BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

UM-1121

In the Matter of	)	
	)	
OREGON ELECTRIC UTILITY	)	**SURSURREBUTTAL TESTIMONY OF**
Company, LLC, et al	)	**PORTLAND GENERAL ELECTRIC**
	)	**COMPANY**
Application for Authorization to Acquire	)	
Portland General Electric Company	)	

October 11, 2004

UM-1121 / PGE EXHIBIT / 400
PIRO

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

PGE Financial Health

PORTLAND GENERAL ELECTRIC COMPANY

Sursurrebuttal Testimony of

James J. Piro

October 11, 2004

1 **Q. Please state your name and position.**

2 A. My name is Jim Piro. I am the Chief Financial Officer of Portland General
3 Electric Company (PGE).

4 **Q. Have you previously submitted testimony in this docket?**

5 A. Yes. I sponsored PGE Exhibit 100.

6 **Q. What is the purpose of your testimony?**

7 A. This exhibit contains my sursurrebuttal testimony on the following topics:

8 - Staff's proposed condition 16, which includes short-term debt in PGE's
9 capital structure and applies a new standard of reasonable expectation to the
10 calculation of minimum equity required before PGE can pay dividends to
11 Oregon Electric. I explain the role short-term debt plays in PGE's financing
12 plans and why the Commission either should not include it in these conditions
13 or should adopt the Oregon Electric proposal. I also explain why the new
14 standard that Staff proposes is inappropriate and the standard that Oregon
15 Electric proposes is better.
16 - Staff's estimate of the effect Enron's bankruptcy had on PGE's current
17 interest expense. I explain that Staff's estimate is too high, even assuming
18 hypothetically that Staff can prove that Enron's bankruptcy is the sole reason
19 for adverse changes in PGE's credit rating on and after December 2001 and
20 that PGE's rating alone determined the interest rate of a particular issuance.
21 - Staff's estimate of the effect of this transaction on PGE's near-term financing
22 costs, including those for Port Westward, and on power purchases. I describe

our near-term financing plans, and explain why Staff's estimate is unsupported.

- Staff and intervenor concerns regarding Oregon Electric's reliance on PGE dividends to meet debt service requirements. I explain that PGE will need to pay dividends to its shareholders, whether the shareholder is Oregon Electric or any other shareholder;
- The effect on PGE of debt at Oregon Electric, in response to surrebuttal testimony by CUB witnesses;
- PGE's reasons for seeking and plans to seek certain adjustment clauses for variability outside of management's control, in response to surrebuttal testimony by Staff;
- Clarification regarding the California refund litigation, in response to surrebuttal testimony by CUB witnesses Brown and Jenks; and
- Clarification of my previous testimony regarding the requests by Eugene Electric and Water Board in this docket, in response to surrebuttal testimony by EWEB witness Beeson.

My sursurrebuttal testimony addresses these topics in the order indicated.

I. PGE's Short-Term Debt and Staff's Proposed Ring-Fencing Condition

Q. Please describe the testimony you are rebutting.

A. I am responding to Staff proposed conditions 16 and 25.

1 Staff's proposed condition 16, regarding the limitation on distributions by
2 PGE to Oregon Electric, proposes to treat amounts that PGE draws or commits
3 under our short-term debt instruments – generally, revolvers – as long-term debt.

4 Further, this condition treats secured and unsecured short-term revolvers
5 differently. Staff condition 16 includes all draws or commitments under secured
6 revolvers as long-term debt but only draws or commitments over $150 million of
7 unsecured debt instruments as long-term debt. Staff proposed condition 25 also
8 uses the existence of secured short-term debt at PGE as the trigger for a restriction
9 on Oregon Electric's use of distributions from PGE.

10 Finally, Staff proposed condition 16 would limit PGE's distributions to
11 Oregon Electric whenever the distribution would, *or could reasonably be*
12 *expected to,* cause PGE's capital structure to fall below the minimum equity
13 amount required for distributions.

14 **Q. What are PGE's short-term financing needs and what financial instruments**
15 **does PGE use to meet them?**

16 A. PGE uses short-term financing for three primary purposes. First, this type of
17 financing simply bridges the gap when cash we receive does not match cash that
18 we need to send out (working cash). PGE's revenues are seasonal, but many of
19 our expenses are not. Second, we use short-term financing to support credit
20 requirements in the wholesale markets for power and natural gas. This is fairly
21 recent; strict credit requirements in these markets appeared toward the end of the
22 1990s and increased significantly in importance after the California power crisis.
23 Last, we use short-term financing for our capital expenditures that exceed

1 internally-generated cash, as a bridge to long-term financing for these
2 investments. Short-term financing allows us to obtain long-term financing in
3 logical amounts and, ideally, when market conditions are favorable.

4 The revolvers referenced in Staff's conditions 16 and 25 are syndicated
5 short-term lines of credit provided by a consortium of banks to finance the short-
6 term liquidity and working capital needs of a company and provide a bridge to
7 long-term financing. Revolvers typically run from 364 days up to three years.
8 We seek approval from the OPUC before issuing any revolver that will run for
9 one year or longer. PGE uses its revolvers primarily: 1) to backstop commercial
10 paper (issued for between one to 270 days) for working cash; 2) to support credit
11 for power and fuel purchases and sales; and 3) to draw on directly for working
12 cash. We typically refer to the maximum amount of revolving debt as the
13 capacity of the instrument – for example, $250 million – but, at any given time,
14 only a portion of this is likely to be in use for one of the three purposes I listed
15 above.

16 **Q. What is PGE's recent history with respect to revolvers?**

17 A. For the past ten years, the capacity of PGE's secured and unsecured revolvers has
18 ranged between $150 million and $425 million, averaging around $250 million.
19 Our needs vary, depending on our capital expenditure program, wholesale market
20 requirements, and other working cash needs. We pay a fee to put in place a
21 revolver that increases with the size of the revolver, so we do not acquire more
22 revolver capacity at any given time than we believe we need.

