Exhibit T _____ (BRD-T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of NORTHWEST NATURAL GAS COMPANY For an Order Approving a Corporate Reorganization to Create a Holding Company, Northwest Natural Holdco, in Connection with the Acquisition of Portland General Electric Company by Northwest Natural Holdco.	**DOCKET NO. UG-01_____**

NORTHWEST NATURAL GAS COMPANY

DIRECT TESTIMONY OF BRUCE R. DeBOLT

December 4, 2001

Q: Please state your name and title.

A: My name is Bruce R. DeBolt. I am Senior Vice President and Chief Financial Officer of Northwest Natural Gas Company ("NW Natural").

QUALIFICATIONS

Q: Please describe your education and employment background.

A: I received an A.B. from Princeton University in 1969. Subsequently, I attended the Stanford Law School and the Stanford Graduate School of Business, and received the J.D. and M.B.A. degrees in 1973. From 1974 through 1980, I was an Assistant Attorney General for the State of Oregon. I joined Northwest Natural Gas Company as Associate Counsel in February 1980 and was elected Vice President and General Counsel on June 1, 1983. I was elected to the position of Senior Vice President, Finance, and Chief Financial Officer on March 1, 1990.

Q: What are your responsibilities with NW Natural?

A: As Senior Vice President and CFO, I am a member of the senior management team reporting to the Chairman and CEO. My responsibilities as chief financial officer of NW Natural include the financial planning, treasury, accounting, information services, budgeting, tax, strategic planning, business continuity and investor relations functions, among others. I participate on matters affecting the rates charged the company by its primary pipeline suppliers, Northwest Pipeline Corporation (a subsidiary of Williams Gas Pipelines West) and PG&E Gas Transmission - Northwest (formerly Pacific Gas Transmission Company). I am jointly responsible for the preparation and presentation of evidence relating to ratemaking and other regulatory activities in Oregon and Washington.

Q: Have you testified previously before regulatory agencies on matters affecting natural gas rates and service?

A: Yes, I have presented testimony on natural gas ratemaking and other issues before the Oregon Public Utility Commission ("OPUC"), the Washington Utilities & Transportation Commission ("WUTC"), the Federal Energy Regulatory Commission ("FERC"), and the National Energy Board of Canada.

Q: Have you had a direct role in the transactions relating to NW Natural's acquisition of Portland General Electric Company?

A: Yes. I was one of four individuals (along with Chairman & CEO Dick Reiten, President & COO Mark Dodson, and Director of Corporate & Business Development Keith White) who were directly involved from start to finish in negotiating the transaction on behalf of NW Natural. I have a continuing role that includes coordinating bank syndication, sales of securities, and managing other financial aspects of the transaction.

PURPOSE OF TESTIMONY

Q: What is the purpose of your testimony?

A: This testimony discusses the structure and the financial and accounting details of NW Natural's purchase of Portland General Electric Company ("PGE") and of the creation of a new holding company, referred to in this Application as "NW Natural Holdco," to own both utilities.

Q: Please describe the structure of your testimony.

A: My testimony is divided into four parts. First, I describe the general structure of the transaction. Second, I explain how NW Natural Holdco will finance the purchase of PGE. Third, I detail how we will account for the transaction, some of the conditions of our financing, and our finance commitments and credit facilities. Fourth, I describe our proposed rate benefits plan and financial commitments.

Q: Are there exhibits that accompany your testimony?

A: Yes. Exhibits ___ (BRD-1) through ___ (BRD-10) were prepared under my supervision.

STRUCTURE AND TERMS OF THE TRANSACTION

Q: Please outline the transaction.

A: In its most basic terms, NW Natural is forming a holding company to purchase PGE and an entity known as "PGH II" from Enron Corp. ("Enron") for $1.8 billion and other consideration. After closing, the new holding company will own NW Natural, PGE, and PGH II.

Q: Please describe the structure of the transaction.

A: At present, NW Natural is a publicly traded company. Its common stock is listed on the New York Stock Exchange under the symbol "NWN." Enron has three subsidiaries that participate in this transaction: PGE, Enron Northwest Assets, LLC, and Portland General Holdings, Inc. The current structure is shown in a diagram at **Exhibit ___ (BRD-1)**.

In the first step of the transaction, NW Natural will establish NW Natural Holdco as a holding company. NW Natural will accomplish this as follows: NW Natural has created NW Natural Holdco as a subsidiary and also has set up a merger subsidiary under NW Natural Holdco. The merger subsidiary will merge with and into NW Natural, with NW Natural as the surviving corporation. NW Natural common stock will be converted, on a 1-for-1 basis, into shares of NW Natural Holdco common stock. As a result, NW Natural Holdco will own all of the shares of NW Natural. NW Natural Holdco's common stock will be registered with the Securities and Exchange Commission and will be listed for public trading on the New York Stock Exchange.

