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**PUBLIC UTILITY COMMISSION  
OF OREGON**

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**UM 1121**

**STAFF SURREBUTTAL TESTIMONY**

**OF**

**BRYAN CONWAY  
THOMAS D. MORGAN  
JAMES E. (ED) DURRENBERGER  
REBECCA T. HATHHORN  
JUDY JOHNSON**

**In the Matter of OREGON ELECTRIC UTILITY COMPANY,  
LLC, *et al*, Application for Authorization to Acquire  
Portland General Electric Company together with Oregon  
Electric/Appendix A and Oregon Electric/Exhibits 1-21**

***Redacted Testimony***

**September 22, 2004**

CASE: UM 1121  
WITNESS: Bryan Conway

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 800**

**Surrebuttal Testimony**

**Contains Confidential Information**

**September 22, 2004**

**INFORMATION CONTAINED IN STAFF EXHIBIT 800  
IS CONFIDENTIAL AND SUBJECT TO PROTECTIVE  
ORDER NO. 04-139. YOU MUST HAVE SIGNED  
THE PROTECTIVE ORDER IN DOCKET UM 1121  
TO RECEIVE THIS EXHIBIT.**

1 **Q. PLEASE STATE YOUR NAME.**

2 A. My name is Bryan Conway.

3 **Q. ARE YOU THE SAME BRYAN CONWAY WHO TESTIFIED EARLIER**  
4 **AND SPONSORED STAFF EXHIBITS 100 AND 101?**

5 A. Yes, I am.

6 **Q. HAVE YOU PREPARED AN EXHIBIT?**

7 A. Yes. I prepared Exhibit Staff/801, consisting of 13 pages.

8

9

**Purpose of Testimony**

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 A. I present Staff's summary recommendations, including Staff's view that  
12 the Applicants' proposal is not in the public interest. I also offer Staff's  
13 alternative that would satisfy the statutory requirement that the acquisition  
14 be in the public interest.

15

16

**Testimony Organization**

17 **Q. HOW IS THE STAFF'S SURREBUTTAL TESTIMONY ORGANIZED?**

18 A. Table 1 provides an index to Staff's surrebuttal testimony. This table lists  
19 the topics covered, the Staff witness and Staff Exhibit number. Staff's lack  
20 of comment on portions of rebuttal testimony does not necessarily indicate  
21 agreement on that testimony.

1

Table 1

Topic	Staff Witness	Staff Exhibit
Summary Witness, New SQM	Bryan Conway	Staff/800
Financial Transactions and Access to Information	Thomas Morgan	Staff/900
Cost Savings, Goodwill Amortization and Acquisition Costs	James (Ed) Durrenberger	Staff/1000
Affiliated Interest Requirements, Corporate and Jurisdictional Allocations	Rebecca T. Hathhorn	Staff/1100
Tax Issues	Judy Johnson	Staff/1200

2

3

**Summary Recommendations**

4

5

**Q. BASED ON THE CONDITIONS AND RATE PROPOSALS SET FORTH BY STAFF, DOES STAFF RECOMMEND APPROVAL OF THE PROPOSED ACQUISITION OF PGE?**

6

7

8

**A.** Assuming the Commission adopts Staff's proposed conditions, including its rate credit proposal, Staff recommends the Commission grant Oregon Electric's application to acquire PGE.

9

10

1       **Q.     BASED ON THE CONDITIONS AND PROPOSALS SET FORTH BY**  
2       **THE APPLICANTS, DOES STAFF RECOMMEND APPROVAL?**

3       A.     No. Based on the Applicant's proposal, the acquisition of PGE is not in  
4       the public interest. Therefore, Staff recommends the Commission deny  
5       Oregon Electric's application to acquire PGE.

6

7

**Future Activities**

8       **Q.     WHAT ARE THE REMAINING SCHEDULED ACTIVITIES IN THIS**  
9       **DOCKET?**

10      A.     Following Staff's surrebuttal testimony in this case, other activities in this  
11      docket include:

- 12           ▪     Sursurrebuttal testimony by the Company
- 13           ▪     Two additional settlement meetings
- 14           ▪     Hearings

15      **Q.     UNDER THE EXISTING SCHEDULE, IS THIS STAFF'S FINAL ROUND**  
16      **OF TESTIMONY?**

17      A.     Yes.

18      **Q.     OTHER PARTIES WILL ALSO PROPOSE CONDITIONS IN THEIR**  
19      **SURREBUTTAL TESTIMONY. WILL STAFF HAVE AN OPPORTUNITY**  
20      **TO CONSIDER THESE CONDITIONS AS WELL?**

21      A.     Yes. There are two settlement conferences after Staff and other parties  
22      file surrebuttal testimony. These settlement conferences may result in  
23      agreements that are filed in this docket. In addition, discovery, through

1 data requests or cross-examination, will be available to explore the  
2 conditions. Finally, parties will also have the opportunity to discuss,  
3 through briefs, conditions proposed by other parties. Staff's  
4 recommendations reflect our conclusions based on the information  
5 submitted to date on the conditions, and the level of rate credits,  
6 necessary to find the transaction would result in net benefits to consumers  
7 and be in the public interest.

8  
9 **Stipulations**

10 **Q. WHAT STIPULATIONS HAVE BEEN REACHED WITH OREGON**  
11 **ELECTRIC?**

12 A. There is one stipulation. The stipulation covers Service Quality Measures  
13 and other selected issues and is dated August 23, 2004. This stipulation  
14 is found in Exhibit Staff/801, Conway/1-6.

15 **Q. IS STAFF HOPEFUL THAT RESOLUTION CAN BE REACHED ON**  
16 **OTHER ISSUES?**

17 A. Yes, many issues not included in the stipulation described above have  
18 been settled in concept. Specifically, in Oregon Electric's rebuttal  
19 testimony, Oregon Electric agreed to several additional conditions. (See  
20 Staff/801, Conway/7-8.)

21 **Q. DO YOU HAVE AN EXHIBIT THAT DISPLAYS THE CONDITIONS**  
22 **AGREED TO THROUGH STIPULATION, THE CONDITIONS OREGON**  
23 **ELECTRIC STATED IT AGREED TO IN CONCEPT, AND ADDITIONAL**

1           **CONDITIONS STAFF RECOMMENDS AS NECESSARY TO FIND THE**  
2           **ACQUISITION IS IN THE PUBLIC INTEREST?**

3           A.     Yes. Exhibit Staff/801, Conway/1-13, lists the conditions and their status.

4           **Q.     IS STAFF WILLING TO ENTER INTO A PARTIAL STIPULATION FOR**  
5           **THOSE CONDITIONS FOR WHICH OREGON ELECTRIC HAS**  
6           **AGREED TO IN CONCEPT?**

7           A.     Yes, Staff is willing to sign a stipulation with only Oregon Electric, or with  
8           any other party, if Staff agrees the stipulation properly addresses an issue.

9           **Q.     DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING EXHIBIT**  
10          **STAFF/801?**

11          A.     Yes, I have two comments. First, as noted earlier, this exhibit contains all  
12          the conditions Staff currently believes are needed to reasonably conclude  
13          that the acquisition is in the public interest. Second, while the parties have  
14          already stipulated to the language of certain conditions, my exhibit  
15          recommends some slight wording changes to one condition that the  
16          Commission should adopt to clarify the conditions. The wording change  
17          corrects the Commission's name. The recommended language changes  
18          are not intended to change the intent or substance of the conditions.

19

20

**Summary of Staff's Testimony**

21          **Q.     WHAT ARE STAFF'S CONCLUSIONS IN THIS DOCKET?**

1 A. Based on the Applicants' proposal, the acquisition of PGE is not in the  
2 public interest. Various Staff witnesses discuss risks or harms associated  
3 with the current proposal and find a lack of sufficient benefits.

4 Staff Witness Thomas Morgan points out several risks that have not  
5 been adequately addressed through testimony or conditions. These risks  
6 include risks associated with double leverage, capital expenditure  
7 commitments, and liabilities and the associated indemnifications. In  
8 addition, Mr. Morgan estimates harm to customers associated with the  
9 loss of certain Enron commitments associated with this transaction.

10 Staff Witness Ed Durrenberger discusses his continued concerns  
11 regarding the potential for imprudent cost cutting due to the desire to  
12 increase returns over a short time horizon. Despite assurances in  
13 testimony from the Applicants', Mr. Durrenberger points out the lack of a  
14 mechanism to ensure adequate investment in PGE's infrastructure. He  
15 also points to another TPG-owned company that appears to have run into  
16 some troubles due to cost cutting measures.

17 Staff Witness Judy Johnson discusses her conclusions regarding the  
18 proper treatment of PGE's income taxes. She concludes that rates should  
19 be calculated on a stand-alone basis rather than based on the  
20 consolidated tax return.

21 Staff Witness Rebecca Hathhorn discusses her conclusions regarding  
22 affiliated interest issues, conditions and other issues related to the yet-to-  
23 be finalized Master Services Agreement (MSA). While it appears likely

1 that the parties will agree on the terms and conditions of a MSA, it is not  
2 yet finalized. Parties appear to disagree on oversight of miscellaneous  
3 transactions between PGE and TPG affiliates and the need for affiliated  
4 interest filings.

5  
6 **Discussion of Staff's Recommendation**

7  
8 **Q. WHAT ARE STAFF'S RECOMMENDATIONS?**

9 A. Staff recommends that the Commission not adopt Oregon Electric's  
10 proposal. However, Staff has an alternative proposal which allows Staff to  
11 conclude the transaction is in the public interest. This proposal rests upon  
12 Staff's recommended conditions and the provision of rate credits for  
13 PGE's customers.

14  
15 **New Conditions**

16 **Q. DO YOU HAVE A RECOMMENDATION WITH RESPECT TO THE NEW**  
17 **SERVICE QUALITY MEASURE (SQM) PROPOSED IN STAFF/700?**

18 A. Yes. While Staff continues to believe an SQM on billing accuracy as  
19 described in Staff/700 is warranted and would benefit customers, Staff  
20 acknowledges that not all of the details have been worked out. For  
21 purposes of this docket, Staff recommends a condition that requires PGE  
22 to work in good faith with Staff and other parties to design and implement  
23 a billing accuracy SQM that will be presented to the Commission within

1 270 days of the closing of this transaction. (See Staff/801, Condition  
2 Number 29.)

3 **Q. PLEASE SUMMARIZE CONDITION 10 LISTED IN STAFF/801 AND**  
4 **EXPLAIN WHY IT IS NECESSARY.**

5 A. This condition outlines a procedure for treating violations of the conditions  
6 that the Commission may adopt in its final order if it approves the  
7 Application. The condition provides that, if the Commission believes that  
8 Oregon Electric and/or PGE have violated any of the conditions, then the  
9 Commission will give Oregon Electric and/or PGE written notice of the  
10 violation.

11 Subsection (a) of the condition outlines deadlines for Oregon Electric  
12 and/or PGE to file reports required by the conditions or to cure violations.  
13 Subsection (b) outlines the procedure that will be followed if the situation  
14 is not resolved under subsection (a). Subsection (c) provides that the  
15 Commission will not be bound by subsection (a) if it determines that PGE  
16 or Oregon Electric has violated any of the material conditions more than  
17 twice in a rolling 24-month period. Subsection (d) gives Oregon Electric  
18 and/ or PGE the opportunity to argue to the Commission, on a case-by-  
19 case basis, that subsection (c) should not apply.