1 In the last couple of years, our cash on hand has increased as Enron did
2 not take normal dividends. This unusual circumstance allowed us to lower our
3 revolver capacity and, thus, reduce our financing fees. As I explained in my prior
4 testimony, however, PGE will pay a catch-up dividend in the near future
5 regardless of whether Oregon Electric or Enron's creditors own our common
6 stock (see PGE/100, Piro/11-12). This dividend will decrease our cash on hand
7 and we plan to increase our revolver capacity to $250 million as a result. This is
8 particularly true given our capital expenditure needs for Port Westward and
9 relicensing expenditures. We currently anticipate that after payment of the Enron
10 catch-up dividend and the closing of this transaction, PGE will acquire a new
11 three-year, $250 million, unsecured revolver to support our short-term capital
12 needs. This will be consistent with PGE's average revolver capacity over the last
13 ten years.

14 **Q. Do you agree with Staff's proposal to treat amounts drawn under short-term**
15 **revolvers as long-term debt for purposes of calculating the minimum equity**
16 **percentage?**

17 A. No. Staff does not explain why it is making this proposal so I cannot address its
18 reasons. Treating amounts drawn or committed under short-term revolvers as
19 long-term debt for purposes of calculating capital structure is contrary to
20 Generally Accepted Accounting Principles (GAAP), which treat this debt as
21 short-term. It is also inconsistent with the Commission's treatment of short-term
22 debt for purposes of applying the Enron merger condition that limited dividends if
23 the common equity in PGE's capital structure fell below 48 percent. I see no need

for this departure from GAAP or for changes to what has been a highly successful minimum equity condition. This existing condition proved more than adequate to protect PGE's finances during the Enron bankruptcy.

In essence, Staff's proposal to include short-term debt simply increases the minimum equity level that PGE must have in its capital structure before we can make a dividend to our equity owners. In my judgment, there is no reason why PGE should now have more equity than the 48% settled upon in the Enron merger docket.

Q. Is Oregon Electric's proposed condition 16 preferable with respect to how it treats unsecured revolving debt?

A. Yes. This condition would treat revolvers as long-term debt only to the extent that, on a twelve-month rolling average basis, the amount PGE has committed or drawn against the revolver exceeds $250 million, excluding amounts committed or drawn for purposes of providing credit in the wholesale power and fuels markets.

The condition's use of a twelve-month rolling average smoothes any temporary needs for large cash outlays, such as we might experience with major equipment purchases for new generation. Excluding trading credit support is necessary because these requirements follow changes in the power and fuels markets and are highly variable. Based on PGE's history, a short-term revolver capability of $250 million is "normal." The minimum equity condition should not include anything at or below this normal level of short-term debt without good reason.

1 **Q. Do you agree with Staff's proposal to treat any amount of secured short-term**
2 **debt as a long-term debt?**
3 A. No. First, I should explain that a secured revolver is one that is generally
4 supported by first mortgage bonds (FMB); in other words, if PGE is in default, the
5 short-term debt rolls into FMB. Because PGE would generally issue FMB with a
6 secured revolver, we also must obtain Commission approval. We did this in
7 Docket UF-4188, filed in May 2002.
8 The use of secured revolvers is rare: in the last 25 years, PGE has had a
9 secured revolver only from June 12, 2002 to May 24, 2004. Because we cannot
10 know the circumstances under which use of a secured revolver might be the best
11 financing tool, the Commission should reserve its consideration of how to treat
12 the secured revolver for purposes of the dividend limitation until PGE files the
13 appropriate application. This is precisely what happened in Docket No. UF-4188,
14 in which the Commission approved PGE's issuance of our only secured revolver
15 but ordered that PGE treat it as long-term debt in applying the Enron merger
16 condition minimum equity percentage limit on distributions.
17 **Q. Why do you object to Staff's proposal to trigger a restriction on distributions**
18 **to Oregon Electric that could *"reasonably be expected to"* cause PGE's capital**
19 **structure to fall below 48% common equity?**
20 A. Again, the inclusion of this phrase is new to this proceeding. PGE has been
21 operating under the Enron condition, which does not have this phrase, since 1997
22 without any problems. My primary concern is that the phrase is subjective and
23 has no standards or interpretations to guide its application.

1 **Q. Has Oregon Electric proposed a different standard that you find acceptable?**

2 A. Yes. Carrie Wheeler explains that Oregon Electric's version of condition 16
3 would limit distributions to those that would, *as determined in accordance with*
4 *Generally Accepted Accounting Principles (GAAP),* cause common equity to fall
5 below the target percentage. GAAP is the standard for all accounting by business
6 in the United States. GAAP provides standards for such accounting matters as the
7 accrual and disclosure of all material loss contingencies (FAS[1] 5) or events that
8 result in asset impairment (FAS 71 and 90). Businesses can access a wealth of
9 prior examples and seek advice from accounting professionals for assistance in
10 applying GAAP. No examples or professional assistance would be available to
11 guide PGE's application of Staff's proposed subjective standard.

12 The practical effect of the standard Staff proposes is another de facto
13 increase in the minimum common equity percentage. Again, Staff has provided
14 no reason for requiring more than 48 percent common equity in the capital
15 structure before PGE can pay dividends to its shareholders.

16 **II. Enron's Effect on PGE's Debt Costs**

17 **Q. What testimony are you rebutting in this section?**

18 A. I am rebutting Staff's testimony (Staff/900, Morgan/24) that PGE's current debt
19 expense is "upwards of five to seven million dollars more than it would have
20 incurred but for Enron's activities and ultimate collapse into bankruptcy."

[1] FAS stands for Statement of Financial Accounting Standards as issued by the Financial Accounting Standards Board.

1 Although this statement is unclear whether the figures are annual or cumulative, I
2 disagree with this assessment under either scenario.

3 **Q. What debt did PGE issue since December 2001, when Enron declared**
4 **bankruptcy and what are the maturity dates of that debt?**

5 A. PGE Exhibit 401 shows the notes PGE issued during this period. This debt
6 carries an annual debt service of $30.1 million total.