In the second step of the transaction, NW Natural Holdco will purchase the common stock of PGE and PGH II. At present, Enron Northwest Assets, LLC, a subsidiary of Enron, has an option to purchase PGE from Enron. Portland General Holdings, Inc., another subsidiary of Enron, owns PGH II. Enron Northwest Assets, LLC will exercise its option to purchase PGE from Enron. NW Natural Holdco will then transfer cash and securities to Enron Northwest Assets, LLC and Portland General Holdings, Inc., in exchange for PGE and PGH II, Inc., respectively. NW Natural Holdco will then own NW Natural, PGE, and PGH II, and Enron's subsidiaries will have received cash and securities.

The final structure is shown at **Exhibit ___ (BRD-2).**

Q: **What is the role of PGH II in the transaction?**

A: PGH II holds a number of assets or business interests (for example, an interest in a fiber optics network and a district cooling system under development in Portland) that have been treated (and accounted for) as non-regulated activities by the Commission. Only a nominal portion of the total purchase price was treated as the consideration for NW Natural Holdco's purchase of PGH II. As a subsidiary of NW Natural Holdco rather than of PGE, PGH II will retain its independent, non-regulated status.

Q: **Why does the transaction require a holding company as part of the structure?**

A: NW Natural would not have been able to borrow, at the utility level, the amount of money necessary to buy PGE, without experiencing a reduction in its credit ratings to below investment grade level. That result would have been a significant detriment to customers as well as to current investors in NW Natural's debt securities. We were not willing to do that.

The holding company structure also enables us to apply protective measures that help support the utilities' credit ratings. These measures are commonly known as "ring-fencing" provisions. They include, for example, limitations on cash flows from the utility subsidiaries to the parent in order to maintain target capital ratios at the subsidiaries. The credit rating agencies analyze a corporate structure very carefully for the presence and effectiveness of ring-fencing provisions.

Q: What will NW Natural Holdco pay to Enron in exchange for PGE?

A: NW Natural Holdco will pay Enron $1.55 billion in cash and $250 million in securities. Enron will acquire $200 million in FELINE PRIDES(SM)[1] securities and $50 million in a combination of NW Natural Holdco "common stock" and "Class B common stock." Enron has helped finance NW Natural's purchase of PGE by taking equity securities, rather than all cash, in order to help ensure a solid financial structure for the new holding company and its operating utility subsidiaries. In addition to the $1.8 billion in cash and securities, NW Natural Holdco will assume a $72 million remaining payment obligation from Enron to PGE relating to a condition dating from Enron's purchase of PGE in 1997.

Q: Please describe the terms of the FELINE PRIDES securities involved in the transaction.

A: FELINE PRIDES are hybrid equity securities that are designed for use in transactions like this one. The FELINE PRIDES have a number of features that made them attractive for NW Natural's use in purchasing PGE. They include a contract commitment by the investor (Enron) to purchase common stock at a specified time in the future, so they help

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1 FELINE PRIDES(SM) is a service mark of Merrill Lynch & Co.

in establishing an equity ratio for NW Natural Holdco that will qualify the holding company for an acceptable credit rating. They have a low cash dividend in the first two years, thereby helping the holding company use as much of its cash as possible to pay down debt. As a preferred stock initially, they dilute the holding company's earnings per share less than common stock during the early years when that entity is working to develop a strong earnings profile. And, as a private security in this transaction, they can be designed with restrictions on sale or transfer so the private investor (here, the seller) will not interfere with the issuer's (here, NW Natural Holdco's) other financing requirements.

The FELINE PRIDES in this transaction have two components. The first component is a $200 million issue of NW Natural Holdco preferred stock, which Enron will receive at closing. NW Natural Holdco will pay cash dividends on the preferred stock at a rate of 6 percent in the first and second years after closing and 9 percent in the third and fourth years.

The second component is a contract obligation for Enron to purchase $200 million of NW Natural Holdco Class B common stock four years after the date of closing. That common stock is in addition to the $50 million of common stock and Class B common stock that Enron will receive at closing.

Another feature of the FELINE PRIDES is that just before the expiration of the fourth year of the preferred stock's five-year term – when Enron's obligation to purchase $200 million of common stock comes due – NW Natural Holdco will remarket the preferred stock on behalf of Enron. The proceeds of the sale will be used to help satisfy Enron's obligation to purchase the $200 million of additional common stock of NW

Natural Holdco.

If the remarketing is not successful, then Enron would settle its obligation under the purchase contract by delivering the preferred stock to NW Natural Holdco in exchange for common shares of NW Natural Holdco. NW Natural Holdco would then have the right to dispose of the preferred shares. In other words, the preferred stock would be cancelled and NW Natural Holdco would issue $200 million of Class B common stock to Enron without further consideration. If this course of action were followed and the preferred stock were cancelled by NW Natural Holdco, then the common stock component of NW Natural Holdco's equity structure will have gone ***up***, and the preferred stock component (with its attendant fixed charges) will have gone ***down***, so NW Natural Holdco's overall credit profile would be somewhat improved. This feature, which results from the two-part structure of the FELINE PRIDES, allows these securities to receive a very high percentage of "equity credit" from the credit rating agencies. The higher the percentage of equity credit is for a particular security, the higher the company's total equity will be as a percentage of total capital for credit-rating purposes. All else being equal, a higher equity ratio means a higher credit rating for the company as a whole.