20 The Commission, in its Order No. 00-702 (UM 967), approved a similar  
21 condition. The condition creates an agreed upon procedure to follow in  
22 the event that the Commission believes Oregon Electric and/or PGE have  
23 violated conditions of this acquisition. The Condition is important because

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

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

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

12  
13 **Rate Credits**

14 **Q. WHAT IS STAFF'S RECOMMENDED RATE CREDIT?**

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

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

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

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

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

11      **Enron purchase of PGE (1997)**

12      Order 97-196

- 13       • \$36 million in rate credits spread out over four years
- 14       • \$105 million to purchase PGE's trading floor
- 15       • Limitations on dividends, minimum equity requirements and other  
16       financial ring fencing
- 17       • Commitment that rates and cost of capital would not be higher due  
18       to the acquisition
- 19       • Service quality commitments

20  
21      **Scottish Power purchase of PP&L (1999)**

22      Order 99-616

- 23       • \$52 million in rate credits spread out over four years
- 24       • Limitations on dividends, minimum equity requirements and other  
25       financial ring fencing
- 26       • Commitment that rates would not be higher due to the acquisition
- 27       • Commitment of \$6 million a year on conservation programs for  
28       three years
- 29       • Commitment to develop 50 additional megawatts of renewable  
30       energy within five years
- 31       • Service quality commitments (Improvements over those approved  
32       in the Enron-PGE merger)

- 1 • Agreement to pay customers \$50 if it missed any of eight customer  
2 guarantees

3  
4 **Sierra Pacific proposed purchase of PGE (2000)**

5 Order 00-702

- 6 • \$95 million in rate credits spread out over seven years  
7 • Rate freeze and other rate commitments such as rates no higher  
8 than without the acquisition  
9 • Limitations on dividends, minimum equity requirements and other  
10 financial ring fencing  
11 • Separation of generating and transmission costs to protect Oregon  
12 customers from higher Nevada rates and a ban on joint ventures  
13 • Service quality commitments (Matched those implemented in the  
14 Scottish Power merger).  
15

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

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

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

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

1 rate credits are used to offset harms. (See Staff/100, Conway/17, lines 5-  
2 8.)

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

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

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

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

1 or harms of the transaction, these conditions serve to mitigate rather than  
2 eliminate risk. Staff witness Thomas Morgan notes an example of a harm  
3 of this transaction in the testimony. Specifically, as a result of this  
4 acquisition, Staff believes the Commission will forego the opportunity to  
5 make a cost of debt adjustment due to increases in PGE's cost of debt  
6 attributable to Enron's bankruptcy. (See Staff/900, Morgan/24, lines 19-  
7 21.)

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

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

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

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

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

7           **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8           A. Yes.

CASE: UM 1121  
WITNESS: Bryan Conway

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 801**

**Exhibit in Support of  
Surrebuttal Testimony**

**September 22, 2004**

Staff/801, Conway/1-6 was the first Stipulation entered into on August 23, 2004. It was available in hardcopy only.

Oregon Electric Agreed-to Condition From Testimony

(See Oregon Electric/100, Davis Page 43 of 60)

7. The Commission or its agents may audit the accounts of Oregon Electric, its affiliates, and any subsidiaries that are the bases for charges to PGE to determine the reasonableness of allocation factors used by Oregon Electric to assign costs to PGE and amounts subject to allocation or direct charges. Oregon Electric agrees to cooperate fully with such Commission audits. (See Staff/1100, Hathhorn/2, Lines 20-23 and Hathhorn/3, Lines 1-5.)

8. Oregon Electric and its affiliates shall not allocate to or directly charge to PGE expenses not authorized by the Commission to be so allocated or directly charged. (See Staff/1100, Hathhorn/3, Lines 6-10.)

9. PGE shall maintain its own accounting system. PGE and Oregon Electric shall maintain separate books and records, both of which shall be kept in Portland, Oregon. (See Staff/1100, Hathhorn/3, Lines 11-14.)

10. If the Commission believes that Oregon Electric and/or PGE have violated any of the conditions set forth herein, any conditions contained in other stipulations signed by Oregon Electric and PGE, or any conditions imposed by the Commission in its final order approving the Application (collectively, the "Conditions"), then the Commission shall give Oregon Electric and PGE written notice of the violation. (See Staff/800, Conway/8, line 3 through Conway/9, line 2)

- a. If the violation is for failure to file any notice or report required by the Conditions, and if Oregon Electric and/or PGE provide the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the ten-day period. For any other violation of the Conditions, the Commission must give Oregon Electric and PGE written notice of the violation. If such failure is corrected within five business days of the written notice, then the Commission shall take no action. Oregon Electric or PGE may request, for cause, permission for extension of the five-day period.
- b. If Oregon Electric and/or PGE fail to file a notice or written report within the time permitted in subparagraph a. above, or if Oregon Electric and/or PGE fail to cure, within the time permitted above, a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation, with an opportunity for Oregon Electric and/or PGE to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that Oregon Electric and/or PGE violated one or more of the Conditions, then the Commission shall issue an Order stating

the level of penalty it will seek. Oregon Electric and/or PGE, as appropriate, may appeal such an order under ORS 756.580. If the Commission's order is upheld on appeal, and the order imposes penalties under a statute that further requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalties specified in the order, and Oregon Electric and/or PGE shall file a responsive pleading agreeing to pay the penalties. The Commission shall seek a penalty on only one of Oregon Electric or PGE for the same violation.

- c. The Commission shall not be bound by subsection (a) in the event the Commission determines PGE and/or Oregon Electric has violated any of the material conditions, contained herein, more than two times within a rolling 24-month period.
- d. PGE and/or Oregon Electric shall have the opportunity to demonstrate to the Commission that subsection (c) should not apply on a case-by-case basis.

11. Oregon Electric shall maintain and provide the Commission unrestricted access to a record of each instance in which TPG Applicants withhold their consent to a decision of the PGE Board of Directors. The record shall detail the basis for the decision, including any governing report or document that memorializes the exercising of the consent rights and shall identify the persons involved in making the TPG Applicant Consent Rights decision. Oregon Electric shall provide the records to the Commission upon request. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information. Nothing in this paragraph shall prevent the Commission from disclosing to the public the number of times the TPG Applicants exercised their consent rights within a certain period of time. (*See* Staff/900, Morgan/18, lines 22-33.)

12. Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all books and records of Oregon Electric and PGE that are reasonably calculated to lead to information relating to PGE, including but not limited to, Board of Directors' Minutes, Board Subcommittee Minutes, and other Board Documents. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information. (*See* Staff/900, Morgan/18, line 35 through Morgan/19, line 5.)

**Additional Staff-Proposed Conditions**

13. PGE shall notify the Commission within 30 days of the formation of a subsidiary. Oregon Electric shall notify the Commission within 30 days of the formation of a subsidiary. The notices shall include a copy of the business plan and capitalization strategy. (See Staff/1100, Hathhorn/3, Lines 15-23 and Hathhorn/4, Lines 1-4.)

14. Oregon Electric and PGE shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between PGE and all its affiliated interests, unless such transactions are exempt under applicable laws or the Master Services Agreement. (See Staff/1100, Hathhorn/4, Lines 5-11.)

15. In the event of a dispute between Commission Staff and Oregon Electric or PGE regarding a Commission Staff request made pursuant to the Acquisition Conditions, the parties agree that an Administrative Law Judge (ALJ) shall resolve the dispute as follows: (i) within ten (10) business days Oregon Electric or PGE shall deliver to the ALJ the books and records responsive to Staff's request and shall indicate the basis for the objection; (ii) Staff may respond in writing and Oregon Electric and/or PGE may reply to Staff's response; (iii) the ALJ shall review the documents in private; and (iv) the ALJ shall issue a ruling determining whether the documents (a) are reasonably calculated to lead to the discovery of relevant information, and, if so, (b) whether the documents should receive the protection requested. The ALJ shall use this standard whether or not Staff is making the request in connection with an open docket. Nothing in this provision shall affect the right of Oregon Electric or PGE to request that the Commission treat the documents as exempt from disclosure to third parties under applicable law. (See Staff/800, Conway/9 lines 3-11.)

16. PGE will not make any distributions to OEUC that would, or could reasonably be expected to, cause the common equity portion of PGE's total capital structure to fall below 48 percent. (See Staff/900, Morgan/19, line 7 through Morgan/20, line 10.)

- a. "Total capital structure" is defined as common equity, preferred equity, and long-term debt.
- b. "Long-term debt" is defined as (1) outstanding debt with an initial term of more than one year plus the sum of committed and drawn balances greater than \$150 million on any of PGE's unsecured revolving lines of credit (Unsecured Revolvers); and (2) the sum of committed and drawn balances on PGE's secured revolving lines of credit (Secured Revolvers).
- c. A "committed balance" is the sum of the commitments used to support any borrowing capacity or other purposes, such as a commercial paper program.

- d. A “drawn balance” is sum of amounts drawn against the Revolvers.
- e. Hybrid securities (e.g., convertible debt) will be assigned to equity and long-term debt based on the characteristics of the hybrid security. The Commission, prior to their issuance, will determine the assignment of the equity and debt characteristics.

17. The allowed return on common equity and other costs of capital viewed on a stand-alone basis will not rise as a result of Oregon Electric’s acquisition 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. (See Staff/900, Morgan/20, lines 11-15.)

18. The customers of PGE shall be held harmless if PGE's revenue requirement is higher due to Oregon Electric’s ownership of PGE. (See Staff/900, Morgan/20, lines 17-19.)

19. Oregon Electric and PGE shall maintain and provide the Commission unrestricted access to all written information provided to stock or bond rating analysts, which directly or indirectly pertains to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided to, and presentations made to, stock and bond rating analysts. For purposes of this condition, "written" information includes, but is not limited to, any written and printed material, audio and videotapes, computer disks and electronically-stored information. Nothing in this condition shall be deemed to be a waiver of Oregon Electric's or PGE's right to seek protection of the information. (See Staff/900, Morgan/20, line 21 through Morgan/21, line 16.)

20. Oregon Electric agrees to provide a guaranteed rate credit in the amount of \$75 million to PGE’s customers. The amount of this credit will be \$15 million per year for 5 years beginning 2005. PGE shall establish a balancing account and credit that account with the \$15 million annual credit, beginning on January 1, 2005 (or within 10 business days of the closing of the transaction), and each subsequent January 1, through 2009. The balancing account will accrue interest on the unamortized balance at PGE’s authorized rate of return. Beginning January 1, 2005, PGE will amortize amounts in the balancing account on an equal cents per kWh basis, as a credit to customers’ distribution rates. PGE will exclude all effects of the rate credit from the company’s results of operations and any rate review. (See Staff/800, Conway/9 lines 14-12..)

21. Oregon Electric will ensure that PGE receives the benefit of the Stock Purchase Agreement indemnifications. (See Staff/900, Morgan/21, line 9 through Morgan/22, line 5.)

22. OEUC and PGE agree to submit a final "transition plan" to the Commission within one year of closing. The plan shall detail the areas where efficiencies and/or cost-cutting efforts could occur and will provide annual estimates of the expected savings. (See Staff/1000, Durrenberger/ Page 3, Lines 14-17)

23. PGE agrees to the following with respect to reporting on its operation and maintenance (O&M) expenses and capital expenditures: (*See Staff/ 1000, Durrenberger/ Page 5, Lines 2-3*)

a. On or about May 1 of each year, PGE will file, as part of the Results of Operations report, an O&M expense and capital expenditure update report (OMCE Update) that details O&M and capital expenditures broken out by individual accounts (FERC Account 101 through 119, 500 through 598 and 901 through 923). The update will contain comparisons of PGE's actual O&M and capital expenditures for the prior calendar year with the average of the preceding three calendar years and, with respect to O&M, to the last approved test year revenue requirement. The OMCE Update shall also include a comparison of planned O&M and capital expenditures for the current year compared to the actual data. The update shall include a written narrative description of major O&M and capital expenditures from the most recent year as well as details about any major changes either planned or anticipated. Tables with benchmark type comparisons of PGE's O&M and capital expenditures to those of representative NW Investor Owned Utilities and the WECC shall also be included. If requested, PGE shall present the major findings of the OMCE Update at a Commission meeting.

b. After completing and presenting its third OMCE Update, the Company may petition the Commission to terminate this condition. Interested members of the public shall have an opportunity to comment on the petition in a manner to be determined by the Commission after receipt of the petition.