7 **Q. Can you calculate the amount of this debt service that is attributable to the**
8 **effect of Enron's bankruptcy on PGE?**

9 A. As I explained in PGE/100, Piro/10-12, many factors affect a company's credit
10 rating, and further affect a given debt issue and I have not undertaken any study of
11 this for the purpose of this testimony. Quantifying the effect of Enron would
12 require, at a minimum, careful study of the factors underlying changes in PGE's
13 credit ratings at the time the changes occurred and of factors that might have
14 influenced those ratings at the time PGE issued the debt, and a determination of
15 the typical interest rate spread between different credit ratings.

16 **Q. Can you comment on Staff's estimate hypothetically, assuming that Staff had**
17 **proved the necessary attribution?**

18 A. Yes. If one makes the simplifying assumptions that the Commission found that
19 (1) PGE's senior secured credit rating was one notch lower than it would have
20 been solely but for Enron and that, (2) in the interest rate environment that
21 prevailed at the time of this debt issued, one notch was worth 25 basis points, then
22 the annual debt service associated with "Enron" would be about $1 million per
23 year. This is the interest rate differential indicated in Oregon Electric/200,

1 Wheeler/16. To reach the additional cost Staff claims, assuming that it is an
2 annual number, would require that one assume a utility rated just one notch higher
3 than PGE at the time these bonds issued could finance for approximately 150
4 basis points – or, 1.5% – less. Based on my experience in utility financing, this is
5 not realistic.

6 III. PGE's Near-Term Financing Costs

7 **Q. What testimony are you rebutting in this section?**
8 A. I address Staff conclusions that this transaction will adversely affect both the
9 interest rate PGE will pay as we refinance certain debt retiring within the next six
10 years and Port Westward's financing costs. I also explain that PGE has access to
11 equity capital in the form of retained earnings and that Staff's concerns about the
12 effect of this transaction on PGE's power purchases is unsupported.
13 **Q. Do you agree with Staff's estimate of the effect of this transaction on the cost**
14 **PGE will pay to refinance retiring debt?**
15 A. Staff's estimate that PGE will have to refinance $550 million of retiring debt is
16 not quite right. Between now and 2010, PGE will replace approximately $405
17 million in retiring debt instruments. Further, I disagree that this transaction will
18 have any material impact on the interest rate PGE pays on this refinancing. Until
19 2010, all of the retiring debt (approximately $405 million) are secured instruments
20 that PGE will replace with secured instruments. I share Thomas Morgan's
21 expectation (Staff/900, Morgan/12) that this transaction will not affect PGE's
22 senior secured debt rating. The Standard & Poors' (S&P) guidance Wheeler

references (Oregon Electric/200, Wheeler/15), indicates a downgrade only to PGE's unsecured debt rating. PGE's senior secured debt rating would remain at its current level.[1] PGE Exhibit 402 provides debt maturity detail for PGE's existing long-term debt.

In July 2004, S&P issued an updated analysis of U.S. utility first mortgage bonds (FMB – provided as PGE Exhibit 403). In this analysis, PGE received a 1+ recovery rating. S&P upgraded the senior secured debt rating for most of those utilities that it gave a 1+ recovery rating. Although S&P did not raise PGE's senior secured rating, S&P noted that they will "determine whether to *upgrade* a first mortgage bond for any company whose first mortgage bond rating is on CreditWatch with negative implications when the CreditWatch listing is resolved" (italics added). This refers to PGE and indicates that factors favorably affecting the cost of PGE's secured debt may be present in the future.

Q. Do you agree with Staff's conclusion regarding the effect of this transaction on PGE's financing cost for Port Westward?

A. No. First, let me explain how PGE plans to put in place long-term financing for Port Westward. We will meet our immediate and short-term cash needs with a combination of cash on hand, commercial paper, and revolver draws. We will issue long-term debt equal to about one-half of the cost of Port Westward to replace any short-term debt relied upon during the construction process, with the timing of issuing the long-term debt dependent on financial market conditions. I

[1] Moody's has not yet issued any guidance regarding the effect of this transaction on PGE's credit ratings.

have already explained why I believe that this transaction will have no material effect on the cost of PGE's senior secured debt.

Q. Do you have an answer to Staff's concerns about whether PGE would have access to equity financing to supplement the debt financing for Port Westward, given the need to maintain minimum equity at PGE at 48 percent (Staff/900, Morgan/13)?

A. Yes. Staff appears to be assuming that the only source for such equity is the equity market. By far the most common source of equity financing for an established utility such as PGE is its retained earnings. Assuming PGE increases long-term debt by $150 million for Port Westward and assuming that we were otherwise exactly at 48% common equity in our capital structure, we can maintain that capital structure by increasing retained earnings by approximately the same amount: $150 million. This can occur during the years of Port Westward's construction. It does not require new equity from Oregon Electric or Oregon Electric's investors or any other source than retained earnings.

Very generally, the decision of how to finance capital expenditures with debt and/or equity and, if equity, whether through retaining earnings or seeking equity from investors is a Board's decision to make. If a company is publicly traded, this decision typically entails an assessment regarding what impact the issuance of additional stock will have on current shareholders' value and of the likely price the market will offer for such stock. A company that is trading below its book value typically will not issue new stock because of the potential adverse effect on existing shareholders. A utility's other choice for financing major

1 capital investment is to increase the amount of debt in its capital structure, which
2 it may also evaluate.

3 If this transaction closes, PGE's Board will determine the means to
4 finance PGE's capital requirements, whether for new generating resources or
5 standard system additions and replacements. Staff's assumption that all of this
6 will require new equity from Oregon Electric is incorrect and the concerns
7 expressed at (Staff/900, Morgan/28, lines 5-8) are unsupported. Under PGE's
8 capital plan, PGE's retained earnings will likely provide the necessary additional
9 equity capital to meet the 48 percent minimum equity limitation on distributions.

