(ACQUISITION BY PUBLIC)
v.
PLAN B (BANKRUPTCY PATH)

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The Enron Plan of Reorganization (July 11, 2003) ["EPOR" or "Plan"] outlines several paths for the disposition of the stock or assets of PGE. As Enron's major creditors include large Wall Street investment banks (including J.P. Morgan Chase, CitiCorp, Goldman Sachs, Bank of New York, Barclays Bank, Credit Suisse First Boston, and many others), it is safe to assume that the creditors will seek to maximize their recovery of funds from the disposition of PGE stock or assets.

The EPOR would allow Enron and/or the creditors to break up and sell PGE's assets in any fashion they may desire. To maximize the sale price, they would have a strong incentive to sell PGE's most valuable assets (transmission lines and hydropower facilities) out from under the regulation of any authority of the State of Oregon, including the Oregon Public Utility Commission (OPUC). This would likely increase the proceeds of the sale on the order of $1-2 billion. This would also result in huge rate increases for PGE ratepayers--approximately $300 million per year, if not more.

1. THE OREGON PUBLIC UTILITY COMMISSION CANNOT STOP THE SALE OF PGE'S ASSETS TO COMPANIES THAT ARE NOT SUBJECT TO REGULATION BY THE STATE OF OREGON.

The OPUC may wish to prevent this from occurring, but the federal courts have consistently ruled that, since the U.S. Bankruptcy Code was amended in 1978, no authority of state government can be invoked to stop a transaction which is allowed in a plan approved by a U.S. Bankruptcy Court, even if such a transaction would otherwise be prohibited by state law or subject to veto or regulation by a state commission. The most recent case is ***In re Pacific Gas & Electric Co.***, 283 BR 41 (ND Cal 2002), in which the U.S. District Court for the Northern District of California overruled the U.S. Bankruptcy Court and held that Pacific Gas & Electric Co. (PG&E) could use the federal bankruptcy process to transfer its generation and transmission assets out from under rate regulation by California. The U.S. District Court held that "Congress intended expressly to preempt nonbankruptcy laws that would otherwise apply to bar, among other things, transactions necessary to implement the reorganization plan." 283 BR at 58. The Court noted that Congress changed the Bankruptcy Code in 1978 to remove "the ability of state regulators to veto reorganization of public utilities in federal bankruptcy proceedings." 283 BR at 56.[1]

Various analysts estimated the impact on PG&E's California ratepayers of having the generation and transmission line assets sold out from under state rate regulation. The Utility Reform Network (TURN), California's largest ratepayer protection group, concluded that the selloff would increase PG&E's charges to customers by $8.4 billion over a period of 12 years. After the State of California and the California Public Utilities Commission (CPUC) lost the case in U.S. District Court on August 30, 2002, they asked the court to stay the order to allow them to appeal it. That motion was denied on November 14, 2002. Faced with bad alternatives, the CPUC in June 2003 announced a settlement with PG&E, under which none of PG&E's assets would be sold out from under state regulation. The catch: the settlement calls for rate

increases to PG&E's customers of $8.9 billion (according to TURN) or $7.6 billion (according to the CPUC itself).

> Thus, by threatening to use federal bankruptcy authority to sell its valuable assets out from under state rate regulation, PG&E is on the road to gaining, through rates, essentially the same money it would have realized by the proposed transfer of generation and transmission line assets.

2. PGE'S HYDRO AND TRANSMISSION LINE ASSETS COMMAND A FAR HIGHER PRICE, IF SOLD OUT FROM UNDER STATE REGULATION.

A. HYDROPOWER.

PGE has over 500 MW of hydropower generating capacity on rivers in Oregon. Under state rate regulation, PGE is required to sell the power these facilities generate to PGE ratepayers at a low price, because the facilities have a low depreciated book value (ratepayers having paid depreciation on these plants for many decades), low fuel costs, and low operating costs. The power produced by these plants (over 2,000 MWh per year) serves about 12% of PGE's retail load (all PGE ratepayers). If these plants were sold to companies that are not regulated utilities in Oregon (i.e., not PacifiCorp or Idaho Power Co.), PGE ratepayers would lose the benefit of this low-cost power and would have to replace it with power costing probably about 5 times more costly. The result would be a PGE rate increase on the order of $100 million per year (based on the current price of natural gas, even though long-term gas contracts are not available).