24. Within the first seven years after closing, PGE agrees, if directed by the Commission, to conduct an audit, at its shareholders' expense, using an independent auditor approved by the Commission, to review the company's O&M and/or Capital construction plans and expenditures. (*See Staff/1000, Durrenberger/5, Lines 6-9.*)

25. Each PGE distribution to OEUC will be used by OEUC exclusively to pay direct operating expenses<sup>1</sup> and debt service for at least five years and until all of the following conditions are met: (*See Staff/900, Morgan/21, line 9 through Morgan/22, line 5.*)

- a. The sum of the drawn balances of all PGE's Secured Revolvers is zero and there has not been a balance for three months; and
- b. OEUC has paid down at least \$250 million of its outstanding debt as compared to the level of outstanding debt at closing including the catch-up dividend from PGE.

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<sup>1</sup> Direct operating expenses are expenses that were incurred from services, supplies or assets provided by OEUC personnel directly and are not based on any type of allocation from an affiliate (parent or subsidiary).

26. No company, entity, or person, other than PGE, shall use PGE's regulated assets as collateral for any loan, guarantee or other such use without prior expressed Commission approval. (*See* Staff/900, Morgan/22, lines 7-21.)

27. OEUC shall not re-leverage, i.e., increase the amount of its outstanding long-term debt once such debt has been liquidated, if the increased debt would, or could reasonably be expected to, bring the consolidated capital structure<sup>2</sup> below 40% common equity. (*See* Staff/900, Morgan/22 line 23 through Morgan/23, line 6.)

28. TPG Applicants<sup>3</sup> will not allocate or direct bill OEUC for any goods, services, supplies or assets until condition number 25 (cash-sweep provision) has been satisfied. (*See* Staff/900, Morgan/23, lines 8-10.)

29. PGE agrees to work in good faith with Staff and other interested parties to design and implement a billing accuracy SQM consistent with Staff/702 and will present the proposed SQM to the Commission within 270 days of the closing of this transaction. (*See* Staff/800, Conway/7 line 16 through Conway/8, line 2.)

30. Oregon Electric shall provide a report to the Commission, on a semiannual basis, that details the date of each instance the TPG Applicants withheld their consent to a decision of the PGE Board of Directors and names the Consent Right that was triggered. (*See* Staff/900, Morgan/25, lines 8-11.)

31. The following actions shall be reported to the Commission within 10 business days after their occurrence and the report shall provide details about the action taken: (*See* Staff/900, Morgan/25, line 13 through Morgan/26, line 15.)

- a. TPG Applicants will notify the Commission if there is a change of control of the General Partner of either of the TPG Applicants.
- b. TPG Applicants will notify the Commission if there is any change in the ownership interest in Oregon Electric, of PGE, or of any of the TPG funds investing in Oregon Electric;
- c. TPG Applicants will report any changes in any agreement that governs the operation of the TPG funds investing in PGE and of Oregon Electric, including but not limited to any changes to any partnership agreement, amendments or changes to the Oregon Electric Operating Agreement, term sheets, Company make-up, assignment of interests or other binding agreements.
- d. TPG Applicants will report when any Member or Manager at Oregon Electric is designated, appointed, elected, removed or replaced by a vote, approval or consent of a majority of the members.

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<sup>2</sup> The capital structure calculations refer to the OPUC policy that does not include short-term debt capital.

<sup>3</sup> See Application of Oregon Electric Utility Company, LLC, et al to Acquire Portland General Electric Company (March 8, 2004) page 6 lines 15-17. TPG Applicants also includes Tarrant Partners.

- e. TPG Applicants will report when they take any of actions over matters of Oregon Electric Utility Company, LLC included in ORS 63.130 (3)(c), (4)(c), (d), (e), (f), (g), (h), (i), and (j).
- f. PGE and Oregon Electric will notify the Commission, through OAR 860-027-0041, whenever an equity infusion (paid-in capital, purchase of stock or other arrangement) occurs with a subsidiary or partnership.

32. OEUC shall provide quarterly reports to the Commission that details its capital structure, including each debt issuance, amounts outstanding, source of financing and other pertinent terms and conditions. This shall be included in a detailed format and could be included within the reports that the Applicants have agreed to, which will be designed to emulate SEC filings. Oregon Electric shall also provide copies of Oregon Electric's and PGE's stand alone and consolidated financial statements to the Commission. These reports shall be made on the 15th day of March, June, September and December. (*See Staff/900, Morgan/26, line 22 through Morgan/27, line 7.*)

33. Until the total consolidated debt at OEUC is less than 60% of total capital, Oregon Electric and PGE shall not, without the prior consent of the Commission, directly or indirectly permit any subsidiaries to, acquire, incorporate or otherwise organize any subsidiary, or enter into substantially new lines of business, which were not in existence as of the January 1, 2005. (*See Staff/900, Morgan/27, lines 12-16.*)

34. The Applicants will file a Master Services Agreement, which includes agreed-upon terms and conditions, no later than 30 days after a final order in UM 1121 is issued approving the transaction. (*See Staff/1100, Hathhorn/5, lines 3-15.*)

CASE: UM 1121  
WITNESS: Thomas D. Morgan

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 900**

**Surrebuttal Testimony**

**September 22, 2004**

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**Introduction**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Thomas D. Morgan and my business address is 550 Capitol Street NE, Salem, Oregon 97308-5148.<sup>1</sup>

**Q. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?**

A. Yes. I prepared Exhibit Staff/200 and Staff/202, supporting Staff's position on the Applicants' request to acquire the common equity in, and control of, Portland General Electric (PGE). In addition, I submitted a Witness Qualifications Statement (Staff/201).

**Q. HAVE YOU PREPARED ANY EXHIBITS?**

A. No.

**Purpose and Scope of Testimony**

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

A. The purpose of my testimony is to respond to financial issues raised in my initial testimony and rebuttal arguments made by Applicant Witnesses Davis (Oregon Electric/100) and Wheeler (Oregon Electric/200) and I also respond to rebuttal testimony submitted by Enron Witness Bingham (Enron/100) and PGE Witnesses Piro (PGE/100) and Tinker-Murray-Hager (PGE/200).

**Q. WHAT PRIMARY AREAS WILL YOU ADDRESS?**

1 A. I will address financial issues that impose stress on PGE and will detail  
2 protective conditions that I recommend the Commission adopt. I will also  
3 propose that the Commission require complete details on all financing at  
4 Oregon Electric and/or TPG that impact this transaction. I further request  
5 that the Commission require ongoing information about the changes in  
6 agreements of, and investors in, the TPG funds<sup>2</sup> that are purchasing PGE  
7 along with information about the companies that will exercise direct control  
8 over PGE<sup>3</sup>.

9 **Q. WHAT IS THE FORMAT OF THIS TESTIMONY?**

10 A. I will first review my initial testimony and then deal with testimony of those  
11 parties identified above. I will discuss a series of additional protective  
12 measures, i.e., ring-fencing, which the Commission should impose in  
13 order to properly shift the risks of this transaction onto the Applicants and  
14 away from the utility or its customers.

15

16

**Review of Initial Testimony**

17 **Q. WHAT WAS THE PRIMARY FOCUS OF YOUR INVESTIGATION?**

18 A. I reviewed the following questions during the course of my analysis. I will  
19 address the concerns that were raised and considerations that the

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<sup>1</sup> My telephone number is (503) 378-4629 and my e-mail address is thomas.d.morgan@state.or.us.

<sup>2</sup> TPG Partners III, L.P., TPG Parallel III, L.P., TPG Investors III, L.P., TPG GenPar Dutch, LLC, FOF Partners III, L.P., FOF Partners III-B, L.P., TPV Partners IV, L.P.

<sup>3</sup> TPG Genpar III, L.P., TPG Genpar IV, L.P. and TPG Advisors, III, In.c and TPG Advisors IV, Inc., and Tarrant Partners, L.P.

1 Commission should give to these questions throughout the course of my  
2 surrebuttal testimony.

- 3 • Should a plan to improve PGE's credit quality be a condition of this sale?
- 4 • What are the risks associated with the leverage at the holding company?
- 5 • What access to books and records should the Commission have at
- 6 OEUC, TPG, and other parties with a major interest in OEUC?
- 7 • If the Commission imposes a condition similar to the Enron Condition No.
- 8 6, should short-term debt be considered when determining the minimum
- 9 equity ratio?
- 10 • What are the unique risks of this transaction due to the type of business
- 11 entities used (e.g., LLC holding company)?
- 12 • What are the unique risks of this transaction due to the type of investment
- 13 funds investing in OEUC (e.g., closed-end private equity funds via limited
- 14 partnerships)?
- 15 • Does the highly leveraged nature of OEUC create risks as to the reliability,
- 16 quality, and rates associated with PGE's operations, and undermine the
- 17 Commission's commitment to ensuring financially secure utilities?
- 18 • How will the loan agreements and operating agreements of OEUC be
- 19 structured?
- 20 • To what extent does the Commission have oversight over a change in
- 21 investors in and/or control of OEUC?

22  
23 **Q. COULD YOU PROVIDE A BRIEF REVIEW OF YOUR INITIAL**  
24 **TESTIMONY?**

25 A. Yes. My initial testimony addressed the following topics:

- 26 1. The impact of liabilities and indemnifications provided in this
- 27 transaction;
- 28 2. The source of investment returns;
- 29 3. The risks of double leverage;
- 30 4. TPG's due diligence and financial analysis;
- 31 5. Required SEC approvals; and
- 32 6. Various risks of the transaction.

1       **Q.    WHAT PRIMARY ISSUES DID YOU DISCUSS REGARDING THESE**  
2       **TOPICS, AND HAVE THEY BEEN RESOLVED?**

3       A.    With the exception of Topic 4, which requires no further discussion  
4       because there has been resolution of Staff's questions, and Topic 6, for  
5       which I have nothing to add from my initial discussion, I will handle all the  
6       topics in order and provide a discussion in either narrative format or a  
7       question-and-answer format.

8

9

#### **Liabilities and Indemnifications**

10

In my opening testimony, I discussed my concerns over the lack of  
11       clarity regarding Enron liabilities and the degree to which PGE customers  
12       are properly protected from Enron and PGE's unregulated utility  
13       operations. (See Staff/200 Morgan/8.) Mr. Davis testified in response that  
14       PGE would be made the sole beneficiary of any indemnity against  
15       potentially substantial, Enron-related liabilities. The indemnifications that  
16       were granted were based on the potential effect on PGE's value.

17

Mr. Davis included a listing of the liabilities in his testimony, under four  
18       broad categories:

19

1. Shared indemnity items;

20

2. Non-shared indemnity items;

21

3. Indemnity items that are capped at the purchase price, i.e., "Tax  
22       and Benefit Matters"; and,

22

23

4. Breaches of post-closing covenants

24

(See *generally* Oregon Electric/100 Davis/34-36)

1  
2           The first two items are subject to a cap of \$94 million, with either 90%  
3 recovery (No. 1) or 100 percent recovery (No. 2). TPG has not provided  
4 valuation data surrounding the items due to their sensitive nature. As  
5 such, Staff's analysis of the issue is limited. I am concerned because the  
6 extent of the exposure is not certain and there has been no agreement by  
7 TPG to shield PGE's customers from the "shared" exposure, i.e., the ten  
8 percent of costs to which TPG and PGE will exposed.

9           The Tax and Benefit Matters will provide protections for 100 percent of  
10 all items, less tax effects, up to the purchase price of about \$1.25 billion.  
11 Mr. Davis indicated that they have no reason to expect any such liabilities  
12 would approach that amount.