10 **Q. Do you agree with Staff that PGE's credit ratings will affect the interest PGE**
11 **pays on power purchases (Staff/900, Morgan/12, lines 7-9)?**

12 A. No. As long as PGE maintains its investment grade rating on an unsecured basis,
13 no additional collateral will be required for PGE's power purchases or sales. The
14 price at which a utility buys or sells power and fuel does not change as a result of
15 that utility's credit rating. To the extent a utility's unsecured credit rating falls
16 below investment grade, that circumstance may affect the number of market
17 participants willing to do business with the utility or require additional credit
18 provisions but would not necessarily impact the contract prices.

19 **IV. PGE's Requirement to Make Dividend Payments**

20 **Q. What testimony are you rebutting in this section?**

21 A. Throughout Staff and other parties' testimony is a consistent concern with the
22 dividends from PGE that Oregon Electric is relying on for cash to meet its debt

1 service and retire its debt (e.g., Staff/900, Morgan/9, lines 16-19). I am concerned
2 that this testimony reflects an implicit assumption that a stand-alone PGE would
3 not need to make dividend payments. This assumption is unfounded.

4 **Q. Do stand-alone public utilities have dividend needs?**

5 A. Yes. Historically, dividends were the primary means by which utilities provided a
6 return to common shareholders. Toward the end of the 1980s and early 1990s,
7 some utilities adopted growth strategies as well, aimed at providing shareholder
8 return through an increase in the price of the stock.

9 PGE is presently tracking the financial results of five utilities that we have
10 identified as reasonably comparable to our situation. These are: Idaho Power,
11 Puget Sound Energy, Avista, Wisconsin Energies, and Unisource. All are
12 subsidiaries of publicly-traded holding companies. PGE Exhibit 404 shows the
13 dividend payout ratio for these utilities in 2003. The ratio ranges from 35% to
14 115% and I believe is consistent with what you would find across the industry.
15 From 1991 until the merger with Enron, Portland General Corporation paid
16 approximately $51 million per year in dividends. And, of course, after the merger
17 with Enron, PGE paid dividends to Enron until the second quarter of 2001. These
18 were approximately $80 million per year.

19 **Q. Are there times that a publicly-traded utility will cut or suspend its**
20 **dividend?**

21 A. Of course. One circumstance would be an investment opportunity that the
22 company's Board decides is best funded with retained earnings. The other
23 circumstance in which this might happen is severe financial stress. At such times

a utility must – through its Board – make the best decision it can how to meet the current and future needs of all of its stakeholders: customers, employees, and shareholders. Market reaction may be severe and the utility's stock may trade well below book value for some time, with the effects on the issuance of new stock that I noted above.

Equity owners require a return on their investment, whether through growth in the value of the stock or dividends or both. Oregon Electric is not unique in this regard.

V. Effect on PGE of Oregon Electric Debt

Q. Is PGE responsible for the debt at Oregon Electric?

A. No. PGE is responsible for the debt it alone issues – no more, no less. That PGE's earnings will be paid to our shareholder as dividends to enable that shareholder to pay interest and retire principal does not make this PGE's debt. The best illustration of this is the methodology by which the Commission sets rates for Oregon utilities. The OPUC considers many costs, including the utility's own debt, in setting fair and reasonable rates. One thing it does not consider is the debt payment needs of the utility's owner.

1 ## VI. Adjustment Clauses

2 **Q. Why has PGE sought, and continues to seek, rate recognition for costs such**
3 **as hydro production or the effect of customer usage decisions on revenues?**

4 A. PGE has sought, and will continue to seek, rate recognition, including adjustment
5 clauses when we believe that addressing particular cost or revenue elements
6 through a rate-making mechanism provides customers the lowest cost or
7 otherwise enables PGE to better balance the interests of investors and our
8 customers.

9 ## VII. California Refund Litigation

10 **Q. Your rebuttal testimony explained PGE's principle on when it is appropriate**
11 **to seek recovery of a liability from customers. Please restate that principle.**

12 A. In general, if the liability or claim arises out of providing service to customers,
13 relates to an asset that PGE has devoted to regulated retail service, or to a benefit
14 that customers have already or will in the future receive, then we will seek
15 coverage on the principle of matching costs and benefits.

16 **Q. CUB states its belief that this principle would not apply to the California**
17 **refund matter (CUB/300, Jenks-Brown/23-24). Do you agree?**

18 A. No. I do not agree with CUB's assertion that none of this liability should attach
19 to customers. This, however, is an issue for another proceeding. When and if
20 PGE requests a rate change, within the context of the 2001 PCA, due to the
21 impact of refunds ordered to California, the Commission will decide this issue.

1 **VIII. EWEB's Requests**

2 **Q. What is your response to EWEB's surrebuttal testimony that you "made**
3 **light" of its concerns (EWEB/200, Beeson/1, lines 24-26)?**

4 A. My testimony was not intended to do this. Based on all the evidence presented in
5 this case, I believe PGE will be able to properly discharge all its responsibilities
6 for the decommissioning of Trojan without the need for additional conditions
7 imposed by the Commission for the benefit of EWEB.