Q: May Enron separate the preferred stock from the contract to purchase the Class B common stock?

A: Yes, but with conditions. Although the preferred stock is initially pledged to a trustee to collateralize the contract to purchase Class B common stock, Enron may cause the pledge to be released and directly hold, or separately transfer, the preferred stock by substituting U.S. Treasury securities for the preferred stock. In addition, if Enron's credit rating is investment grade (Baa3/BBB- or better) by at least two of the three rating agencies, Enron would have the right to substitute a non-interest bearing demand note payable by Enron to support the share purchase contract. If Enron's credit rating were less than investment grade, then it would be obligated either to maintain or to reinstate the preferred securities as collateral, or to provide U.S. Treasury securities as replacement collateral.

Q: Please describe the common stock and Class B common stock of NW Natural Holdco that Enron will receive.

A: Enron will receive a total of $50 million in "common stock" and "Class B common stock" at closing. It is obligated, as an element of the FELINE PRIDES, to purchase another $200 million of Class B common stock four years after closing. The difference between NW Natural Holdco's "common stock" and "Class B common stock" is that the common stock will have voting rights while the Class B common stock will not. Under the Purchase Agreement, Enron will own common stock up to 4.9 percent of the total shares of NW Natural Holdco common stock; any additional shares Enron owns will be Class B common stock. The purpose of issuing Class B common stock is to limit Enron's ownership of NW Natural Holdco voting common stock so that Enron will not be treated as a holding company or as an affiliate of NW Natural Holdco under the Public Utility Holding Company Act of 1935.

Q: Will Enron be restricted in transferring the common stock of Northwest Natural Holdco that it acquires?

A: Yes. Until the earliest of (i) thirty months after closing; (ii) six months following the second $150 million offering of common stock by NW Natural Holdco; and (iii) a change of control of NW Natural Holdco, Enron may not transfer the common stock, the Class B common stock, or the FELINE PRIDES except (a) in a transaction not involving a public offering; (b) to any "Designated Transferee"; or (c) to an affiliate. Designated Transferee means any corporation, partnership, limited liability company, or other entity created by Enron in connection with a monetization, securitization, or other structured finance transaction.

This restriction is intended to enhance NW Natural Holdco's ability to sell additional common stock to the public at about two years from closing. We do not want the market for this offering to be adversely affected by the possibility that Enron might sell its stock at about the time when we intend to sell another $150 million in common stock in the public market. After the transfer restriction period described above ends, NW Natural Holdco will be required to register the securities issued to Enron under the Securities Act of 1933, to facilitate the public offering and transfer of the securities by Enron.

Q: Does the transaction require approval by the shareholders of Enron or NW Natural?

A: I am advised that approval by Enron's shareholders is not required. The approval of NW Natural's shareholders is required for the creation of NW Natural Holdco as a holding company, for the conversion of NW Natural stock into NW Natural Holdco stock, and for the issuance to Enron of the equity securities that constitute a portion of the purchase price. NW Natural will prepare a proxy statement and schedule a meeting of shareholders for approval of these actions during the first half of 2002. Shareholder approval is not required for the transfer of the capital stock of PGE and PGH II by Enron to NW Natural Holdco.

Q: What will be the resulting form and ownership of NW Natural Holdco?

A: The holding company, NW Natural Holdco, will own two regulated utility operating subsidiaries, NW Natural and PGE. NW Natural Holdco also will own PGH II with its group of unregulated assets. The newly consolidated company will be one of the major energy providers in the West, with $5 billion in assets.

FINANCING THE TRANSACTION

Q: Please describe how it is that NW Natural is able to purchase PGE, a much larger company.

A: This transaction is possible because of strong cash flow from both utilities, particularly PGE, and because of Enron's seller financing. To summarize, Enron is providing $250 million in seller financing but in return is getting only 4.9 percent voting rights and the right to appoint up to two board positions. The combination of these factors allows us to meet the debt requirements necessary to finance this deal.

Q: Beyond the seller financing from Enron, how will NW Natural Holdco finance the transaction?

A: NW Natural Holdco has obtained a financing commitment from two investment banks, Merrill Lynch and Credit Suisse First Boston. The investment banks are jointly obligated under a $2.1 billion debt commitment.

The debt commitment breaks down as follows: NW Natural Holdco will have a $100 million revolving credit facility, which we intend to use primarily to pay the expenses of the transaction upon closing. Initially, NW Natural Holdco also will have $1.1 billion in longer-term debt financing commitments in the form of three term loans.