13           Unfortunately, uncertainty remains regarding these indemnifications.  
14 Notwithstanding the assurances that PGE will benefit from the  
15 indemnifications, nothing has been set down in writing for Staff review.  
16 Staff must rely on the Applicants' promise that any potential liabilities that  
17 may affect PGE due to its ownership by Enron will not erode PGE's  
18 financial integrity and that all indemnifications will benefit PGE directly. To  
19 help remedy this uncertainty, I propose a condition (See Number 21,  
20 Staff/801,) that would require that all indemnifications be directly assigned  
21 to PGE. Even though this would not provide 100 percent recovery, it  
22 increases the overall level of comfort surrounding the matter. If the  
23 Applicants oppose this condition, I have an alternative proposal. In order

1 to insulate any Enron-effects, OEUC would agree to provide PGE with  
2 equity infusions, not debt-financed at Oregon Electric, if any Enron-related  
3 liability, directly or indirectly, were to cause PGE's common equity ratio to  
4 fall below a 48 percent threshold. This condition would assist PGE in  
5 maintaining a healthy stand-alone capital structure.

### 7 **Sources of Investment Return**

8 TPG stands to gain significantly from its purchase of PGE. Even  
9 though Staff understands the due diligence efforts were designed to set  
10 the purchase price, it is clear that significant resources were allocated to  
11 determining the potential for "efficiencies." TPG has indicated that it will  
12 not achieve "synergies" because they are not merging with PGE and they  
13 are not an "operating utility" that could achieve such synergies. (See  
14 Oregon Electric/Exhibit 22, Davis/Page 9 of 26, line 22 through  
15 Davis/Page 10, line 4.)

### 17 Operational Efficiencies

18 It is reasonable to expect that TPG will try to use its historical practice  
19 of active management to reduce some operational costs. Any savings  
20 that are anticipated will increase the investment returns. PGE's CFO-  
21 witness Mr. Piro testifies that management's focus on improving PGE's  
22 financial results is an on-going obligation regardless of ownership. He

1 also states that PGE will have access to capital on efficient and  
2 economical terms. (See *generally* PGE/100, Piro/10.)

### 3 Capital Appreciation

4 A large amount of the investment returns to TPG will be through capital  
5 appreciation as opposed to immediate cost savings. Still, any sustained  
6 cost-savings could be expected to increase the value of PGE. Until TPG  
7 has actually achieved savings or received a return of principal, it may not  
8 have the necessary cash flow to fund additional debt pay-down that I  
9 recommend.

10 Even though Staff's proposed rate credits (See Staff/801, Condition 20)  
11 may not be directly tied to projected savings, savings were clearly  
12 important in setting the purchase price for PGE and reflect a significant  
13 portion of the return that the investors anticipate.

14 I would like to comment on an assertion made by Tinker-Murray-Hager  
15 where they estimate the required return on equity, due to the leverage and  
16 based on the allowed return from the utility, for Oregon Electric is 19  
17 percent. (See PGE Exhibit/200 Tinker-Murray-Hager/6, Line 5.) They  
18 state that, "Mr. Morgan appears to assume that Oregon Electric's cost of  
19 equity capital is the same as PGE's." (See PGE//200, Tinker-Hager-  
20 Murray/4, Lines 19-20.)

21 I did not mean to imply that the leveraged equity was no more risky  
22 than that held by investors of public utilities with more typical debt and  
23 equity capital structures. I agree that an increased return would be

1 warranted, due to the increased risk of default brought on by the leverage  
2 itself. However, the testimony of Tinker-Murray-Hager does not rebut the  
3 contention of many parties in this docket that there is increased risk that is  
4 not completely mitigated through ring-fencing or other provisions.

### 6 **Double Leverage Risks**

7 As I indicated in my opening testimony, the increased leverage at  
8 Oregon Electric will have an immediate impact on PGE's financing costs.  
9 (See Staff/200 Morgan/29, beginning on line 17.) The increased debt  
10 service, resulting from higher leverage, would correspond to a greater  
11 required return. Because the debt payment is not discretionary, it would  
12 increase the need for PGE to operate at a high level of efficiency. PGE  
13 may also seek to shift some risks onto customers through such  
14 mechanisms as power cost adjustments and revenue decoupling  
15 mechanisms.

16 I would like to clarify my position regarding PGE's operating  
17 performance and the overall chance that the earning capacity would not  
18 allow a \$50 million dividend to meet required debt service. It is likely that  
19 such funds would be available.

20 However, it is not sufficient to say that there would be only a small risk  
21 of default for the reason that PGE's dividends are *expected* to be sufficient  
22 to fund debt service requirements. If this assertion were correct, then I  
23 could argue that any public utility could achieve a better return for its

1 investors simply by setting up a holding company, shifting the public utility  
2 assets into the subsidiary, imposing some ring-fencing measures, and  
3 leveraging it excessively. My point here is that, as debt increases, so  
4 does the need to ensure there is sufficient income to repay it. Again, PGE  
5 could seek regulatory mechanisms to be approved by the Commission to  
6 limit volatility surrounding PGE's profitability.

7 **Q. DO YOU HAVE ANY CONDITIONS TO REDUCE THE UNCERTAINTY**  
8 **CAUSED BY THE DOUBLE-LEVERAGING?**

9 A. Yes. The Commission should require a cash flow sweep, for a period of  
10 five years, with the result that all available cash remitted to Oregon  
11 Electric is dedicated to paying down its debt and, once the consolidated  
12 debt is within a reasonable range, that Oregon Electric not re-leverage  
13 itself. I have included this condition as a recommendation at the end of  
14 my testimony. The Commission should not allow the holding company of  
15 a rate-regulated public utility to risk harm to the utility and its customers by  
16 embracing a long-term leveraged structure. A highly leveraged structure,  
17 over time, is not in the best interests of PGE, and could present additional  
18 risks should interest rates increase.

19 In addition, it is important that cash not be drained from PGE that  
20 would otherwise allow for meaningful debt liquidation at the holding  
21 company. For this reason, I also address a restriction on dividend  
22 payouts.

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### **Risks of the Transaction**

Any risks, other than those that PGE would face as a stand-alone utility, require increased scrutiny. Since the acquisition at issue here would be one of the first leveraged buy-outs of a public utility, there is limited past precedent to rely on in assessing the risks that might surface after such a transaction. The Commission has a reputation of requiring innovative ring-fencing measures as a condition for merger approvals.

However, Staff has learned from experience that existing ring-fencing measures do not fully insulate utility from activities of the parent. Nevertheless, it is incumbent on Staff to propose measures, many building on past experience, that serve to protect PGE and its customers while not being overly onerous or prescriptive. Staff has attempted to do so in this docket.

### **Review of Filed Testimony**

**Q. HAVE YOU REVIEWED THE TESTIMONY SUBMITTED IN THIS DOCKET BY OTHER PARTIES?**

A. Yes. I reviewed the testimony and will respond to issues addressed by the Applicants Davis and Wheeler and by PGE witness Mr. Piro.

First of all, Mr. Davis testifies that the application presents minimal potential harm or risks and that PGE's customers are protected against the risks of Oregon Electric's debt. (See Oregon Electric/100 Davis/3.)

1 He also suggests that PGE's cost of capital is unlikely to rise as a result of  
2 the application. (Ibid.)

3 My overriding concern with the latter statement is that PGE's cost of  
4 debt has already increased as a result of Enron's ownership. PGE's  
5 senior-secured debt rating is not expected to be immediately affected due  
6 to the acquisition. However, its unsecured ratings will be hovering just  
7 above non-investment-grade. This rating will affect the interest rate  
8 charged on PGE's revolving lines of credit, and power purchases, among  
9 other "spillover effects" that Mr. Davis has not addressed.

10 Mr. Piro claims that the transaction will not put unusual pressure on  
11 PGE to cut costs. He implies that the financial results are an on-going  
12 obligation regardless of ownership. He testifies that PGE has an incentive  
13 to reduce risks that may affect the near-term consequences of decisions  
14 to change O&M or capital expenditure levels. He states that PGE always  
15 weighs "the effects of various proposed capital expenditure and cost  
16 changes on customer satisfaction."

17 As far as any unusual pressure to cut costs, Mr. Piro indicates that  
18 debt service obligations do not represent a unique risk to customers. I  
19 disagree. The amount of debt service required under the financing  
20 arrangements of this deal is not normal.

21 Mr. Piro reiterates part of Ms. Wheeler's testimony (Oregon  
22 Electric/200) that the worst sensitivity circumstances, i.e., sustained

1 decreases in EBIT of 30 percent, are highly improbable.<sup>4</sup> He indicates  
2 that, based on 14 years of earnings history, PGE's earnings were  
3 impacted by such "extreme" downturns only once and approached those  
4 levels in only one other year – 12 years apart. I agree that prolonged  
5 periods of depressed earnings would be highly unlikely for PGE.  
6 Nevertheless the business risk is present that earnings could be  
7 insufficient to service the debt.

8 Mr. Piro also claims that PGE has access to capital, on efficient and  
9 economical terms. Unfortunately, he appears to direct his observations  
10 toward the access to debt markets and does not directly address PGE's  
11 current or post-transaction access to equity markets. Because PGE would  
12 be privately held, on-going access to equity would not be accessible  
13 through the public markets. In his references to Port Westward, he does  
14 not address from where the appropriate equity investment would be  
15 obtained; he only indicates that PGE would not have problems accessing  
16 the debt that they would acquire.

17 I made a statement in my direct testimony regarding the weak  
18 capitalization of Oregon Electric. (See Staff/200 Morgan/29, line 11.) Mr.  
19 Piro mistakenly understood my statement to reference PGE's  
20 capitalization. It does not. I think that PGE's capitalization has been  
21 reasonable over the past several years. In fact, the debt ratings of PGE in  
22 1996-2000, prior to Enron's demise and the problems in the Western

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<sup>4</sup> This statement relates to the sensitivity analysis requested by Staff that targeted decreases in

1 Energy, were solidly investment-grade, in the mid-A-range. At the same  
2 time, PGE maintained an average of 53.5 percent common equity in its  
3 capital structure. Mr. Piro indicated that the 48 percent common equity  
4 floor may not be the "right" level, but was based on a settlement. Based  
5 on his data, I don't know if he is stating that a figure closer to 53.5 percent  
6 would be more appropriate, however Staff recommends a 48 percent level  
7 in the conditions that I address at the end of my testimony.

8 One issue that Mr. Piro generally appears to allude to in his testimony  
9 is that PGE's maintenance of an investment-grade rating is sufficient and  
10 that the transaction will not impair PGE's access to capital on economical  
11 and efficient terms and result in weak capitalization. I disagree. PGE had  
12 maintained A-rated debt for many years. Simply maintaining investment-  
13 grade debt is not recommended because it reduces the "cushion" if a  
14 company performs poorly, to allow for a ratings downgrade while still  
15 maintaining an investment grade level. Also, the unsecured bond ratings  
16 affect a utility's ability to purchase energy from power and fuel market  
17 participants and the credit provisions such participants require. PGE's  
18 unsecured ratings are now only one notch into the investment-grade  
19 category by Standard & Poor's and Moody's. Fitch rates PGE's unsecured  
20 securities as one notch into the non-investment grade ratings.

21 Although I testified that private ownership may adversely affect PGE's  
22 credit ratings because of lack of regulatory oversight, Mr. Piro indicates

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earnings levels to view their impact on the operational levels.

1 that nothing in S&P's description of its process, or his knowledge of the  
2 process, suggests this is the case. (See PGE/200, Piro/16, lines 3-7.)  
3 He indicates that two key reasons cited by S&P and Moody's for  
4 maintaining investment-grade ratings relates to the likely PUC conditions  
5 on this transaction and the elimination of potential Enron liabilities. (See  
6 PGE/200, Piro/20, lines 1-5.) Mr. Piro believes that any concerns about  
7 regulatory oversight will be mitigated though conditions. (Ibid.) I agree  
8 that a lot of the concerns can reasonably be addressed by the adoption of  
9 all the conditions that I have identified in my testimony.

10 Finally, I would like to address Mr. Piro's position regarding the issue of  
11 liabilities and the general principle that he thinks is important when  
12 considering whether to seek customer contribution to offset a liability. He  
13 indicates that, if liability or claim arises out of providing service to  
14 customers or relates to assets that have always been devoted to regulated  
15 service or to benefit customers, then the principle of "matching costs and  
16 benefits" should be the deciding factor. (See PGE/200, Piro/27, line 18.)