8 **Q. Does this conclude your testimony?**

9 A. Yes, it does.

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List of Exhibits

PGE Exhibit	Description
401	Acquired New Debt Since Enron Bankruptcy
402	Debt Maturity on Existing Debt
403	S&P Updated Analysis and Recovery Ratings
404	Dividend Payout Ratios

Aquired New Debt Since Enron Bankruptcy

Type	Description	Issue Date	Maturity Date	Term	Coupon	Gross Proceeds	Order	Order Date	Annual Interest Cost	Annual Interest Delta @ 25 Basis Points
FMB	5.6675% Series	28-Oct-02	25-Oct-12	10	5.668%	$100,000,000	02-477	07/26/06	5,668,000	250,000
FMB	8.125% Series	10-Oct-02	01-Feb-10	8	8.125%	$150,000,000	02-477	07/26/06	12,187,500	375,000
FMB	5.279% Series	08-Apr-03	01-Apr-13	10	5.279%	$50,000,000	02-477	07/26/06	2,639,500	125,000
FMB	5.625 Series	04-Aug-03	01-Aug-13	10	5.625%	$50,000,000	03-391	07/03/03	2,812,500	125,000
FMB	6.750 Series	04-Aug-03	01-Aug-23	20	6.750%	$50,000,000	03-391	07/03/03	3,375,000	125,000
FMB	6.875 Series	04-Aug-03	01-Aug-33	30	6.875%	$50,000,000	03-391	07/03/03	3,437,500	125,000
Totals						$450,000,000			30,120,000	1,125,000

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Debt, Preferred & Common Equity Stock Schedules
August 1, 2004

Preliminary

Type (C)	Description (D)	Issue Date (E)	Maturity Date (F)	Term (G)	Coupon (H)	Gross Proceeds (I)	DD&E Issue Costs (J)	Call Premium & Unamort. DD&E of Refunded Issue (K)		Net Proceeds (L) [I-J-K]	Embedded Cost (M)	Net to Gross Rate (N) [L/i]	Face Amount Outstanding (O)	Net Outstanding (P) [N*O]	Face Amount Weight (Q) [O/Total]	Weighted Rate (R) [Q*M]
FMB	5.6675% Series	28-Oct-02	25-Oct-12	10	5.668%	$100,000,000	$12,217,227	$0		$87,782,773	7.420%	87.783%	$100,000,000	$87,782,773	11.348%	0.842%
FMB	8.125% Series	10-Oct-02	01-Feb-10	8	8.125%	$150,000,000	$2,550,000	$0		$147,450,000	8.421%	98.300%	$150,000,000	$147,450,000	17.021%	1.433%
FMB	5.279% Series	08-Apr-03	01-Apr-13	10	5.279%	$50,000,000	$4,209,517	$0		$45,790,483	6.434%	91.581%	$50,000,000	$45,790,483	5.674%	0.365%
FMB	5.625 Series	04-Aug-03	01-Aug-13	10	5.625%	$50,000,000	$408,842	$0		$49,591,158	5.734%	99.182%	$50,000,000	$49,591,158	5.674%	0.325%
FMB	6.750 Series	04-Aug-03	01-Aug-23	20	6.750%	$50,000,000	$521,342	$0		$49,478,658	6.846%	98.957%	$50,000,000	$49,478,658	5.674%	0.388%
FMB	6.875 Series	04-Aug-03	01-Aug-33	30	6.875%	$50,000,000	$521,342	$0		$49,478,658	6.958%	98.957%	$50,000,000	$49,478,658	5.674%	0.395%
Series MTN	9.07% Series	12-Aug-91	15-Aug-05	14	9.070%	$18,000,000	$136,419	$0		$17,863,581	9.167%	99.242%	$18,000,000	$17,863,581	2.043%	0.187%
Series MTN	9.31% Series	12-Aug-91	11-Aug-21	30	9.310%	$20,000,000	$176,577	$0		$19,823,423	9.399%	99.117%	$20,000,000	$19,823,423	2.270%	0.213%
Series IV M	7.15% Series	16-May-95	15-Jun-07	12	7.150%	$50,000,000	$462,754	$3,530,900	*13*	$46,006,346	8.209%	92.013%	$50,000,000	$46,006,346	5.674%	0.466%
Notes	7.875% Series	13-Mar-00	15-Mar-10	10	7.875%	$150,000,000	$1,472,800	$1,266,000	*17*	$147,261,200	8.128%	98.174%	$149,250,000	$147,310,450	16.936%	1.377%
PCB	Brdmn 98A Fixec	28-May-98	01-May-33	35	5.200%	$23,600,000	$172,702	$1,267,030	*5,16,1ᵢ*	$22,160,268	5.570%	93.899%	$23,600,000	$22,160,268	2.678%	0.149%
PCB	Clstrp 98A Fixed	28-May-98	01-May-33	35	5.200%	$97,800,000	$172,702	$1,617,373	*6,16,1ᵢ*	$96,009,925	5.323%	98.170%	$97,800,000	$96,009,925	11.098%	0.591%
PCB	Colstrip 98B Fixe	28-May-98	01-May-33	35	5.450%	$21,000,000	$172,702	$438,143	*16,18*	$20,389,155	5.652%	97.091%	$21,000,000	$20,389,155	2.383%	0.135%
PCB	Trojan 85A Fixed	01-Jul-98	01-Apr-10	25	4.800%	$20,200,000	$218,352	$244,162	*16*	$19,737,486	5.058%	97.710%	$20,200,000	$19,737,486	2.292%	0.116%
PCB	Trojan 85B Fixed	01-Jul-98	01-Jun-10	25	4.800%	$16,700,000	$180,519	$184,473	*16*	$16,335,008	5.046%	97.814%	$16,700,000	$16,335,008	1.895%	0.096%
PCB	Trojan 90A Fixed	01-Jul-98	01-Aug-14	24	5.250%	$9,600,000	$103,771	$184,980	*16*	$9,311,249	5.537%	96.992%	$9,600,000	$9,311,249	1.089%	0.060%
PCB	Troj Ser 1990B-F	15-Dec-90	15-Dec-14	24	7.125%	$5,100,000	$163,234	$0		$4,936,766	7.412%	96.799%	$5,100,000	$4,936,766	0.579%	0.043%
	Loss on Reacquired Debt							$880,250		($880,250)						
	Total Debt					$882,000,000	$23,860,801	$9,613,311		$848,525,888			$881,250,000	$849,455,388	100.00%	7.181%

Cost of LT Debt (includes loss from reacquired)	7.281%

Losses on Reacquired Debt	Reacquired		Gross Proceeds	Total Gain/Loss to Amortize	Annual Expense
13.50% FMB Due 10/1/12	25-Apr-88		$75,000,000	$8,989,952	$368,184
9.46 Series Due 08/12/2021	01-Sep-03	**Estimated**	$25,000,000	$1,074,754	$59,709
7.75% Series Due 8/15/2023	08-Dec-03	**Estimated**	$115,100,000	$17,641,949	$452,358
					$880,250