We intend to sell $150 million of common stock to the public at or about the time of closing, and to pay down $150 million from one of the term loans (Term Loan A) with the proceeds of that sale, thereby reducing the term loans to a total of $950 million. The $950 million will be divided among three term loans, as follows: $150 million in Term Loan A, which will have a 6-year term; $500 million in Term Loan B, which will have a 7-1/2 year term; and $300 million in Term Loan C, which will have an 8-1/2 year term.

The debt commitment will include a $450 million capital markets tranche with a one-year term.[2] We will use the proceeds from the sale of $450 million in long-term senior notes within one year of closing to pay off this capital markets tranche of the debt commitment.

The final pieces of the financing commitment are a $150 million revolving credit facility for NW Natural and a $300 million revolving credit facility for PGE. These facilities will replace the lines of credit the two utilities have now. The revolving credit facilities are unsecured loans to the operating utilities. It is our intention to manage short-term cash requirements at both utilities in much the same manner they are being managed now. Because the NW Natural and PGE revolving credit facilities are expected to have terms longer than one year, we are requesting Commission approval of these facilities.

In sum, $550 million of the $2.1 billion total financing commitment is earmarked for revolving credit facilities for NW Natural Holdco, NW Natural, and PGE. The

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2 "Capital markets" refers to raising money (capital) in a public debt (bond) offering. "Tranche" is a term used when there is more than one debt series being sold. For example, the term loan credit facility includes tranche A, which refers to Term Loan A, tranche B, which refers to Term Loan B, and so on. In the PGE acquisition, NW Natural Holdco expects to sell a capital markets tranche with a maturity of ten years, called Senior Notes, to replace the $450 million tranche which has a term of one year.

remaining $1.55 billion is in the form of cash, which will be paid to Enron at closing in exchange for the stock of PGE and PGH II.

The terms of the Senior Credit Facilities are shown in greater detail at **Exhibit ___ (BRD-3).**

The payment of $1.55 billion to Enron leaves $250 million from the total purchase price of $1.8 billion. As described above, this final piece of the purchase price is financed by the seller, Enron, through its receipt of the $200 million in FELINE PRIDES and the $50 million in common stock at closing.

A financial overview showing the structure, the credit facilities, and the equity investments at the holding company, as well as the new revolving credit facilities and existing debt at the utilities, is at **Exhibit ___ (BRD-4).**

Q: Are any of the current assets of PGE or NW Natural pledged as part of the financing of the transaction?

A: No, because all of the financing is being done at the level of the holding company, NW Natural Holdco. The utilities themselves will not be individually or collectively responsible for those debts, and their assets will not be pledged as part of the financing of the purchase. The NW Natural Holdco revolving credit facility, Term Loans A, B, and C, and the capital markets tranche all will be secured, subject to certain limitations, by a priority lien on, and pledge of, the stock of NW Natural and PGE owned by NW Natural Holdco. The lenders' exercise of their rights to foreclose under this pledge of the utilities' common stock will be subject to obtaining required regulatory approvals.

Q: Please describe how NW Natural Holdco intends to discharge the debt used to finance the transaction.

A: First, we will issue $150 million of common stock at or about the time of closing. We will use the cash generated from that sale to pay down $150 million of the balance in Term Loan A. We plan to sell another $150 million of common stock two years after closing. Again, we will use the cash generated by that sale to pay off another $150 million from the term loans, this time on a pro rata basis among the three term loans. We also assume that another $200 million of Class B common stock will be issued four years after closing in settlement of the FELINE PRIDES purchase contract.

We have no current plans for additional public sales of common stock by NW Natural Holdco other than pursuant to dividend reinvestment and employee plans. That means our remaining debt principal pay-downs will come from internal cash flows.

In any event, we intend to aggressively pay down the combined entity's debt arising from the purchase. Our expectation is that the consolidated entity's pre-closing capitalization will be about 80 percent debt and 20 percent equity. The pro forma consolidated debt ratio will go down to about 76 percent upon sale of the first $150 million in common stock, and we expect to have NW Natural Holdco's consolidated debt ratio below 70 percent by the end of its third year of operation. There is a prescribed amortization schedule for the term loans under which 45 percent ($67.5 million) of the principal of Term Loan A is required to be paid down by the end of the third year, $75 million in each of the fourth and fifth years, and the remaining $82.5 million in the sixth year. Term Loan B ($500 million) pays down in nominal amounts during the first six years, then in six large installments during the next six calendar quarters. Similarly, Term Loan C ($300 million) pays down nominally during the first 7-1/2 years, then in four large installments during the next four calendar quarters. **Exhibit ___ (BRD-5)** provides graphs showing the plan for paying down debt.