17 He answers the question whether OEUC's capital structure would  
18 increase the cost of debt and states that it is possible, although the next  
19 five years' impact would likely be small. (See PGE/200, Piro/21, lines 11-  
20 14.) I do not know what he means by "small", since by 2010, almost \$550  
21 million in retiring debt will be affected and every one-half percentage point  
22 in debt costs for that figure would reflect almost three million dollars in  
23 additional interest costs.

1           In her testimony, Oregon Electric/200, Ms. Wheeler provides some  
2 information surrounding the double leverage issue, including the concerns  
3 over: (1) the potential for extreme cost cutting or borrowing to fund  
4 dividends; (2) the bankruptcy risk due to the OEUC capital structure; and,  
5 (3) the expected PGE downgrade will increase cost of debt. She indicates  
6 that each concern is unfounded. (See Oregon Electric/200, Wheeler/5,  
7 starting at line 22; Wheeler/11, starting at line 1; and Wheeler/15, starting  
8 at line 1.) I disagree with her impression of these issues and think that  
9 each concern has a reasonable foundation.

10           Ms. Wheeler also indicates that the concern about debt potentially  
11 placing undue pressure on PGE to cut costs is without basis because  
12 TPG's modeling gave them a high degree of confidence that PGE's  
13 dividends will be more than sufficient to meet debt service. However, I am  
14 concerned about the chance of the pressure occurring, regardless of how  
15 "remote" the Applicants feel it is. Ms. Wheeler also indicates that there is  
16 a remote chance that the revolving credit facility at PGE would be drawn  
17 for the purpose of providing dividends to Oregon Electric. Even if it is  
18 remote, the chance is a very serious concern.

19  
20           **Proposed Protective Measures (Ring-fencing Conditions)**

21       **Q.   WHAT RING-FENCING CONDITIONS DO YOU PROPOSE TO**  
22       **PROTECT PGE AND ITS CUSTOMERS FROM ANY FINANCIAL RISK**  
23       **DUE TO THIS TRANSACTION?**

1 A. I will list the conditions that are proposed and provide a brief commentary  
2 on each, as needed. These will help insulate PGE from any problems at  
3 the holding company. Even though they should not be construed as being  
4 perfect, they will increase the flow of information throughout TPG's  
5 participation in OEUC's ownership of PGE. This information should  
6 provide advance warnings of any action or involvement that the  
7 Commission might need to undertake in the future to exercise its authority.

8 The following lists the conditions that are necessary to provide  
9 sufficient protections for PGE and its customers. I list the conditions that  
10 Staff has identified as being supportive of PGE's financial condition. The  
11 conditions are numbered in the same sequence that is provided in  
12 Staff/801.

13

14

#### **Condition Listing**

15

16

17

The first four Proposed Conditions (4, 6, 11, and 12) are consistent with those that Staff has supported and which appear to be generally acceptable to the Applicants in their current form.

18

19

20

21

22

The next five Proposed Conditions (16, 17, 18, 19 and 21) represent those conditions that Staff supports, although the Applicants may disagree with the limits placed on Proposed Condition 16 and may propose minor edits to 19. It appears that Proposed Condition 17 and 18 are acceptable in the current form that I am including in this testimony.

1           The next four Proposed Conditions (25, 26 27 and 28) may not be  
2 agreeable to the Applicants.

3           The final four conditions (30, 31, 32 and 33) impose additional  
4 reporting requirements in order to keep the Commission apprised of certain  
5 actions by PGE or the investors.

6           Each condition will be provided in single-spacing format. After each  
7 condition, where necessary, I will summarize issues that are important for  
8 consideration; and I will discuss what may be disagreeable to the Applicants.  
9 I will indicate why the Commission should support Staff's proposals.

#### 11                           **Listing and Discussion of Proposed Conditions**

12           4. Unless such a disclosure is unlawful, Oregon Electric shall notify  
13 the Commission of: (a) Its intention to transfer more than 5% of PGE's  
14 retained earnings to Oregon Electric over a six-month period, at least 60  
15 days before such a transfer begins; (b) Its intention to declare a special  
16 dividend from PGE, at least 30 days before declaring each such dividend;  
17 and (c) Its most recent quarterly common stock cash dividend payment  
18 from PGE within 30 days after declaring each such dividend.

19  
20           6. PGE and Oregon Electric shall maintain separate debt ratings and,  
21 if more than \$5 million of preferred stock is outstanding, then PGE and  
22 Oregon Electric shall maintain separate preferred stock ratings.

23  
24           11. Oregon Electric shall maintain and provide the Commission  
25 unrestricted access to a record of each instance in which TPG Applicants  
26 withhold their consent to a decision of the PGE Board of Directors. The  
27 record shall detail the basis for the decision, including any governing  
28 report or document that memorializes the exercising of the consent rights  
29 and shall identify the persons involved in making the TPG Applicant  
30 Consent Rights decision. Oregon Electric shall provide the records to the  
31 Commission upon request. Nothing in this condition shall be deemed to  
32 be a waiver of Oregon Electric's or PGE's right to seek protection of the  
33 information. Nothing in this paragraph shall prevent the Commission from

1 disclosing to the public the number of times the TPG Applicants exercised  
2 their consent rights within a certain period of time.

3  
4 12. Oregon Electric and PGE shall maintain and provide the  
5 Commission unrestricted access to all books and records of Oregon  
6 Electric and PGE that are reasonably calculated to lead to information  
7 relating to PGE, including but not limited to, Board of Directors' Minutes,  
8 Board Subcommittee Minutes, and other Board Documents. Nothing in  
9 this condition shall be deemed to be a waiver of Oregon Electric's or  
10 PGE's right to seek protection of the information.

11  
12 16. PGE will not make any distributions to OEUC that would, or could  
13 reasonably be expected to, cause the common equity portion of PGE's  
14 total capital structure to fall below 48 percent.

- 15 a. "Total capital structure" is defined as common equity,  
16 preferred equity, and long-term debt.
- 17 b. "Long-term debt" is defined as (1) outstanding debt with  
18 an initial term of more than one year plus the sum of  
19 committed and drawn balances greater than \$150 million  
20 on any of PGE's unsecured revolving lines of credit  
21 (Unsecured Revolvers); and (2) the sum of committed  
22 and drawn balances on PGE's secured revolving lines of  
23 credit (Secured Revolvers).
- 24 c. A "committed balance" is the sum of the commitments  
25 used to support any borrowing capacity or other  
26 purposes, such as a commercial paper program.
- 27 d. A "drawn balance" is sum of amounts drawn against the  
28 Revolvers.
- 29 e. Hybrid securities (e.g., convertible debt) will be assigned  
30 to equity and long-term debt based on the characteristics  
31 of the hybrid security. The Commission, prior to their  
32 issuance, will determine the assignment of the equity and  
33 debt characteristics.

34  
35 **Proposed Condition 16**

36 This condition is designed to limit the ability of PGE to make distributions  
37 to Oregon Electric that could harm PGE's financial integrity. Along with  
38 amounts that would actually cause PGE's common equity capitalization

1 percentage to fall below 48 percent, Staff proposes that the limitation be  
2 imposed on any transfers that could be reasonably expected to cause such a  
3 decrease. Staff further recommends that the capitalization percentage  
4 calculations continue as they have since Enron's merger.

5 OEUC appears to oppose that part of Condition 16 shown in italics as  
6 follows, "PGE will not make any distributions to OEUC that would, *or could*  
7 *reasonably be expected to*, cause the common equity portion of PGE's total  
8 capital structure to fall below 48 percent." The text shown in italics serves to  
9 protect PGE's credit rating and lower cost of capital. Under the requirement  
10 stated in the text, if PGE knows that it has a substantial payment obligation,  
11 PGE would factor this into account in determining how much cash could be  
12 distributed to OEUC. For example, absent the italicized clause, PGE could  
13 first send a cash dividend to OEUC, then pay the liability obligation and have  
14 its equity fall below 48% as a result.

15 17. The allowed return on common equity and other costs of capital  
16 viewed on a stand-alone basis will not rise as a result of Oregon Electric's  
17 acquisition of PGE. These capital costs refer to the costs of capital used  
18 for purposes of rate setting, avoided cost calculations, affiliated interest  
19 transactions, least cost planning, and other regulatory purposes.

20  
21 18. The customers of PGE shall be held harmless if PGE's revenue  
22 requirement is higher due to Oregon Electric's ownership of PGE.

23  
24 19. Oregon Electric and PGE shall maintain and provide the  
25 Commission unrestricted access to all written information provided to  
26 stock or bond rating analysts, which directly or indirectly pertains to PGE  
27 or any affiliate that exercises influence or control over PGE. Such  
28 information includes, but is not limited to, reports provided to, and  
29 presentations made to, stock and bond rating analysts. For purposes of  
30 this condition, "written" information includes, but is not limited to, any  
31 written and printed material, audio and videotapes, computer disks and

1 electronically-stored information. Nothing in this condition shall be  
2 deemed to be a waiver of Oregon Electric's or PGE's right to seek  
3 protection of the information.  
4

5 **Proposed Condition 19**

6 Staff desires that PGE maintain the records that are itemized in this  
7 condition so that they are available if Staff requests that Oregon Electric or  
8 PGE to provide them.

9  
10 21. Oregon Electric will ensure that PGE receives the benefit of the  
11 Stock Purchase Agreement indemnifications.  
12

13 25. Each PGE distribution to OEUC will be used by OEUC exclusively  
14 to pay direct operating expenses<sup>5</sup> and debt service for at least five years  
15 and until all of the following conditions are met: (See Staff/900,  
16 Morgan/21, line 9 through Morgan/22, line 5.)  
17

- 18 a. The sum of the drawn balances of all PGE's Secured  
19 Revolvers is zero and there has not been a balance for  
20 three months; and  
21 b. OEUC has paid down at least \$250 million of its  
22 outstanding debt as compared to the level of outstanding  
23 debt at closing including the catch-up dividend from PGE.  
24

25 **Proposed Condition 25**

26 Staff recommends that the "cash sweep" provision apply, for a five-year  
27 period, to only debt service and direct operating expenses, which should be  
28 defined as those expenses that are incurred from services, supplies, or  
29 assets provided by Oregon Electric personnel directly and are not based on  
30 any type of allocation from an affiliate (parent or subsidiary). Further, Staff  
31 recommends that the \$50 million dollar amount apply to the current sum of

1 the balances on any *unsecured revolvers*. This recommendation is to limit  
2 the ability of Oregon Electric to absorb the liquidity available to PGE, yet  
3 maintain some flexibility to Oregon Electric. Staff also recommends that a  
4 three-month rolling average of balances on any *secured revolvers* also be  
5 below \$50 million dollars and that for the most recent three months, there  
6 would be no outstanding balance. This is because, were PGE to require a  
7 secured revolver, it would likely reflect weak financial performance, because  
8 revolving lines of credit are generally unsecured.

9  
10 26. No company, entity, or person, other than PGE, shall use PGE's  
11 regulated assets as collateral for any loan, guarantee or other such use  
12 without prior expressed Commission approval.  
13

14 **Proposed Condition 26**

15 Oregon Electric does not believe this condition is necessary because ORS  
16 § 757.480 already requires it. The language proposed in Staff's condition  
17 includes the words "guarantee" and "other such use". These modifiers offer  
18 additional clarification and improve the supportive statutory language by  
19 limiting Oregon Electric or the TPG funds from borrowing monies against the  
20 dividend stream, or from offering PGE's equity as collateral support for  
21 borrowed funds provided by the regulated assets of PGE. Because the equity  
22 in PGE would convert to the ownership of the lenders in the event of default,

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<sup>5</sup> Direct operating expenses are expenses that were incurred from services, supplies or assets provided by OEUC personnel directly and are not based on any type of allocation from an affiliate (parent or subsidiary).