Special Report

Ratings of U.S. Utility First Mortgage Bonds Revised and Recovery Ratings Assigned

Standard & Poor's Ratings Services has updated its analysis of U.S. utility first mortgage bonds in response to changes in the industry. Before 1997, a utility's first mortgage bond rating was determined solely by the corporate credit rating (CCR). In 1997, Standard & Poor's incorporated a more rigorous analysis of ultimate recovery potential to supplement the analysis of default risk for first mortgage bonds. The incorporation of ultimate recovery is particularly important for electric, gas, and water utility first mortgage bond ratings. If, in Standard & Poor's analytical conclusion, full recovery of principal can be anticipated in a post-default scenario, an issue's rating may be notched above the CCR or default rating. Developments in the industry since 1997 have caused Standard & Poor's to revise the method used to determine collateral value. As a result, the first mortgage bonds of 20 utility companies have been raised and one has been lowered.

Standard & Poor's has also assigned recovery ratings to all first mortgage bonds. Recovery ratings, first introduced for industrial and utility issuers in December 2003, focus solely on the likelihood of loss and recovery in the event of default or bankruptcy. First mortgage bonds have a strong record of investor protection because, historically, the underlying assets that secure them have not been subject to liquidation in bankruptcy and the bonds have not defaulted, even when the company is in bankruptcy. The recovery rat-

Table 1

Notching Criteria

Rating category	Assets/secured debt (x)	Notches above CCR
A and above	2	1
BBB	2	2
	1.5	1
B and BB	2	3
	1.5	2

Table 2

First Mortgage Bond Upgrades

Company	Old FMB rating	New FMB rating
Empire District Electric Co.	BBB	A-
Entergy Arkansas Inc.	BBB+	A-
Entergy Gulf States Inc.	BBB-	BBB
Entergy Louisiana Inc.	BBB+	A-
Entergy Mississippi Inc.	BBB+	A-
Entergy New Orleans Inc.	BBB	A-
Indianapolis Power & Light Co.	BB+	BBB-
Jersey Central Power & Light Co.	BBB	BBB+
Kansas Gas & Electric Co. (Westar)	BB+	BBB
Monongahela Power Co.	BB-	BB
Nevada Power Co.	BB	BB+
Northern States Power Co.	BBB+	A-
Northern States Power Wisconsin	BBB+	A-
Pennsylvania Power Co.	BBB-	BBB
Potomac Edison Co.	BB-	BB
Public Service Co. of Colorado	BBB+	A-
Public Service Co. of Oklahoma	BBB	A-
Sierra Pacific Power Co.	BB	BB+
Southwestern Electric Power Co.	BBB	A-
System Energy Resources Inc.	BBB-	BBB

Special Report

Utility Bankruptcies
Empirical evidence suggests that utilities that file for bankruptcy do not default on their first mortgage bond obligations. Of the five utility bankruptcies in the past 30 years, utilities continued to make timely debt-service payments on their first mortgage bonds (see table 6). This is also true of the most recent case, NorthWestern Corp., which is still in bankruptcy. Utility managements have historically elected to pay first mortgage bond obligations in a bankruptcy because a payment default would result in higher interest costs. Because first mortgage bondholders typically emerge from bankruptcy with full recovery, management has an incentive to avoid incurring additional interest expense. In addition, a payment default on the first mortgage bonds adds another group of creditors to the bankruptcy case and prolongs the process. In the case of El Paso Electric, which missed one first mortgage bond payment, the bankruptcy judge ordered that the payment be made. The company's first mortgage bondholders received the missed payment, with accrued interest on the payment, as part of the bankruptcy proceedings.

ings assigned to first mortgage bonds reflect this strong record, with every first mortgage bond assigned one of the two highest recovery ratings of either '1+' or '1'.

Updated First Mortgage Bond Rating Methodology

Over the past 50 years, no U.S. utility bankruptcy has ended in liquidation (see sidebar, Utility Bankruptcies) and Standard & Poor's believes that the likelihood of liquidation in any future utility bankruptcy proceeding is remote. Therefore, the single most important factor in determining a utility's asset value upon emergence from bankruptcy is the revenue stream that regulators allow it to collect. Even in bankruptcy, regulators tend to set rates high enough for the utility to recover prudently incurred fixed and operating costs. As a result, there is a very high correlation between rate base and the assets' book value. Therefore, absent extenuating circumstances, such as the market's inability to support prices based on the asset base, Standard & Poor's will assume that the assets' book value assets represents a fair value for the assets. Importantly, the few utility bankruptcies since the 1930s have not resulted in any material asset write-downs.

The decision to notch a utility's first mortgage bond rating above its CCR is based on the estimate of collateral value relative to the maximum amount of first mortgage bonds that may be outstanding at any time under the indenture's terms. The recovery for creditors going into the workout process is a function of the value of their collateral and priority of position. Therefore, determining the collateral value provides a basis for how well creditors are secured. The analysis does not attempt specifically to predict the ultimate outcome of any bankruptcy proceeding. Rather, our recovery estimate compares the level of collateral to the potential amount of secured debt. Higher collateral coverage levels increase confidence that asset values will cover the secured debt.

First mortgage bondholders benefit from a first-priority lien on substantially all of the utility's property and franchises owned or thereafter acquired. The first mortgage bond indenture typically includes as collateral the entire physical plant of a utility, including electric generation, electric and gas transmission and distribution, and water distribution assets, as well as construction work in process. Because of their essential nature, utility asset values are largely independent of the owner's financial condition. In addition to the asset protection, the mortgage indenture typically contains fairly restrictive covenants, including a limitation on the issuance of additional secured bonds based on interest coverage and debt-to-asset tests.