Meeting the third-year target in particular is essential from the standpoint of the credit rating agencies and the lenders, who have stressed the importance of the entity's ratio of total debt to total capital in evaluating the credit profile of the holding company and the operating companies. In their reviews and in providing advisory ratings, they were not rating the new holding company on the basis of its credit ratio and other key credit statistics as of December 31, 2002, the assumed date of the closing, but rather in terms of the Base Projections as of the end of 2005, three years forward. In order to achieve our objective of investment-grade ratings for the utilities (originally targeted at Baa2/BBB) and at least a Ba1/BB+ rating for the holding company, the rating agencies advised that they needed to see a consolidated debt ratio lower than 70 percent by the end of the third year. If we are able to operate in a manner consistent with the Base Projections, then I believe we can reasonably expect to meet that target ratio.

Extending the analysis even further, we have a goal for the holding company to achieve an investment grade rating in its own right by the end of the third year. In order to achieve that goal, we will need to continue making progress toward improving all of the entity's credit statistics. In this regard, the Base Projections estimate a reduction in the debt ratio to about 67 percent at the end of 2005, to about 61 percent at the end of 2007, and to a level below 60 percent by the end of the sixth year after closing (2008).

The projected credit ratios contributing to what we believe will be a strong credit profile for the holding company are shown at **Exhibit ___ (BRD-6).**

A feature of the transaction that is consistent with our debt strategy is known as the "excess cash flow sweep." This feature works so that excess cash flow available at the holding company must be used to pay down additional debt from Term Loans A, B, and C (ratably), rather than being available either for additional dividend payments to common shareholders or for use in other business ventures. "Excess cash flow" means what is left after (i) the utilities have paid all of their interest and principal obligations and have made cash dividend and tax allocation payments to the holding company; (ii) NW Natural Holdco has made all of its interest payments, its scheduled principal paydowns, and dividend payments on the preferred stock; and (iii) NW Natural Holdco has made dividend payments to its common shareholders consistent with a conservative dividend policy defined in the debt covenants. This feature of the transaction is a benefit to customers of PGE and NW Natural, because it constrains the holding company to use any excess cash to which it may be entitled in a way that will help improve the credit ratings at the utilities.

Q: What are you referring to in your use of the term "Base Projections"?

A: The term "Base Projections," with a capital "B" and a capital "P," has special meaning in the context of this transaction and as I use it in my testimony. The final results of the financial model we used in negotiating the transaction for the purchase of PGE are more than just an ordinary financial spreadsheet analysis. The prospects for our being able to deliver operating results consistent with the Base Projections have a substantial bearing on whether the deal can be closed, not to mention succeed over the years. Excerpts from the Debt Commitment and the financial model are attached as **Exhibit ___ (BRD-7)**.

The Senior Secured Facilities Commitment Letter (the "Debt Commitment") provides that the results for a number of key elements defined in the debt term sheet have to be "Satisfactory" to the Arrangers (Merrill Lynch and Credit Suisse First Boston), representing all of the lenders. These elements include "the governmental approval, order, action or inaction, capital structure, financial statement, financial projection or dividend restriction ***." The Arrangers need to be able to determine, in their sole discretion, that the outcomes for these elements do not result in NW Natural Holdco being unable to achieve, by an amount the Arrangers determine to be material, "*** the results of operations, financial position or cash flows described in the projections dated October 5, 2001, as updated from to time with the consent of the Borrower and the Arrangers, and identified as the "Final Base Projections" (the "Base Projections")."

In short, if the Arrangers determine that NW Natural Holdco will not be able to operate in close consistency with the Base Projections, then they are not obligated to make the $2.1 billion of credit facilities available. In turn, if the Arrangers are not ready, willing, and able to deliver the debt financing, then NW Natural and NW Natural Holdco cannot go forward with the purchase of PGE. That is to say, the transaction will not close, and Enron will continue to own PGE.

Q: **What assumptions have you made with regard to changes in the dividend policies at either of the utilities?**

A: We assumed in modeling the transaction that PGE would be regulated around a 48 percent pro forma common equity ratio both for purposes of cash dividends to its parent company and for purposes of establishing a pro forma capital structure for ratemaking purposes. Because the Commission established a lower equity ratio – 45 percent – as a target or pro forma level for ratemaking purposes in UE-115, then I think it is reasonable for the Commission to use a 45 percent common equity ratio as the basis for a condition restricting cash dividend payments by PGE to NW Natural Holdco.

In NW Natural's case, the Company's dividend policy in recent years, as determined by its Board of Directors, has been built around a desire to maintain a common equity ratio between 45 and 50 percent while steadily increasing cash dividends to shareholders. The market typically expects a gas utility to maintain a higher equity ratio than an electric utility in order to achieve and maintain an equivalent credit rating. The reason is a perception of somewhat greater business or financial risk. For example, NW Natural's earnings have tended to fluctuate from year to year, to a greater extent than PGE's, due to NW Natural's greater sensitivity to variations in weather conditions. Normally, NW Natural's capital investment program also is expected to require more in proportion to its internal cash generation than PGE's equivalent capital investment program. For these reasons, it would be appropriate to design a more flexible condition relating to NW Natural's dividend payments to NW Natural Holdco. We have proposed a level of 45 percent.