1 this condition will reduce the chance that the Commission would be faced with  
2 an unanticipated 757.511 filing.

3

4 27. OEUC shall not re-leverage, i.e., increase the amount of its  
5 outstanding long-term debt once such debt has been liquidated, if the  
6 increased debt would, or could reasonably be expected to, bring the  
7 consolidated capital structure<sup>6</sup> below 40% common equity  
8

9

**Proposed Condition 27**

10 This condition is required to limit the ability for Oregon Electric to maintain  
11 a highly-leveraged capital structure. As I have indicated in testimony, this  
12 presents a considerable risk to PGE and its customers that this Commission  
13 should not support, other than for the initial acquisition.

14

15 28. TPG Applicants<sup>7</sup> will not allocate or directly bill OEUC for any  
16 goods, services, supplies or assets until condition number 25 (cash-sweep  
17 provision) has been satisfied.  
18

19

**Proposed Condition 28**

20 This condition is designed to ensure that Oregon Electric and TPG do not  
21 take actions that are contrary to the spirit of the cash flow sweep.

22

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<sup>6</sup> The Capital Structure calculations refer to the OPUC policy that does not include short-term debt capital.

<sup>7</sup> See Application of Oregon Electric Utility Company, LLC, et al to Acquire Portland General Electric Company (March 8, 2004) page 6 lines 15-17. TPG Applicants also includes Tarrant Partners.

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**Proposed New Conditions**

The following conditions are being proposed to support PGE's financial strength.

**PGE Debt Financing Costs**

PGE's credit rating has gone down because of Enron's demise and activities that have served to increase PGE's cost of debt. If Enron still owned PGE, and PGE came in for a rate case, Staff would advocate that PGE's shareholders (Enron) absorb the increased cost of debt, not PGE's ratepayers. Staff's rate case recommendation would arise from the Enron condition that PGE's customers will not be harmed due to Enron's ownership. In the event OEUC acquires PGE, the adjustment discussed above would no longer hold since the Enron merger condition becomes void.

Therefore, customers would no longer have the protection from ongoing harm, through increased debt costs, incurred as a result of Enron's ownership. I estimate PGE's increased debt expense is costing the company upwards of five to seven million dollars more than it would have incurred but for Enron's activities and ultimate collapse into bankruptcy. Fortunately, most of this high-priced debt will mature by 2010. With this transaction, Staff believes it is likely foregoing the opportunity to include these costs in rates during a future PGE ratecase.

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24**Port Westward Financing Costs**

As I indicated in my original testimony, PGE's anticipated development of the Port Westward generation facility is expected to have about \$150 million financed with debt. Based on my assessment of interest rate spreads, I would anticipate an increase of at least 50 basis points from what would have otherwise occurred, were PGE a stand-alone entity. Assuming this figure, and that the Commission passed through the entire financing cost to customers, then customers would face over one million dollars in additional financing costs.

Because of the foregoing discussion, I propose that the Commission adopt a condition that would require Oregon Electric to absorb any additional financing costs, i.e., cost of capital, over that which PGE would be expected to incur assuming continued Enron ownership. The impact of such an adjustment would occur in PGE's next general rate case filing.

**Reporting Requirements**

The following reporting conditions (Number 30 and Number 31) require a semi-annual report, and on-going reports as warranted by actions taken at TPG and Oregon Electric:

30. Oregon Electric shall provide a report to the Commission, on a semiannual basis, that details the date of each instance the TPG Applicants withheld their consent to a decision of the PGE Board of Directors and names the Consent Right that was triggered.

1 31. The following actions shall be reported to the Commission within 10  
2 business days after their occurrence and the report shall provide details about  
3 the action taken:

- 4 a. TPG Applicants<sup>8</sup> will notify the Commission if there is a change of  
5 control of the General Partner of either of the TPG Applicants.  
6 b. TPG Applicants will notify the Commission if there is any change in the  
7 ownership interest in Oregon Electric, of PGE, or of any of the TPG  
8 funds investing in Oregon Electric;  
9 c. TPG Applicants will report any changes in any agreement that governs  
10 the operation of the TPG funds investing in PGE and of Oregon Electric,  
11 including but not limited to any changes to any partnership agreement,  
12 amendments or changes to the Oregon Electric Operating Agreement,  
13 term sheets, Company make-up, assignment of interests or other  
14 binding agreements.  
15 d. TPG Applicants will report when any Member or Manager at Oregon  
16 Electric is designated, appointed, elected, removed or replaced by a  
17 vote, approval or consent of a majority of the members.  
18 e. TPG Applicants will report when they take any of actions concerning  
19 matters of Oregon Electric Utility Company, LLC included in ORS  
20 63.130 (3)(c), (4) (c), (d), (e), (f), (g), (h), (i), and (j).  
21 f. PGE and Oregon Electric will notify the Commission, through OAR 860-  
22 027-0041, whenever an equity infusion (paid-in capital, purchase of  
23 stock or other arrangement) occurs with a subsidiary or partnership.  
24

25 The next proposed condition (Number 32) provides notification to the  
26 Commission regarding Oregon Electric's financings, and supplements  
27 Condition 27. I propose this condition because it is important for the  
28 Commission to maintain an ongoing understanding of financings at Oregon  
29 Electric.

30 32. OEUC shall provide quarterly reports to the Commission that details its  
31 capital structure, including each debt issuance, amounts outstanding, source  
32 of financing and other pertinent terms and conditions. This shall be included  
33 in a detailed format and could be included within the reports that the  
34 Applicants have agreed to, which will be designed to emulate SEC filings.  
35 Oregon Electric shall also provide copies of Oregon Electric's and PGE's  
36 stand alone and consolidated financial statements to the Commission. These

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<sup>8</sup> See Application of Oregon Electric Utility Company, LLC, et al to Acquire Portland General Electric Company (March 8, 2004) page 6 lines 15-17. TPG Applicants also includes Tarrant Partners.

1 reports shall be made on the 15th day of March, June, September and  
2 December.  
3

4 Finally, the last proposed new condition limits the ability of Oregon Electric  
5 or PGE to expand into any unregulated form of business that might increase  
6 operational risk and is a precursor to Condition 13, which is discussed in  
7 Staff/1100 Hathhorn/3, beginning on Line 15.

8 33. Until the total consolidated debt at OEUC is less than 60% of total  
9 capital, Oregon Electric and PGE shall not, without the prior consent of the  
10 Commission, directly or indirectly permit any subsidiaries to, acquire,  
11 incorporate or otherwise organize any subsidiary, or enter into substantially  
12 new lines of business, which were not in existence as of the January 1, 2005.  
13

#### 14 **Conclusions**

#### 15 **Q. WHAT OTHER ISSUES ARE IMPORTANT TO ADDRESS?**

16 A. In this testimony, I have recommended conditions that would be  
17 supportive of PGE's credit quality and that would work to counter some  
18 negative effects of the formidable consolidated leverage. Other Staff  
19 conditions are designed to address access to financial and other records.

20 Because it is not possible to insulate PGE and its customers from  
21 every risk of the holding company and investment from private equity  
22 funds, I have proposed conditions that require reporting of certain actions  
23 so that the Commission can be informed in case it deems a need to exert  
24 its authority. Unfortunately, the Applicants and their financiers have not  
25 agreed to final financing documents, nor has a final Operating Agreement  
26 been designed for Oregon Electric.

1           Additionally, there are a few issues that have not been fully detailed by  
2           the Applicants in this docket. For instance, TPG appears to support the  
3           development of Port Westward. However, there have been no  
4           commitments to its development, only general assertions that TPG  
5           supports the development of a gas-resource plan for PGE. Because of  
6           the additional required equity from TPG to fund any new capital resources,  
7           I am concerned that there may be an unnecessary delay in obtaining  
8           needed resources.

9           Additionally, there have been no commitments regarding how TPG  
10          plans to address the short position<sup>9</sup> that would still exist at PGE, even if it  
11          were to expeditiously move forward with Port Westward.

12       **Q.    WHAT DO YOU CONCLUDE GIVEN THE TESTIMONY AND EVIDENCE**  
13       **YOU REVIEWED?**

14       A.    I conclude that the Commission should require specific conditions  
15       designed to protect customers and to protect the financial integrity of PGE.

16           I believe that with the additional conditions, there would be decreased  
17       chance of significant harm to PGE or its customers.

18       **Q.    DOES THIS COMPLETE YOUR PREPARED DIRECT TESTIMONY?**

19       A.    Yes, it does.

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<sup>9</sup> By "short position," I mean the lack of long-term, committed energy resources sufficient to meet forecasted load requirements.

CASE: UM 1121  
WITNESS: James E. Durrenberger

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 1000**

**Surrebuttal Testimony**

**Contains Confidential Information**

**September 22, 2004**

**INFORMATION CONTAINED IN STAFF EXHIBIT 1000  
IS CONFIDENTIAL AND SUBJECT TO PROTECTIVE  
ORDER NO. 04-139. YOU MUST HAVE SIGNED  
THE PROTECTIVE ORDER IN DOCKET UM 1121  
TO RECEIVE THIS EXHIBIT.**

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**  
2 **ADDRESS.**

3 A. My name is James E. (Ed) Durrenberger. I am a Senior Revenue Requirement  
4 Analyst for Electric and Natural Gas Revenue Requirements in the Utility  
5 Program of the Oregon Public Utility Commission. My business address is 550  
6 Capitol Street NE Suite 215, Salem, Oregon 97301-2551.

7 **Q. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?**

8 A. Yes, I prepared Staff/300. I included exhibits and documents that support my  
9 recommendations.

10 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

11 A. The purpose of my testimony is to respond to the rebuttal testimony submitted  
12 by Applicants' Oregon Electric Utility Company's (Oregon Electric) witness  
13 Kelvin L Davis (UM 1121, Oregon Electric/100/Davis) concerning the following  
14 points:

- 15 1. Cost reductions in Operating and Maintenance (O&M) and capital  
16 spending at Portland General Electric (PGE) are uncertain;
- 17 2. Cost reductions would not negatively impact PGE customers;
- 18 3. Savings realized from cost reductions would benefit both customers  
19 and owners, and
- 20 4. The Applicants' plan to continue to re-invest in PGE's basic  
21 infrastructure.

1 I will also respond to the Applicants' proposed treatment of acquisition  
2 adjustments and transition costs, and describe conditions Oregon Electric has  
3 agreed to that adequately resolve this issue.

4 **Q. DID YOU PREPARE AN EXHIBIT FOR THIS DOCKET?**

5 A. Yes. I prepared Exhibit Staff/1001, Durrenberger, which includes published  
6 press releases from the FAA over regulatory compliance of maintenance  
7 standards. The exhibits consist of 2 pages.

8 **Q. WHAT DOES MR. DAVIS SAY REGARDING COST REDUCTION PLANS**  
9 **FOR PGE?**

10 A. Mr. Davis explains at length the purpose of the due diligence reports produced  
11 by TPG's consultants. (See Oregon Electric/100 Davis/Pages 14-16.) He  
12 states that any cost savings findings contained in the reports are of a  
13 preliminary nature and not the basis of cost-cutting plans. Mr. Davis further  
14 states, "Only post-closing, Board-directed work – with significant involvement  
15 by management – will result in operational plans." In consideration of that, Mr.  
16 Davis states "Oregon Electric is quite confident that it can help PGE operate  
17 more efficiently without decreasing the reliability, safety and service quality for  
18 which PGE is so well known." (See Oregon Electric/100 Davis/Pages 17-18.)

19 **Q. WHAT PROCESS DOES MR. DAVIS DESCRIBE FOR REALIZING O&M**  
20 **EFFICIENCIES THAT MAY RESULT IN COST SAVINGS?**

21 A. The stated plan calls for PGE's management and Board of Directors to initiate  
22 a full company review, after closing, with the goal of developing operating

1 plans to decrease the company's cost structure as much as possible while  
2 maintaining safety and reliability.