In the past, Standard & Poor's attempted to assess different values for types of assets and attributed higher collateral value to the electric, gas, and water delivery assets than to production assets. Standard & Poor's differentiated companies on the basis of the relative efficiency of their nonnuclear generating plants, as measured by total variable production costs. We assigned zero value to nuclear assets because of their perceived low value in a utility bankruptcy and liquidation. However, because liquidation potential is low, Standard & Poor's will not assign greater values for regulated delivery assets or lower values for regulated generation assets, unless extenuating circumstances warrant a valuation adjustment.

Notching Above the Default Rating

Issuers rated in the 'A' category and above carry a low probability of default, so the relevance of post-default recovery carries less weight in our rating analysis of first mortgage

Table 3

First Mortgage Bond Downgrade

Company	Old FMB rating	New FMB rating
PECO Energy Co.	A	A-

Table 4

Standard & Poor's Recovery Ratings

Recovery rating scale	Analytical description	Recovery expectation
1+	Highest expectation of full recovery of principal	100% of principal
1	High expectation of full recovery of principal	100% of principal
2	Substantial recovery of principal	80-100% of principal
3	Meaningful recovery of principal	50-80% of principal
4	Marginal recovery of principal	25-50% of principal
5	Negligible recovery of principal	0-25% of principal

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Table 5

First Mortgage Bond Recovery Ratings

Company	Corporate credit rating	Current FMB rating	Recovery rating
ALLETE Inc.	BBB+/Watch Dev/A-2	A	1
Atlantic City Electric Co.	BBB+/Stable/A-2	A-	1
Avista Corp.	BB+/Stable/—	BBB-	1
Baltimore Gas & Electric Co.	A-/Stable/A-2	A	1+
Baton Rouge Water Works Co. (The)	AA/Stable/—	AA	1
Black Hills Power Inc.	BBB-/Negative/—	BBB	1
Carolina Power & Light Co.	BBB/Stable/A-2	BBB	1
CenterPoint Energy Houston Electric LLC	BBB/Negative/—	BBB	1
Central Illinois Light Co.	A-/Watch Neg/—	A-	1
Central Illinois Public Service Co.	A-/Watch Neg/—	A-	1
Central Vermont Public Service Corp.	BBB-/Stable/—	BBB+	1
Cleco Power LLC	BBB/Negative/A-3	BBB+	1
Cleveland Electric Illuminating Co.	BBB-/Stable/—	BBB-	1
Commonwealth Edison Co.	A-/Negative/A-2	A-	1
Connecticut Light & Power Co.	BBB+/Stable/—	A-	1+
Consumers Energy Co.	BB/Negative/—	BBB-	1
Delmarva Power & Light Co.	BBB+/Negative/A-2	A-	1
Detroit Edison Co.	BBB+/Negative/A-2	A-	1
Duke Energy Corp.	BBB/Stable/A-2	BBB+	1
Duquesne Light Co.	BBB/Negative/A-3	BBB+	1
Empire District Electric Co.	BBB/Stable/A-2	A-	1+
Entergy Arkansas Inc.	BBB/Stable/—	A-	1+
Entergy Gulf States Inc.	BBB-/Stable/—	BBB	1
Entergy Louisiana Inc.	BBB/Stable/—	A-	1+
Entergy Mississippi Inc.	BBB/Stable/—	A-	1+
Entergy New Orleans Inc.	BBB/Stable/—	A-	1+
Florida Power & Light Co.	A/Negative/A-1	A	1
Florida Power Corp.	BBB/Stable/A-2	BBB	1
Gulf Power Co.	A/Stable/—	A+	1+
Idaho Power Co.	A-/Watch Neg/A-2	A	1
Illinois Power Co.	B/Watch Pos/—	B	1
Indianapolis Power & Light Co.	BB+/Stable/—	BBB-	1
Interstate Power & Light Co.	BBB+/Negative/A-2	A-	1
Iowa-Illinois Gas & Electric Co.	A/Stable/A-1	A+	1
Jersey Central Power & Light Co.	BBB-/Stable/—	BBB+	1+
Kansas Gas & Electric Co.	BB+/Positive/—	BBB	1
Kentucky Utilities Co.	BBB+/Stable/A-2	A	1
Laclede Gas Co.	A/Stable/A-1	A	1
Madison Gas & Electric Co.	AA/Negative/A-1+	AA	1+
Massachusetts Electric Co.	A/Stable/A-1	A+	1+
MDU Resources Group Inc.	A-/Negative/A-2	A-	1
Metropolitan Edison Co.	BBB-/Stable/—	BBB	1
Midwest Power Systems Inc.	A/Stable/A-1	A	1
Mississippi Power Co.	A/Stable/A-1	A+	1+
Monongahela Power Co.	B/Stable/—	BB	1+
Narragansett Electric Co.	A/Stable/A-1	A+	1+
Nevada Power Co.	B+/Negative/—	BB+	1+
Niagara Mohawk Power Corp.	A/Stable/—	A+	1
Nicor Gas Co.	AA/Stable/A-1	AA	1
North Shore Gas Co.	A-/Stable/A-2	A-	1
Northern States Power Co.	BBB/Stable/A-2	A-	1+
Northern States Power Wisconsin	BBB+/Stable/—	A-	1+
NorthWestern Corp.	D/—/—	D	1

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Table 5

First Mortgage Bond Recovery Ratings (cont')