Q: What must NW Natural Holdco do to achieve its financial objectives?

A: In order for NW Natural's acquisition of PGE to close as a transaction, and then to succeed on an ongoing basis, there must be an ability to meet NW Natural Holdco's financing requirements, to provide earnings growth for NW Natural Holdco shareholders, and to provide benefits for PGE's and NW Natural's customers.

First, we must carry out the financing plan described above. The elements of the plan are designed to optimize the financial positions of the holding company and the operating utilities at closing and at all key points during the early years following the closing. For this purpose, I define the "early years" to be 2003-08. We need sufficient cash flow to support the debt at the holding company, and we need to increase retained earnings at the holding company in order to support the sale of the new equity.

Second, in order to meet the tests of the Base Projections in the transaction, and thereby ensure the availability of the lenders' credit facilities, we must be able to (1) maintain current base revenue levels at the two utilities and (2) retain most transaction benefits within the organization during the first six years.

Maintaining current base revenue levels means that revenues from transmission and distribution services would not go up – i.e., there would be "no harm" to customers – but also that they would not go down. Commodity-related rate changes (both up and down) pursuant to NW Natural's Purchased Gas Adjustment (PGA) mechanism and PGE's regulatory mechanisms for pricing and valuing supply still would occur as they have in the past. Similarly, rate changes designed to add permanent supply resources in response to system growth, such as increases in firm pipeline capacity or NW Natural's cost of service relating to gas storage plant additions, would be allowed.

We also needed to assume into our transaction model a level of transaction benefits ("synergies") that we believed we realistically could achieve. The purposes of this approach were both to be able to offer a price high enough that the seller would be willing to sell, and then to have adequate cash available from achieving the synergies to use in servicing the debt required to pay that price.

The Base Projections assume cost savings due to synergies growing to as much as \$30 million annually. In order to provide benefits to customers immediately, we decided during the course of the negotiations to build a sharing mechanism into the transaction model rather than simply to apply a "rate freeze" in the early years. A rate freeze would flow all of the cost savings to the holding company to pay down debt. In contrast, the sharing mechanism in the Base Projections will deliver $31.5 million in benefits to customers of the utilities over six years, in the form of revenue credits to be deferred and amortized.

The schedule for achieving synergies, the costs to achieve the synergies (such as employee severance costs), and the schedule for crediting synergy benefits to customers are shown at **Exhibit ___ (BRD-8)**.

Q: Where will you find the cost savings?

A: The combination of NW Natural and PGE offers significant opportunities for operating efficiencies. How quickly and to what extent these savings are achieved requires detailed analysis that will continue during and after the approval process for this transaction. But we clearly have the opportunity to generate significant synergies and, as a result, benefits for the customers of both utilities.

The estimated breakdown of synergies resulting from combining the two companies is that approximately 6 percent of the operating synergies would come from the distribution functions of the two companies, 22 percent from the customer service functions, and 72 percent from administrative and general functions. The estimated breakdown of operating synergies by category is shown at **Exhibit ___ (BRD-9)**. The companies expect that most of the synergies made possible by the transaction will be in full effect by the second year following closing.

Q: Please describe in more detail the capital structure of NW Natural Holdco.

A: We have attached to our application a pro forma statement of capitalization for NW Natural Holdco. As that statement shows, we project an initial total capitalization of approximately $4 billion. Assuming a projected closing date of Dec. 31, 2002, our pre-closing debt ratio would be 80 percent, with a total consolidated debt of about $3.2 billion. About half of that consolidated debt is the existing debt of NW Natural and PGE. The other half represents the cash that NW Natural Holdco will borrow to purchase PGE.

The total pre-closing equity is about $794 million. That total includes $33.2 million of existing NW Natural preferred stock, $30 million of existing PGE preferred stock, the $200 million preferred stock component of the FELINE PRIDES, and about $531 million of common equity.

Our pro forma statement also shows the capitalization immediately after closing. The only difference is the treatment of the $150 million of common stock sold at closing, with the proceeds used to retire $150 million in term debt. After closing, our debt component will be that much lower, and we will have added common equity. The result is that the debt ratio goes down from about 80 percent before closing to about 76 percent after closing.

Q: What will be the capital structures of PGE and NW Natural after the closing of the transaction?

A: The capital structures of PGE and NW Natural are not being altered as a result of this transaction. The capital structures for 2002 on a pro forma basis are shown at **Exhibit ___ (BRD-10)**.

Q: Please describe the projected credit ratings for NW Natural Holdco.