3 **Q. IS THERE ANY CERTAINTY ABOUT HOW MUCH THE PROSPECTIVE**  
4 **OWNERS CAN SAVE IN DECREASING PGE'S COST STRUCTURE?**

5 A. No. As I stated in my opening testimony, the prospective buyers' consultants  
6 concluded there was the potential for up to [CONFIDENTIAL] ██████████  
7 ██████████ [CONFIDENTIAL] in cost savings related to efficiencies in O&M and  
8 capital spending. (See Staff/300 Durrenberger/Page 2.) Because the  
9 company review is yet to be conducted under the oversight of the new Board of  
10 Directors there is no certainty in how much can be trimmed from PGE's cost  
11 structure without affecting safety and reliability. Nonetheless, there remains a  
12 gap between the cost savings that the consultant's concluded were possible,  
13 and the unquantified savings that the applicants' state may be possible, but  
14 cannot be known until after a top down review. I propose that Oregon Electric  
15 and PGE submit a final transition plan ("Transition Plan") to the Commission  
16 within one year of closing that includes detailed areas where efficiencies and/or  
17 cost cutting efforts could occur and provide annual updates of the expected  
18 and achieved savings (See Staff/801, Condition 22).

19 **Q. WHAT WILL THE TRANSITION PLAN BE USED FOR?**

20 A. The Transition Plan will be used to focus Staff's audit efforts on areas where  
21 cost reductions at PGE are planned or have been made to ensure such actions  
22 do not adversely affect customer service, safety and reliability.

1 **Q. WOULD COST CUTTING MEASURES HAVE A NEGATIVE IMPACT TO**  
2 **PGE'S CUSTOMERS?**

3 A. Not necessarily. As Mr. Davis states in his rebuttal testimony, "Given that rates  
4 are cost based, responsible cost savings will benefit customers over time  
5 through lower rates." (See Oregon Electric/100, Davis/Page 8.) Mr. Davis  
6 goes on to say; " Oregon Electric has no incentive to cut costs irresponsibly;  
7 rather it has every incentive to sustainably decrease PGE's cost structure, if  
8 possible, while the maintaining safety and reliability..." (See Oregon  
9 Electric/100, Davis/Page 8.) It is further possible that perhaps some Enron-  
10 associated costs could be eliminated at PGE with no effect whatsoever to  
11 customer safety or reliability.

12 **Q. DO YOU STILL HAVE CONCERNS ABOUT THE APPLICANTS' STATED**  
13 **INTENT TO REDUCE PGE'S COST STRUCTURE?**

14 A. Yes, I do. Despite the Applicants' well-reasoned testimony that they do not  
15 intend to cut costs at PGE irresponsibly and they do intend to invest prudently  
16 in PGE's systems, few of the specifics have been put into a written plan.

17 **Q. DO YOU HAVE ANY REASON TO QUESTION WHETHER THE**  
18 **APPLICANT'S WOULD ONLY CUT COSTS IRRESPONSIBLY?**

19 A. Perhaps. I am aware that TPG is involved in owning a company that was  
20 recently involved in a dispute with a federal regulatory agency over  
21 maintenance practices that on two occasions resulted in stipulated agreements  
22 where penalties of \$2.5 million and \$667 thousand were imposed. (See

1 Staff/1001, Durrenberger/Page 1.) Staff looks forward to the Applicants'  
2 response to the issues raised by the FAA documents.

3 **Q. WHAT REMEDY DO YOU PROPOSE?**

4 A. I propose that PGE be required to make an annual report to the Commission  
5 regarding current and planned construction expenditures and O&M expenses,  
6 with detail at the FERC account level and structured so that a comparison can  
7 be made between historical, current and planned project spending levels (See  
8 Staff/801, Condition 23). Additionally, the Applicants should agree to conduct  
9 an independent audit should the prudence of the O&M and Construction  
10 programs come into question. The first such audit would be at the  
11 shareholders' expense, using an outside auditor approved by the Commission  
12 (See Staff/801, Condition 24).

13 **Q. DO SAVINGS GENERATED FROM COST REDUCTIONS TO O&M AND**  
14 **CAPITAL EXPENDITURES BENEFIT CUSTOMERS AS WELL AS THE**  
15 **SHAREHOLDERS?**

16 A. Not necessarily.

17 **Q. PLEASE EXPLAIN.**

18 A. Any cost savings realized from cost reductions would not immediately lead to a  
19 reduction in the customer's power bill. Absent a rate case, any cost reductions  
20 will improve PGE's earnings, to the benefit of shareholders, until such time as  
21 the cost reductions are reflected in rates. Increased earnings would also likely  
22 increase the value of the company and make PGE more attractive to other  
23 potential investors. In the long run, lower costs benefit the customer by

1 reducing the need for, or size of, a future rate increase as other costs escalate.  
2 The timing of flowing through to customers the cost savings is uncertain and  
3 becomes less valuable over time when compared to immediate rate reductions.

4 **Q. DID THE APPLICANTS DISCUSS THEIR INTENTIONS FOR REINVESTING**  
5 **IN BASIC UTILITY INFRASTRUCTURE AT PGE?**

6 A. Yes. The rebuttal testimony of Mr. Davis explained the Applicants' position on  
7 the PGE Integrated Resource Plan (IRP). (See Oregon Electric/100,  
8 Davis/Pages 23-30.) His rebuttal testimony states that the Applicants fully  
9 support the IRP and its implications for constructing the Port Westward power  
10 plant. The concerns I expressed in my earlier testimony, about the applicants'  
11 commitment to investing in PGE's utility infrastructure and future growth, have  
12 been adequately addressed by Mr. Davis's rebuttal testimony.

13 **Q. HOW WILL ACQUISITION ADJUSTMENTS, GOODWILL AND**  
14 **TRANSACTION COSTS BE TREATED FOR THIS SALE?**

15 A. It is a long-standing Commission policy that all transaction costs, goodwill and  
16 acquisition adjustments are excluded from utility accounts. In their direct  
17 testimony, the Applicants stated that the new owners shall pay these costs.  
18 The Applicants further agreed to conditions stipulating that Oregon Electric and  
19 PGE shall exclude from PGE's utility accounts all goodwill resulting from this  
20 acquisition (See Staff/801, Condition 2). They have also agreed that all costs  
21 and fees of the acquisition shall be excluded from PGE's utility accounts and  
22 that a complete accounting of the acquisition costs will be provided to the  
23 Commission after completion of the final accounting related to the transaction

1           (See Staff/801, Condition 3). These conditions satisfy my concerns on this  
2           matter.

3           **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

4           A. Yes it does.

CASE: UM 1121  
WITNESS: James E. Durrenberger

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 1001**

**Exhibit in Support of  
Surrebuttal Testimony**

**September 22, 2004**



# Press Release

Staff/1001, Durrenberger/1

Contact: Les Dorr  
Phone: 202-267-3462  
72-01  
Date Posted: October 22, 2001

## **FAA Proposes Fines Totaling \$667,050 Against America West**

WASHINGTON - The Federal Aviation Administration (FAA) is proposing two civil penalties against America West Airlines for alleged maintenance violations and allegedly flying numerous aircraft in violation of Federal Aviation Regulations.

A proposed fine of \$317,050 covers America West's use of improper bolts in maintaining the elevator systems of 13 aircraft. The fine also addresses operation of those aircraft in violation of the regulations on more than 1,800 passenger-carrying flights, including 1,605 flights after America West was aware that it had used bolts of an unauthorized size. The alleged violations occurred in May and June 1999.

A second proposed fine of \$350,000 covers America West's operation of numerous aircraft in violation of FAA regulations. One plane made 1,847 passenger-carrying flights after a fuel line was improperly repaired. The airline also flew thousands of passenger-carrying flights using numerous other aircraft that had not been modified in accordance with 11 separate FAA airworthiness directives. The alleged violations occurred between November 1997 and September 2000.

America West has 15 days from the time it receives the FAA's civil penalty letters to respond.

The announcement of the civil penalty proposals is in accordance with the FAA's policy of releasing information to the public on newly issued enforcement actions in cases that involve penalties of \$50,000 or more.

[Questions About This Page](#)



# Press Release

Staff/1001, Durrenberger/2

Contact: Hank Price  
Phone: 202-267-3883  
APA 90-98  
Date Posted: July 14, 1998

## **FAA Announces Civil Penalty Settlement Against America West**

WASHINGTON -- The Federal Aviation Administration today announced an agreement to settle a \$5 million civil penalty with America West Airlines of Phoenix, Ariz., by accepting a payment of \$2.5 million and suspending the remaining \$2.5 million if the carrier complies with the terms of the agreement. The settlement involves alleged violations of aircraft maintenance and operations regulations.

In reaching the agreement, the FAA considered America West's overall record of compliance with Federal Aviation Regulations and the positive manner in which the carrier's management team responded to the allegations. The signing of the agreement does not constitute an admission of wrongdoing by America West.

"The airline understands it must meet the FAA's stringent standards and we expect full accountability for any air carrier's failure to comply with safety regulations," said FAA Administrator Jane F. Garvey. "The FAA is pleased with America West's cooperative attitude, actions to correct problems and commitment to operate at the required levels of safety."

The FAA has found that America West is currently qualified to operate under aviation safety rules and regulations. Today's actions require that the carrier have the appropriate systems in place to maintain safety. Under the settlement agreement, America West must implement improvements that exceed regulatory requirements

Alleged violations cited in the settlement agreement include conducting numerous flights of 17 Airbus A320 airplanes overdue for significant structural inspections. Also cited were instances in which passenger and cargo flights were made with cargo hold webbing improperly installed, and a case in which an aircraft was put back in service with an elevator part not serviced according to requirements.

This announcement is being made in accordance with the FAA's policy of releasing information to the public on newly issued enforcement actions involving penalties of \$50,000 or more.

### An electronic version of this news release is available via the World Wide Web at: <http://www.faa.gov>

[Questions About This Page](#)

CASE: UM 1121  
WITNESS: Rebecca T. Hathhorn

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 1100**

**Surrebuttal Testimony**

**September 22, 2004**

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND**  
2 **OCCUPATION.**

3 A. My name is Rebecca T. Hathhorn. My business address is 550 Capitol Street  
4 NE Suite 215, Salem, Oregon 97301-2551. I am employed by the Public Utility  
5 Commission of Oregon (OPUC) as a Program Manager of the Corporate  
6 Analysis and Water Regulation Section in the Economic Research and  
7 Financial Analysis Division.

8 **Q. ARE YOU THE SAME WITNESS WHO SPONSORED DIRECT**  
9 **TESTIMONY ON AFFILIATED INTEREST ISSUES?**

10 A. Yes.

11 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

12 A. The purpose of my surrebuttal testimony is to explain the importance and  
13 significance of each stipulated condition. In addition, I will summarize the  
14 Master Services Agreement (MSA) in its current draft form and explain why the  
15 applicants should submit this version of the MSA to the Commission for  
16 approval.

17 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

- 18 A. I discuss the following three issues:
- 19 • Issue 1 – Stipulated Conditions
  - 20 • Issue 2 – Conditions Agreed to “In Principle”
  - 21 • Issue 3 – Master Services Agreement

22 **ISSUE 1 – STIPULATED CONDITIONS**

1 **Q. STAFF HAS FILED AS EXHIBIT STAFF/801, CONWAY/1-6 A PARTIAL**  
2 **STIPULATION. DO YOU HAVE ANY COMMENT ABOUT THIS PARTIAL**  
3 **STIPULATION?**

4 **A.** Yes, I would like to discuss Condition No. 1 of the Partial Stipulation. PGE and  
5 OEUC agree in Condition 1 to (paraphrasing) maintain separate accounting  
6 systems. Condition 1 thus creates a clear distinction between the two  
7 companies, which makes it easier to audit each company. In addition, PGE's  
8 and OEUC's financial books and records will be maintained in Portland,  
9 Oregon, which will assist also assist Staff in its auditing efforts.

