.

The documents show Enron was dissatisfied with the offer, however, including price. Enron wanted another \$300 million.

There were other issues as well. Enron wanted any buyer to assume all PGE legal liabilities. Enron also claimed that at least \$200 million in PGE's profits belonged to Enron creditors. That money had been building up because PGE had stopped paying dividends to Enron in mid-2001.

The city's initial offer called for those retained earnings to remain with PGE.

"This is a really big problem for them," Tim Grewe, the city's chief administrative officer, said in an April 17 e-mail about the dividend issue. Enron officials "aren't taking the city seriously. Think we are arrogant. . . .

Insecure about a public process."

City sweetens offer

At some point that spring -- the documents don't make clear when -- the city made two significant concessions. It upped its offer from \$2.1 billion to \$2.33 billion. And the city also accepted that the PGE retained earnings belonged to Enron, adding the prospect of more cash to the deal, according to three sources who were involved with the negotiations.

An agreement seemed tantalizingly close in May.

On May 9, Grewe sent an optimistic message to his City Hall colleagues. After months of halting negotiations and slow progress, Enron executives seemed as positive as they'd ever been about cutting a deal to sell PGE to the city.

"It was by far the most engaged meeting we have had with Enron to date," Grewe said of a 90-minute negotiating session the day before. "They want to proceed all the way to a binding definitive offer. Meaning they are not interested in any type of tentative offer."

Days later, Cooper said during a conference call with the city's negotiating team that the two sides were "within spitting distance" of agreement, according to an e-mail that summarized the conversation.

That account was soon challenged by Enron, however. On May 15, Mitchell Taylor, Enron's managing director and a point-person in negotiations with the city, called Grewe to express a "disconnect in communications" and complain that "it was not the case" that the two sides were close to a deal.

Taylor told the city to complete a more thorough analysis of PGE, a process known as due diligence. Enron also worried that the city's proposal allowed Portland to back away too easily, even after commitments were made. "They won't give us time, they won't give us exclusivity, they won't do a deal with outs," says an e-mail from Grewe. He later said the city couldn't afford spending \$2 million for the kind of due diligence Enron wanted.

City officials remained undeterred.

"Cooper said that he would love to do a deal with us," said Kathleen Gardipee, an assistant to Sten, in a May 19 e-mail to other city officials. "Cooper said he is willing to ship the team out to Oregon and they will stay there until we can get something hammered out."

But optimism was tempered by a May 23 letter from Enron's Taylor, who seemed to play Enron's "bad cop" to Cooper's "good cop." The city's price was still too low, Taylor said. Just as significantly, Enron demanded insulation from all of PGE's legal liabilities, which included costs associated with the shuttered Trojan Nuclear Plant, Enron pension lawsuits and legal issues associated with fraudulent electricity trades.

Taylor also questioned the city's ability to finance the deal and took Sten to task for talking too freely to the media, which he said posed a possible violation of the confidentiality order signed by all parties.

Rapid-fire letters and phone calls continued through the rest of May. But the back-and-forth ended after Taylor came to Portland for a much-anticipated meeting with the city's negotiating team.

In a June 3 e-mail that summed up the meeting, Ater Wynne partner Jonathan Ater told his colleagues at the firm that the city and Enron were at an impasse over the liability question and the structure of Newco.

Enron reported that another candidate had emerged in the PGE auction -- presumably Texas Pacific -- that had performed "a great deal of due diligence on the liabilities."

Enron officials want "to put their energies into that deal rather than dealing with the city," Ater said in the e-mail. "They tell us that would be true even if the city's price were higher."

"For the time being," Ater concluded, "we are not actively in the race."

The documents also indicate Enron was wavering between selling PGE and spinning it out to creditors.

"We just were too far apart"

Mayor Katz tried to lure Enron back to the table in a June 5 letter. She defended the city's approach to the

liabilities and even said the city was likely willing to offer a higher price. She also argued that Enron creditors would get their money significantly quicker if the city bought PGE. Unlike a private-sector buyer, the city would need neither Oregon Public Utility Commission or U.S. Securities and Exchange Commission approval.

Enron's lack of interest became clear when it filed its bankruptcy reorganization plan on July 11. In an interview that day with media, Cooper confirmed that the deal with the city had crumbled.

"Between the proposed economics and other commercial terms and conditions, we just were too far apart," Cooper said.

The city attempted to restart talks with Enron in September and October with a sweetened offer. But Enron again rejected the city's entreaties, explaining it was in the final stages of negotiations with someone else. At the time, city officials didn't know that Texas Pacific was about to prove itself the victor. In fact, as late as mid-October, Grewe was hearing "on the street, right or wrong, that the other deal has cratered," he wrote in an e-mail.

That possibility only added to officials' frustration.

"It is now clear that Enron is not going to meet," Grewe added in the Oct. 13 e-mail. "They have yet again stiff-armed us without even hearing our proposal."

Texas Pacific announced its tentative agreement to buy PGE at a news conference on Nov. 18.

The company's base offer of \$2.35 billion includes \$1.25 billion in cash and \$1.1 billion in assumed PGE debt. Further adjustments linked to 2003 and 2004 PGE earnings brings the total to an estimated \$2.5 billion.

That is not far off the city's offer of \$2.33 billion plus additional cash linked to PGE retained earnings, although the documents do not specify an amount.

After the deal was announced last fall, Texas Pacific's stature as one of the country's leading buyout funds persuaded Sten and the City Council to back off.