If sold as part of a regulated utility, the PGE hydropower facilities are worth very little to a buyer. Conventional rate regulation allows PGE to earn a profit on these facilities equal to only the authorized return on investment times the depreciated book value of the plants. The depreciated book value of PGE's hydro plants is only $130 million. With an authorized return on investment of 9%, the allowed profit on those plants is less than $12 million per year. If the buyer could sell the long-term hydropower on the open market, however, it would expect to bring in revenue on the order of $100 million per year or more. As the value of an asset can be derived from its expected revenue, the value of the hydropower facilities, if sold out from under regulation, would be the present value of a cash flow of about $100 million per year.

Considering today's low interest rates (and consequently low discount rate), that asset would likely command a price exceeding $1.5 billion. On the other hand, as part of the regulated utility, the same asset would be worth only about $180 million. It is not hard to imagine, then, that Enron's creditors would prefer to have the hydropower assets sold out from under state regulation.

B. TRANSMISSION LINES.

PGE owns two types of transmission lines. One set of lines is used to bring power to the PGE service area from PGE power plants, although much of that function is performed by the Bonneville Power Administration (BPA). The other set of lines is PGE's 800 MW share of the Pacific Intertie transmission system, which runs from The Dalles to the California-Oregon Border (COB) near Malin. Let us examine only the Pacific Intertie transmission system.

If PGE's share of the Pacific Intertie transmission system were sold to companies that are not regulated utilities in Oregon (i.e., not PacifiCorp or Idaho Power Co.), PGE ratepayers would lose the benefit of the net revenues that result from PGE's use of these transmission lines to buy power where is it cheap and to sell power where it is expensive. Although PGE generates less than half of the power used by PGE's customers (about 19,000 MWh per year), PGE typically sells to other utilities over 12,000 MWh per year. It is able to do so, because it owns part of the "bottleneck facility" (the Pacific Intertie transmission system) that connects the Pacific Northwest and the Pacific Southwest. In the summer, power in the Pacific Northwest (including Canada) is cheap (as that is when the rivers are running), while power in the Pacific Southwest is expensive (due to increased load for air conditioning). Conversely, in the winter power in the Pacific Southwest is relatively cheap, because utilities can produce more power simply by running their already-built thermal power plants. And winter power in the Pacific Northwest is more expensive, because load increases for electric space and water heating. Owning part of the constrained transmission system between the regions enables PGE to make money both ways.

Most of the profits from these sales are credited to PGE ratepayers in Oregon, as the Pacific Intertie transmission system has been in PGE's ratebase for decades and is thereby considered an asset that constructively belongs to ratepayers. In PGE's current rates, ratepayers are credited with about $140 million per year.

Again, if sold as part of a regulated utility, the PGE share of the Pacific Intertie transmission system would be very little value to a buyer. Conventional rate regulation allocates the profits attributable to the Pacific Intertie transmission system to PGE's retail ratepayers. The utility can earn only its authorized return on investment times the depreciated book value of the lines. The depreciated book value of **all** of PGE's transmission system appears to be about $200 million. With an authorized return on investment of 9%, the allowed profit on those lines is less than $18 million per year (and that includes many more lines than just the Pacific Intertie transmission system). If the buyer could use the lines to buy and sell power on the open market, however, it would expect to bring in revenue on the order of $140 million per year or more. As the value of an asset can be derived from its expected revenue, the value of the Pacific Intertie transmission system if sold out from under regulation, would be the present value of a cash flow of about $120 million per year.

Considering today's low interest rates (and consequently low discount rate), that asset would likely command a price exceeding $1.8 billion. On the other hand, as part of the regulated utility, the same asset would be worth only about $230 million. It is not hard to imagine, then, that Enron's creditors would prefer to have the Pacific Intertie transmission system assets sold out from under state regulation.

C. THERMAL POWER PLANTS.

On the whole, PGE's existing thermal power plants produce power at a cost below that of long-term power purchases on the open market. The same analysis applicable to PGE's hydropower facilities thus applies to PGE's thermal power plants, although to a lesser degree (because the thermal plants have higher depreciated book values and cost more to operate than the hydro dams). Selling the thermal power plants out from under state regulation may thus further benefit Enron's creditors and harm PGE ratepayers.

Although I have not yet quantified the benefit or harm, the attached graph titled "Price of power from PG&E Generation Contract" illustrates the difference between market price of power and the cost of power from the existing power plants owned by Pacific Gas & Electric Company (PG&E). The same analysis would be applicable to PGE.