10 **ISSUE 2 – CONDITIONS AGREED TO “IN PRINCIPLE”**

11 **Q. HAVE THE PARTIES AGREED TO CONDITIONS RELATING TO YOUR**  
12 **ASSIGNED ISSUES OTHER THAN THOSE SHOWN IN THE PARTIAL**  
13 **STIPULATION?**

14 **A.** Staff witness Conway explains that, while there is only one signed stipulation to  
15 date, the Applicants have agreed to the concepts encompassed by other  
16 conditions. See Exhibit Staff/800, Conway/4. As far as my area of  
17 responsibility, there are five affiliated interest related conditions agreed to in  
18 principle and are included as Conditions 7, 8, 9, 13, and 14 in Exhibit Staff/801,  
19 Conway/7-9.

20 **Q. PLEASE SUMMARIZE CONDITION 7 AND STATE WHY IT IS IMPORTANT.**

21 **A.** Condition 7 states that the Commission has the right to audit the accounts of  
22 OEUC and any OEUC affiliates and subsidiaries that are the basis for charges  
23 to PGE. It is important that the Commission receive full cooperation from PGE

1 and OEUC so that the Commission can ensure that any allocation factors  
2 used, or direct charges, are reasonable in assigning such costs to PGE.

3 In addition, ratepayers should be assured that they are not subsidizing any  
4 non-regulated business ventures that OEUC may decide to develop or that are  
5 currently in existence.

6 **Q. PLEASE SUMMARIZE CONDITION 8 AND STATE WHY IT IS IMPORTANT?**

7 A. Condition 8 states PGE and OEUC must first receive Commission  
8 authorization to conduct business with the affiliate before any charges accrue  
9 to PGE. This condition helps assure that OEUC and its affiliates are not  
10 subsidized by PGE.

11 **Q. PLEASE SUMMARIZE CONDITION 9 AND STATE WHY IT IS IMPORTANT?**

12 A. Condition 9 states that PGE should maintain its own accounting system.  
13 Ratepayers should be assured that they are not paying for an accounting  
14 system that would be beneficial to OEUC rather than PGE ratepayers.

15 **Q. PLEASE SUMMARIZE CONDITION 13 AND STATE WHY IT IS**  
16 **IMPORTANT?**

17 A. Condition 13 states any new subsidiary, affiliate, or partnership arrangement  
18 developed by PGE or OEUC must be reported to the Commission within 30  
19 days of its formation. In addition, for subsidiaries of PGE and OEUC, each  
20 organization should provide its respective business plan and capitalization  
21 strategy.

22 The Commission must know the businesses related to OEUC or PGE in  
23 order to conduct meaningful audits. If the Commission does not know about a

1 particular business venture, it would be difficult to determine whether there is a  
2 significant risk to ratepayers.

3 Staff witness Morgan has further discussion related to financial limitations  
4 for forming an affiliate that he discusses in Exhibit Staff/900, Morgan/27, Lines  
5 8-12. Staff witness Morgan also supports Condition 33 in Exhibit Staff/801.

6 **Q. PLEASE SUMMARIZE CONDITION 14 AND STATE WHY IT IS**  
7 **IMPORTANT?**

8 A. Condition 14 states the Commission must have access to all books and records  
9 of any affiliates that pertain to transactions between PGE and all of its affiliates.

10 The Commission is responsible for ensuring that only proper charges are  
11 allocated to PGE.

12 **ISSUE 2 – MASTER SERVICES AGREEMENT**

13 **Q. HAVE ANY OF THE PARTIES AGREED TO A MASTER SERVICES**  
14 **AGREEMENT?**

15 A. No. Several parties have worked together on several occasions making  
16 changes to a working draft of the MSA to address each of the parties concerns.  
17 Participants in this process included CUB, Strategic Energy, PGE, OEUC and  
18 Staff.

19 **Q. DOES STAFF ANTICIPATE THAT IT WILL BE ABLE TO REACH AN**  
20 **AGREEMENT ON A MSA?**

21 A. Yes. Staff is confident that a final version of the MSA should be completed by  
22 the middle of October. At that time, Staff intends to file a motion in this case to

1 submit the agreed-upon MSA, with brief explanatory testimony, as a late filed  
2 exhibit.

3 **Q. WOULD THE COMMISSION BE EXPECTED TO ISSUE A DECISION**  
4 **ABOUT THE MSA THE PARTIES SUBMIT IN THIS DOCKET?**

5 A. No, the Commission should not reach a decision on the MSA in this docket.

6 The MSA would be submitted for the Commission's information. Instead, Staff  
7 expects the Applicants to file the same version of the MSA that is submitted in  
8 this docket with the Commission no later than 30 days after the approval of  
9 UM 1121, assuming UM 1121 is approved. At that point, Staff and other  
10 interested parties would review the MSA in the separate UI docket. Staff  
11 proposes Condition 34. The condition states:

12 34. The Applicants will file a Master Services Agreement,  
13 which includes agreed-upon terms and conditions, no  
14 later than 30 days after a final order in UM 1121 is issued  
15 approving the transaction.

16 **Q. ARE THERE ANY MSA ISSUES THAT REMAIN UNRESOLVED?**

17 A. OEUC brought up an issue in the work sessions related to transactions with  
18 potential affiliates that were of a diminutive amount. PGE believes it is not  
19 necessary to file for Commission approval of an affiliated interest application if  
20 PGE paid a vendor \$1000 for services during the year and later found out,  
21 through its relationship with OEUC, that the vendor was an affiliate through  
22 TPG. Given the diminutive nature of the service charges, PGE asserts the  
23 process for approval is too burdensome to keep track of such transactions.

1 **Q. WHAT IS STAFF'S POSITION ON THIS ISSUE?**

2 A. Pursuant to ORS 757.495, "any public utility doing business in this state [that]  
3 enters into any contract to make any payment....the contract shall be filed with  
4 the Public Utility Commission ..." There is no statutory exemption based on  
5 dollar amounts for contracts. OAR 860-027-0043 states a utility can request a  
6 waiver to the requirements for OARs 860-027-0040 and 860-027-0041.  
7 However, this waiver is for detailed information about the transaction rather  
8 than a waiver of approval. Approval remains a statutory requirement.

9 For the reasons stated above, Staff is opposed to any waiver of approval of  
10 any affiliated interest contract except for that specifically provided in OAR 860-  
11 027-0043.

12 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

13 A. Yes.

CASE: UM 1121  
WITNESS: Judy Johnson

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 1200**

**Surrebuttal Testimony**

**September 22, 2004**

1       **Q.     PLEASE STATE YOUR NAME.**

2       A.     My name is Judy Johnson. I previously offered testimony and exhibits in  
3       this proceeding. (See Staff/ 500 – 502)

4       **Q.     WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5       A.     I will make a recommendation on the issue of state and federal corporate  
6       income taxes.

7       **Q.     WHAT ARE YOUR RECOMMENDATIONS?**

8       A.     I recommend that the Commission continue to set rates based on the  
9       assumption that PGE files its taxes on a stand-alone, normalized basis.  
10      The Commission could consider Staff's recommended rate credits as  
11      reflecting, in part, any tax benefits realized (stand alone versus  
12      consolidated) at the holding company level.

13      **Q.     DO YOU RECOMMEND THE COMMISSION BASE RATES FOR PGE  
14      USING A STAND ALONE OR CONSOLIDATED TAX CALCULATION?**

15      A.     The Commission should not change its current practice of viewing each  
16      utility's taxes on a stand-alone basis; that is, setting PGE's rates to reflect  
17      the costs of the company's regulated operations. Treating taxes on a  
18      stand-alone basis potentially benefits customers by:

19           1. Helping to insulate PGE from business risks at the parent and  
20           subsidiary level;

21               a. Debt rating agencies can justify higher ratings for PGE than for  
22               the parent.

23               b. Lower ratings for PGE could increase PGE's cost of procuring

1 power if collateral commitments are required in order to buy and  
2 sell wholesale power; and,

3 2. Avoiding fluctuating rates as losses or gains at the holding company or  
4 at a subsidiary change consolidated tax obligations.

5 Further, if the Commission were to take the benefits of lower taxes, it  
6 should probably also take on a greater share of the risk and/or the interest  
7 payments that created the tax savings. If PGE's risks rise due to this  
8 policy, then PGE's cost of capital would also rise.

9 The Commission currently regulates six energy utilities in Oregon and  
10 has always treated each utility as its own entity, separate from any parent  
11 company and/or subsidiaries. In addition, most, if not all, of the other  
12 commissions in the country regulate their utilities this same way.

13 **Q. WHY SHOULDN'T THE COMMISSION CONSIDER A TRUE-UP**  
14 **MECHANISM FOR TAXES, SO THAT CUSTOMERS PAY ONLY WHAT**  
15 **THE UTILITY ACTUALLY OWES?**

16 A. A true-up mechanism would likely raise PGE's costs due to a probable  
17 loss in accelerated tax depreciation currently available to PGE. The IRS  
18 may view a true-up tax mechanism as a Commission attempt to use flow-  
19 through rather than normalization for ratemaking purposes. If that were  
20 the case, the IRS would simply take away the utility's ability to use the  
21 accelerated tax depreciation. This would raise PGE's cost of service  
22 because customers would lose the benefit of accumulated deferred  
23 income taxes as a reduction to rate base.

1       **Q.     PLEASE EXPLAIN.**

2       A.     The IRS requires that the Commission use normalization accounting for  
3             calculating income taxes in setting rates. Normalization or "deferred tax"  
4             accounting is the process of recognizing timing differences when  
5             transactions affect taxable income for "book" and "tax" purposes. The  
6             most common example is depreciation expense, where book and financial  
7             reporting depreciation is typically lower in the early years of an asset's life  
8             than the accelerated tax depreciation that the IRS allows as a deduction  
9             for calculating "current" income tax expense. All else equal, actual taxes  
10            paid will be lower in the earlier years for the utility's tax return than is  
11            calculated for book purposes, which recognizes an additional "deferred  
12            tax" (based on the difference each year between book and accelerated  
13            depreciation). This timing difference turns around in the later years of the  
14            asset's life so that the total tax deduction over the life of the asset is the  
15            same. Meanwhile, the full value of the "interest free loan" is provided to  
16            customers by recognizing the time value difference for the additional tax  
17            they pay early, because these amounts are recognized as "accumulated  
18            deferred taxes" that reduce the utility's rate base and the return on  
19            investment included in rates.

20            If the Commission were to violate this normalization principle, then the  
21            utility, and thereby its customers, would lose its ability to take advantage  
22            of accelerated depreciation. The IRS has ruled numerous times that it

1 views, as does Staff, accelerated tax depreciation as essentially an  
2 "interest-free" loan from the government.

3 **Q. ARE THERE ANY OTHER RISKS ASSOCIATED WITH A TRUE-UP**  
4 **MECHANISM?**

5 A. Yes. Since a true up is based on actuals, customers could be exposed to  
6 the financial impacts of non-normalized weather and hydro conditions.  
7 These variables can cause significant changes in earnings, taxes, and  
8 thereby rates. For example, if the weather changed markets such that  
9 PGE's costs of supply decreased, earnings would increase and so would  
10 taxes. A true up of taxes would cause rates to increase to reflect higher  
11 taxes. This could occur even though customers did not receive any  
12 benefit from the lower power production costs due to those costs being set  
13 on a normalized expected basis.

14 **Q. DO YOU HAVE ANYTHING ELSE TO ADD?**

15 A. Yes. The acquisition proposed in this proceeding will lead to substantially  
16 increased debt leverage at the consolidated level. (See Staff/900,  
17 Morgan/9, line 7 through Morgan/10, line 6.) On an expected basis, this  
18 increased leverage will yield an income tax benefit of approximately \$15  
19 million annually. These savings, along with system efficiencies, will be  
20 available to OEUC to fund rate credits the Commission finds necessary as  
21 part of this transaction.

22 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

23 A. Yes.