A: Once we were at a point in the negotiations where we had tentative terms for a transaction, including a draft financing plan, we took advantage of a relatively new service offered by two of the credit ratings agencies, Moody's and Standard & Poor's. Through their "ratings advisory services," the agencies are willing to review the financial projections underlying a transaction and to advise the parties what the credit ratings for the affected entities would be, assuming those financial projections were met. Before these services were available, parties contemplating mergers, acquisitions, or reorganizations had to guess at the ratings implications of the transaction and risk being wrong.

In this case, Moody's and S&P indicated through their ratings advisory services that the senior secured debt of NW Natural Holdco would be rated Baa3 and BB+, respectively. Both ratings assume our ability to achieve results – including conditions from regulatory approvals – that are consistent with the Base Projections. As I said earlier, our original target had been to achieve an investment-grade rating for NW Natural Holdco within three years. Based on what the advisory services have told us, however, we now expect to have a split rating at the outset, with Moody's at the higher rating and S&P at the lower, and with Moody's at an investment-grade rating (Baa3) right from the start.

Q: Please describe the expected effect, if any, the proposed transaction will have on the credit ratings of PGE and NW Natural.

A: We expect the ratings for both utilities' secured debt to be downgraded from their current levels. This downgrading will not be the result of any change in the capital structures at the utilities, because there will not be any changes due to the transaction, and it will not be the result of any changes in cash flows at the utilities. The downgrade happens because the ownership structure is changing, and the rating agencies generally limit the ratings of operating subsidiaries based on the ratings of the parent, here NW Natural Holdco. We will maintain separate credit ratings for the two utilities, but in the short term it is inevitable that the change of ownership will have some downward effect on the utilities' ratings. Based on what the ratings services have told us, we expect the utilities' ratings for secured debt to be downgraded one notch by Moody's, from A2 to A3, and three notches by S&P, from A to BBB.

We see the same dynamic occurring with the utilities' senior unsecured ratings. These are the ratings applicable to the utilities' revolving credit facilities. Currently, both utilities are rated A3/A- by Moody's and S&P. Our anticipated ratings after closing are Baa1 and BBB-, respectively. Again, these ratings are a reflection of the proposed change of ownership, not a reflection of any change in operations or capital structure at the utilities.

Finally, we anticipate ratings for the utilities' commercial paper to be P2/A2, giving NW Natural and PGE the ability to continue issuing commercial paper in the markets where the companies currently are active.

We understand that the utilities' credit ratings are an important issue. We address this issue first by aggressively paying down the debt of NW Natural Holdco, which in turn has a positive effect on the ratings of the utilities.

FINANCIAL ACCOUNTING FOR THE TRANSACTION

Q: How will NW Natural Holdco account for the transaction?

A: We will account for the transaction as a purchase.

Q: Please describe the treatment of the acquisition costs associated with the transaction.

A: We have assumed $60 million for costs associated with the acquisition, including bankers' fees, legal costs, and other incremental costs incurred in carrying out the transaction. That $60 million will be drawn from the $100 million revolving credit facility that NW Natural Holdco will receive in the financing package. NW Natural Holdco will incur the acquisition costs at the holding company level.

We intend to hold utility customers harmless from the costs of the acquisition. We will not flow acquisition costs or goodwill (the difference between the price paid for the PGE common stock and the book value of PGE's common equity) through from NW Natural Holdco to the customers of NW Natural or PGE.

Q: Please describe the financial conditions associated with this transaction.

A: In Exhibit ___ (MSD-2), we have proposed two conditions under the heading, "Finance." First, NW Natural agrees to maintain separate debt and preferred stock ratings. (Condition 5) Second, NW Natural will not make a distribution to the holding company, without Commission approval, if the distribution would reduce the utility's common equity capital to below 45 percent of total capital. (Condition 6) For purposes of this condition, "total capital" includes common equity, preferred equity, and long-term debt.

BENEFITS TO CUSTOMERS

Q: Please describe NW Natural Holdco's proposed plan to benefit customers with a portion of the synergy savings you describe above.

A: We propose that synergy savings resulting from this transaction be used first to meet debt service requirements – interest and principal – and to strengthen NW Natural Holdco credit ratings and those of the two utilities. Second, those savings would be used to benefit both customers and shareholders.

Our financial model projects that we achieve synergy savings of up to $18 million in calendar year 2003 and up to $29 million in 2004. Eventually, we could achieve savings of up to $30 million per year. We estimate it will cost $9.2 million to achieve these synergies, with the costs occurring either at closing or in the first year to two years after completion of the transaction. After using most of these savings to meet debt service requirements, our model identifies the following yearly amounts that could be passed to customers as a rate benefit: $2 million in calendar year 2003, $3 million in 2004, $4 million in 2005, $5 million in 2006, $7.5 million in 2007, and $10 million in 2008. The total benefit to customers will be $31.5 million. We propose to structure the payment of these benefits so that we would have the option to accrue one-half of the benefit amounts each year as credits in a deferral account, to ensure that we can meet financing cash flow needs. Any deferred amounts would include carrying charges and would all be amortized to customers no later than December 31, 2008.