Enron advisers invited the city to enter a rival bid for PGE to the bankruptcy court in early 2004. The city declined. In a Jan. 27, 2004, letter of explanation, the city's Grewe said it would have been a wasted effort, given Enron's past reluctance to deal with the city.

A bid also would have been expensive. The city still hadn't asked commissioners for another \$2 million to complete the required due diligence. More daunting, overbids required a \$20.25 million deposit, though losing bidders would get their deposits refunded.

Battle continues

Months later, a rivalry between the city and Texas Pacific still simmers.

In June, the City Council vowed in a letter to the Oregon Public Utility Commission, which must approve the Texas Pacific purchase, that it could lower rates 10 percent if it owned the utility. PGE, according to its own surveys, has some of the highest rates for residential customers among the Northwest utilities.

Texas Pacific claims the 10 percent rate reduction is based on a low-ball purchase price, and unrealistic debt and equity requirements. In a meeting with *The Oregonian*, Texas Pacific founder David Bonderman called the city's claims "delusional."

Texas Pacific has told the PUC it has no plans to cut rates but might give ratepayers a credit on their bills if its return on equity exceeds the 10.5 percent allowed by regulators.

The dispute heated up Wednesday, when staffers from the PUC issued a strongly worded recommendation to reject Texas Pacific's purchase application. The staff cited the company's failure to offer rate concessions to PGE customers and said increased debt from the deal could affect the utility's financial stability.

The staff recommendation, while a setback for Texas Pacific, follows the pattern in such cases. Staff opposed Enron's purchase of PGE in 1997 and Scottish Power's purchase of PacifiCorp in 1999. The deals eventually won approval after the companies made rate concessions.

Sten vowed the city will continue its efforts to buy PGE.

"Both Enron and Texas Pacific have come from a clear point of view that the local community isn't particularly important to them," Sten said. "Their goal has been to make as much money as possible for Texas Pacific and to keep Enron in its comfort zone. I think we all need to be uncomfortable with Enron's comfort zone."

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CERTIFICATE OF SERVICE

I hereby certify that on September 22, 2004, I served the foregoing SURREBUTTAL TESTIMONY OF SUSAN ANDERSON ON BEHALF OF THE CITY OF PORTLAND, OREGON upon all Persons on the Service List maintained by the Public Utility Commission for the UM 1121 proceeding who had an e-mail address posted. I further certify that for those persons on the Service List who were not identified as having an e-mail address, a copy was sent by first class mail, contained in a sealed envelope, with postage paid, and deposited in the post office at Portland, Oregon on said day.

Benjamin Walters, OSB #85354
Deputy City Attorney
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CITY OF
PORTLAND, OREGON

Vera Katz, Mayor
Jim Francesconi, Commissioner
Randy Leonard, Commissioner
Dan Saltzman, Commissioner
Erik Sten, Commissioner

23 June, 2004

Lee Beyer, Chair
Ray Baum, Commissioner
John Savage, Commissioner
Oregon Public Utility Commission
550 Capitol St NE #215
PO Box 2148
Salem OR 97308-2148

Re: *In re Application of Oregon Electric Utility Company, LLC
to Acquire Portland General Electric, UM 1121*

Dear Chair Beyer and Commissioners Baum and Savage:

As you are aware, the City of Portland continues to be very interested in the future of Portland General Electric (PGE). We would like you to be aware that should the Texas Pacific Group's bid to acquire PGE fail for any reason, the City of Portland is interested in pursuing a purchase of the utility on behalf of the region. We have studied a potential purchase. We know it is viable.

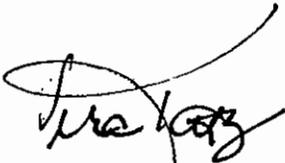
The City has the financial ability to purchase PGE. The City of Portland has a triple-A bond rating and could issue revenue bonds to purchase the assets of PGE. Prior to Enron's decision to sell PGE to the Texas Pacific Group, the City of Portland had a highly regarded team of experts analyzing the potential of a public purchase. The team included Goldman Sachs, RW Beck, and the Ater Wynne law firm. All these companies agreed that a purchase transaction was feasible and would result in benefits to the region and to ratepayers.

Conservatively, a publicly owned utility would provide local businesses and residents with a 10% rate advantage. This 10% advantage assumes all operational costs stay the same. The City's cost analysis also assumes that payment of all state and local taxes would continue at current levels as set in rates. The rate advantage derives from the fact of the City's lower costs for debt and financing. Also, publicly owned utilities do not pay federal taxes, so these amounts would not be included in rates.

Public ownership and operation of PGE would also provide long-term stability. The region would not have to continue to ride an unstable cycle of temporary ownership, facing the uncertainty of who might be the utility's owner in five or ten years. Public ownership would provide local accountability. Local leadership would respond to the concerns of consumers. These are true and unquestionable public benefits.

We believe it is important for the Commission to know that the City of Portland remains willing and able to pursue public ownership of PGE. The request by Texas Pacific Group should be considered in this light.

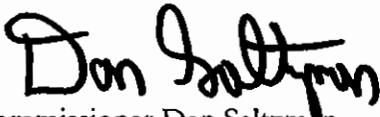
Sincerely,



Mayor Vera Katz



Commissioner Randy Leonard



Commissioner Dan Saltzman



Commissioner Erik Sten

- c. UM 1121 Service List
Tim Grewe, Chief Administration Officer, City of Portland
Linda Meng, City Attorney
Benjamin Walters, Deputy City Attorney