3. THE ENRON PLAN OF REORGANIZATION INCLUDES AUTHORITY TO SELL PGE ASSETS INSTEAD OF PGE STOCK.

While Enron and PGE executives have for 18 months insisted that Enron would only sell PGE stock, and not PGE's assets, the EPOR provides otherwise. It clearly authorizes Enron to sell off PGE's assets, in any of several ways:

A. THE "PGE TRUST" PROVISION.

The Plan authorizes Enron to create the PGE Trust and to transfer all of PGE's stock into the PGE Trust. The PGE Trustee "shall manage, administer, operate and **liquidate the assets** contained in the PGE Trust and distribute the proceeds thereof or the Existing PGE Common Stock or the PGE Common Stock, as the case may be." EPOR § 1.144 (emphasis added). The "PGE Trustee" is Stephen Cooper, LLC, and the PGE Trust Board is appointed by Enron, which can designate another entity as the PGE Trustee, if it wishes. EPOR § 1.145.

The PGE Trust is one of the "Operating Trusts" established by the EPOR, which sets forth the Purpose of the Operating Trusts as follows:

> 20.2 Purpose of the Operating Trusts: The Operating Trusts shall be established for the sole purpose of holding and liquidating the respective

assets in the InternationalCo Trust, the CrossCountry Trust and the PGE Trust in accordance with Treasury Regulation Section 301.7701-4(d) and the terms and provisions of the Operating Trust Agreements. Without limiting the foregoing, the Operating Trust Agreements shall each provide that the applicable Operating Trust shall not distribute any of the InternationalCo Common Stock, CrossCountry Common Stock or PGE Common Stock, as the case may be, prior to the date referred to in Sections 28.1(c)(i), (ii) and (iii), respectively.

B. THE "SALE TRANSACTION" PROVISION.

EPOR § 1.175 defines "Sale Transaction" as:

> One or more transactions jointly determined by the Debtors and the Creditors' Committee, in their sole and absolute discretion, to sell all or a portion of the issued and outstanding InternationalCo Common Stock, CrossCountry Common Stock, Existing PGE Common Stock or PGE Common Stock **or substantially all of the assets of InternationalCo, CrossCountry or PGE**, which transaction or transactions, if determined to be made, shall be consummated on or prior to the Effective Date. (emphasis added)

EPOR § 28.1 provides for the distribution of PGE stock to the creditors (commencing sometime after December 31, 2004, and having no specified end date), but § 28.1(c) then indicates that

> in the event that a Sale Transaction has occurred prior to the Effective Date [not earlier than December 31, 2004], the proceeds thereof shall be distributed in accordance with the provisions of Section 28.1(a) of the Plan in lieu of the Plan Securities that would have been distributed pursuant to Section 28.1(c) . . . .

In other words, the EPOR allows Enron and the creditors to sell the assets of PGE and distribute to the creditor groups the resulting cash instead of PGE stock.

C. THE "TITLE TO ASSETS" PROVISION.

EPOR § 38.1 states:

> 38.1 Title to Assets: Except as otherwise provided by the Plan, including, without limitation, Section 38.2 of the Plan, on the Effective Date, title to all assets and properties encompassed by the Plan shall vest in the Reorganized Debtors free and clear of all Liens and in accordance with section 1141 of the Bankruptcy Code, and the Confirmation Order shall be

> a judicial determination of discharge of the liabilities of the Debtors and the Debtors in Possession except as provided in the Plan. Notwithstanding the foregoing, the Debtors and the Reorganized Debtors, in their sole and absolute discretion, may (a) encumber all of the Debtors's assets for the benefit of Creditors or (b) transfer such assets to another Entity to secure the payment and performance of all obligations provided for herein.

This appears to authorize Enron ("the Debtors") to sell the assets of PGE at any time. An "Entity" is defined as any person, organization, or corporation.

PLAN A: THE PUBLIC ACQUISITION PATH

This plan is outlined in the presentation of Dan Meek and Linda Williams to the City of Portland's October 29, 2002, public meeting on the subject of acquiring PGE.

The ability of local governments to acquire PGE's assets by eminent domain, without hinderance by the federal bankruptcy proceeding, is indicated in the Linda K. Williams memorandum of August 12, 2002.

[1] In ***Public Service Co. of New Hampshire v. State of New Hampshire***, 108 BR 854 (D NH 1989), the court addressed the utility's plan to create new companies, unregulated by the State of New Hampshire, and to transfer to one of the new companies all of its generation and transmission line assets. The plan also included contracts requiring the company holding the distribution assets (the remaining regulated utility) to buy power from the new generation/transmission company at rates regulated by FERC, not by New Hampshire. The reason was that New Hampshire law did not allow a regulated utility to charge ratepayers (in retail rates) for investment in power plants prior to their completion, while federal law allows such charges in wholesale rates.