Q: What is your justification for using synergy savings first to service holding company debt?

A: Our goal in designing the financial model and crafting the rate benefits plan was to provide benefits to customers in a manner and to a degree that would still permit the transaction to succeed. Naturally, if the transaction fails, there will be no benefits plan. Besides Commission approval, two components are necessary for success – financing of the transaction by NW Natural Holdco's lenders, and shareholder approval. We expect that the conditions for financing the transaction will be met if we meet our Base Projections. We expect our shareholders will approve this transaction if the company has a reasonable opportunity to enhance its earnings. We have structured this transaction to enable us to satisfy lenders and shareholders and still provide rate benefits to customers.

Q: What are the assumptions that form the basis of your financial model and the rate benefits plan?

A: Our Base Projections and the rate benefits plan are based on certain assumptions about the status quo. Those assumptions include the following: (1) For PGE, that current transmission and distribution revenue levels will be maintained and that the power cost adjustment mechanism will continue without a material change in terms; (2) For NW Natural, that current transportation and distribution revenue levels will be maintained, that the cost of the Mist pipeline extension will be incorporated into rates when that facility is placed in service in 2003 or 2004, and that the purchased gas adjustment mechanism will continue without a material change in terms; and (3) For all companies, that no adverse, material change occurs in law, regulation, economic conditions, or sales levels.

BENEFITS TO WASHINGTON CUSTOMERS

Q. How will Washington customers receive the rate benefits you describe in your testimony?

A. The existing state allocation methodology assures that NW Natural's Washington customers will receive their fair share of both the rate credits the company proposes and, ultimately, their fair share of the annual cost savings achieved by the combination of NW Natural and PGE. This allocation methodology was an important component of NW Natural's most recent Washington general rate proceeding, Docket No. UG-000073. The rates approved by the Commission in its Second Supplemental Order Approving and Adopting Settlement Agreement, issued on October 26, 2000, were based on a state allocation study that was developed in consultation with both the Washington and Oregon commissions. For the first time, NW Natural's Washington and Oregon rates are based on costs allocated between the states based on traditional cost allocation principles. Another important component of the review was that the rate spread approved in the case was based on a full, formal embedded cost-of -service methodology developed for the filing. As a result of the issues raised and resolved in Docket No. UG-000073, the Commission and customers can be assured that NW Natural's current rates are reflective of costs of serving Washington.

Q. How does the allocation methodology ensure that Washington customers receive their fair share of both the rate credits the company proposes and the annual cost savings achieved by the combination of NW Natural and PGE?

A. NW Natural's proposed rate benefits plan shows a schedule of rate credits that will flow to NW Natural and PGE customers. The rate credits and ongoing realized operational savings will first be allocated between NW Natural Holdco's electric and gas operations on the basis of the origin of the savings. For example, if 60% of the savings come from electric operations, then 60% of the rate benefits will go to electric customers. Of the 40% attributable to natural gas operations, Washington customers would receive their share of the 40% on the basis of the three-factor rate that is used as a determinant in the Commission-approved NW Natural state allocation studies for rate-making. The three-factor rate reflects gross plant, numbers of customers, and employees by state, and is used extensively to allocate expenses in the administrative and general area. As we have testified, most of the cost savings from the combination of NW Natural and PGE are expected to come from administrative and general (A&G) expenses, and so the three-factor formula will allocate these benefits accordingly.

Q. Do you expect Washington customers to receive all of the benefits right away?

A. Only partially. NW Natural proposes a schedule of rate credits, in which Washington gas customers will share, beginning almost immediately in 2003 and ramping up through 2008. After 2008, ongoing realized cost savings resulting from efficiencies will flow to customers in the normal ratemaking process.

Q. How do these rate credits and ongoing operational savings relate to whether or not this Application is consistent with the public interest?

A. I have been advised that the legal standard governing Washington review and approval of transactions such as this is that the transaction must be consistent with the public interest. The Commission has generally interpreted this as a "no harm" standard. In other words, unless the transaction has an adverse impact on Washington customers, it will be approved. With the rate credits and operational savings that this transaction will produce, NW Natural is proposing to go far beyond a commitment of "no harm" to Washington customers and to produce tangible benefits for them in the form of lower rates and operational efficiencies.

Q. Has NW Natural been providing financial benefits to Washington customers other than through this transaction?

A. Yes. Over the past decade, NW Natural has become very lean in its operations. We have continued to improve our customer service but at a lower total cost. However, we may have reached a point at which we simply cannot lower costs further without negatively affecting customer service. The acquisition of PGE offers a path to NW Natural to (1) remain independent and locally accountable to its customers, and (2) further improve efficiency. Because of the significant overlap of the NW Natural's and PGE's service territories, and the Northwest-based headquarters of both utilities, no other transaction provides the opportunities that this one will provide to lower overall costs and yet maintain good customer service.

Q: Does this conclude your direct testimony?

A: Yes, it does.

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