Company	Corporate credit rating	Current FMB rating	Recovery rating
Northern States Power Wisconsin	BBB+/Stable/—	A-	1+
NorthWestern Corp.	D/—/—	D	1
NorthWestern Energy Montana	NR	NR	1
NSTAR Gas Co.	A/Stable/—	A	1
Ohio Edison Co.	BBB-/Stable/—	BBB	1
Oncor Electric Delivery Co.	BBB/Negative/—	BBB	1
PECO Energy Co.	A-/Negative/A-2	A-	1
Pennsylvania Power Co.	BBB-/Stable/—	BBB	1
Portland General Electric Co.	BBB+/Watch Neg/A-2	BBB+	1+
Potomac Edison Co.	B/Stable/—	BB	1+
Potomac Electric Power Co.	BBB+/Negative/A-2	A-	1
PPL Electric Utilities Corp.	A-/Negative/A-2	A-	1
Public Service Co. of Colorado	BBB/Stable/A-2	A-	1+
Public Service Co. of New Hampshire	BBB+/Stable/—	BBB+	1
Public Service Co. of Oklahoma	BBB/Stable/—	A-	1+
Public Service Electric & Gas Co.	BBB/Stable/A-2	A-	1
San Diego Gas & Electric Co.	A/Stable/A-1	A+	1
Savannah Electric & Power Co.	A/Stable/—	A+	1+
Sierra Pacific Power Co.	B+/Negative/—	BB+	1+
South Carolina Electric & Gas Co.	A-/Stable/—	A-	1
Southern Californa Gas Co.	A/Stable/A-1	A+	1+
Southern California Edison Co.	BBB/Stable/A-2	BBB	1
Southern Indiana Gas & Electric Co.	A-Negative/—	A-	1
Southwestern Electric Power Co.	BBB/Stable/—	A-	1
System Energy Resources Inc.	BBB-/Stable/—	BBB	1
The Peoples Gas Light & Coke Co.	A-/Stable/A-2	A-	1
Toledo Edison Co.	BBB-/Stable/—	BBB-	1
Tucson Electric Power Co.	BB/Watch Neg/—	BBB-	1
Union Electric Co.	A-/Watch Neg/A-2	A-	1
Virginia Electric & Power Co.	A-/Stable/A-2	A-	1+
Westar Energy Inc.	BB+/Positive/—	BBB-	1
Wisconsin Electric Power Co.	A-/Stable/A-2	A-	1
Wisconsin Public Service Corp.	AA-/Stable/A-1+	AA-	1+

Table 6

Bankruptcies of Utilities With First Mortgage Bonds

Company	Year filed	Year emerged	Paid
FMBs			
NorthWestern Corp.	2003	Pending	Yes
Pacific Gas & Electric Co.	2001	2004	Yes
El Paso Electric Co.	1992	1996	Yes
Public Service Co. of New Hampshire	1988	1991	Yes

bonds. In these cases, it is rare for Standard & Poor's to enhance the rating of a first mortgage bond by more than one notch above the CCR. As the default risk increases, post-default recovery becomes more relevant to the credit analysis and the potential for multiple notches above the default rating increases. Accordingly, speculative-grade first mortgage bonds with very good recovery prospects, expected for continuing payments during a bankruptcy, and strong structural provisions in the bond indentures may be notched up a full rating category (three notches) above the CCR.

Standard & Poor's has adopted the following guidelines for notching utility first mortgage bonds above the CCR. As mentioned above, because companies rated 'A' and above have such a remote likelihood of default, the hurdle for justifying a notch-up is higher than that for companies in the lower investment-grade or noninvestment-grade categories.

Special Report

For this reason, it is possible for the secured debt of a highly rated company (e.g., 'A' or higher) to receive a recovery rating of '1' and still not be notched above the CCR (see table 1).

First Mortgage Bond Rating Changes

Standard & Poor's raised its ratings on the utility first mortgage bonds of 20 utility companies based on an updated analysis of ultimate recovery prospects. These rating actions reflect Standard & Poor's high expectations of full recovery of principal for first mortgage bonds, general and refunding bonds, collateral trust bonds, or otherwise designated senior secured debt, in a bankruptcy scenario. Standard & Poor's has also determined that the asset valuations on one utility company does not support the ratings being notched above their CCRs and, consequently, lowered these ratings to the CCR. (See table 3.) No unsecured ratings are affected.

Standard & Poor's will determine whether to upgrade a first mortgage bond for any company whose first mortgage bond rating is on CreditWatch with negative implications when the CreditWatch listing is resolved. Also, a few companies may be missing from the list because of insufficient indenture and collateral information, preventing us from making an ultimate recovery decision at this time. Standard & Poor's has affirmed the CCRs and outlooks for 20 companies, where the first mortgage bonds have been upgraded. A list appears in table 2.

Recovery Rating

Standard & Poor's has also assigned recovery ratings to each of the first mortgage bonds it rates. First mortgage bonds and the underlying assets that secure them differ significantly from typical bank loan ratings. Historically, as noted, the assets have not been subject to liquidation in a bankruptcy nor have the bonds defaulted. Consequently, the recovery ratings assigned to first mortgage bonds differ slightly from the recovery ratings assigned to bank loans. First mortgage bonds that have strong structural provisions and carry an asset value to secured debt ratios of greater than 2 to 1 received a '1+' recovery rating indicating the "highest expectation of full recovery of principal." Structural provisions can include an interest coverage test, a percentage of bondable property test and conservative required collateral valuations. Where the asset values to secured debt ratio equal or exceed 1 to 1, Standard & Poor's assigned its '1' recovery rating, indicating a "high expectation of full recovery of principal." (See tables 4 and 5.) ■

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Utility Comps
Overview

2003 Stats ($ millions)	Group Avg.	PGE	Avista	IDACORP	Puget	Wisconsin Energy	UniSource
Revenues	$1,869	$1,752	$1,123	$823	$2,492	$4,054	$970
Net Income	$95	$56	$51	$52	$122	$246	$45
ROE (Avg.)	7%	5%	6%	5%	9%	11%	5%
Allowed ROE	11%	11%	11%	11%	11%	12%	11%
Dividend yield	4%	N/A	3%	7%	4%	2%	2%
Payout ratio	74%	N/A	53%	115%	76%	35%	92%
Capital Exp.	$251	$167	$106	$149	$286	$659	$137
Pretax int. cov.	1.9x	1.6x	1.9x	1.6x	2.0x	2.8x	1.3x
Debt/total cap.	0.60%	0.50%	0.60%	0.50%	0.60%	0.60%	0.50%