

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UM 1147**

In the Matter of

PUBLIC UTILITY COMMISSION OF
OREGON

Staff Request to Open an Investigation
Related to Deferred Accounting.

**PORTLAND GENERAL ELECTRIC
COMPANY'S REPLY COMMENTS
(PHASE III)**

Portland General Electric Company ("PGE") appreciates the opportunity to submit these Reply Comments. Our reply comments focus on the central issue in this phase of the docket: the appropriate interest rate to be applied against deferred amounts for which amortization has begun. With respect to the other issues addressed in opening comments, PGE requests that the Commission adopt its recommendations for the reasons set forth in PGE's Opening Comments.

I. THE COMMISSION SHOULD REJECT A TREASURY BASED INTEREST RATE AND ADOPT A LONG-TERM RATE

Staff proposes the use of a blended 1-3-5 year Treasury rate (the "Blended Treasury Rate") because according to Staff it "[1] better reflects the risk associated with deferred amounts approved for amortization and [2] is consistent with how a prudent utility could finance these amounts." Staff Opening Comments at 1. Treasury rates, however, are considered by the financial community as a risk-free asset since the probability of default is almost zero. Thus, the proposed Blended Treasury Rate reflects neither the risk associated with deferred accounts nor is it how a prudent utility actually finances, much less could finance, such expenditures.

The specific risk associated with the recovery of utility investments in deferred accounts is reduced after the Commission orders amortization, but it is by no means eliminated. The Oregon Legislature has enacted statutes allowing utilities to issue bonds for conservation program expenditures by essentially guaranteeing recovery of such investments and permitting

bondholders to hold a security interest in the conservation assets. ORS 757.455 and ORS 757.460. No similar guarantee and security interest apply to recovery of deferred amounts generally, even after the Commission has ordered amortization. Indeed, the Commission statutes expressly authorize the Commission to "suspend, rescind, or amend" its orders, including amortization orders, at any time. ORS 756.568.

If the proposed Blended Treasury Rate appropriately reflects investors' expectations regarding risk for amortizing deferred accounts, then the rate for conservation bonds should reflect similar term Treasuries. In fact, when PGE issued conservation bonds in 1996, the interest rate for these bonds, which were secured by conservation assets and backed by Commission-guaranteed recovery provided by law, was 75 to 80 basis points *higher* than the comparable term Treasuries.¹ Treasuries, therefore, fail to capture the risk associated with less risky securitized conservation bonds. It follows, then, that Treasuries necessarily underestimate the much greater risk associated with recovery of amortizing deferred accounts that lack the security and guarantees afforded to conservation bonds.

Bond (or fixed income) and equity investors don't view a return on, or of, their investment as "guaranteed" in any sense. They don't have the option of earmarking their investment dollars specifically to deferred accounts versus any other utility investment, much less the power to elect to invest in deferred accounts only after the Commission orders amortization. Even if shareholders had that power, which they don't, the risk associated with

¹ This proceeding is being conducted as a policy docket with parties submitting comments, not testimony. Nevertheless, the questions raised at this point in the proceedings—what rate of interest reflects the appropriate level of risk, what interest rate will make utilities whole, and what financing opportunities are available and prudent—require a factual foundation. As a result, Staff's opening comments and our reply comments contain various factual statements regarding actual utility financing costs and practices. If the Commission concludes that these factual questions, which must be resolved in this phase, require a contested case format or affidavits, PGE will submit testimony or affidavits in support of the factual statements made in our comments. We note that in Phase I, PGE requested that these proceedings be conducted as a contested case but the Administrative Law Judge elected to hold these proceedings as a policy docket. *See* Status Conference Memorandum, November 5, 2004.

such an investment cannot reasonably be compared with the risk that the United States government will default on its obligations, which Treasuries measure.

Nor does financing deferred accounts with funds at the Blended Treasury Rate reflect actual or prudent utility financing. Utilities must fund operations immediately without delay. Utilities have an obligation to provide customers with safe and reliable energy when, and in the amount, they demand it.² Because we have already spent the funds for necessary operations, we don't have the option of waiting to fund "investments" in deferred accounts until the Commission orders amortization of deferred amounts. When the utility makes investments in deferred accounts, it has no way of knowing how long it will take to recover that investment or whether it will recover the cost.

After amortization has begun, refinancing deferred amounts with funds at the Blended Treasury Rate is also not possible. As a threshold matter, utilities do not refinance their investments in deferred accounts during the amortization period. These deferred accounts have already been funded and there is no reason to refinance them. No one in this docket has cited a single utility anywhere that refinances deferred amounts during amortization or provided any evidence showing why this would be a prudent utility practice.

Most important, even if a utility elected to refinance deferred accounts, borrowing at the Blended Treasury Rate is impossible. Staff appears to recognize that one-year Treasuries are not reflective of the risk profile of utilities, and that utilities have no access to one-year Treasury rates, offering a "premium" through a blended 1-3-5 year Treasury Rate. But such a blended 1-3-5 year "premium" is insufficient to reflect the appropriate level of risk to which utility investors are exposed and the financing costs utilities must incur.

Based on the information Staff provided about the Blended Treasury Rate levels, PGE's actual financing cost for *short-term* debt is approximately 110 basis points *higher* than the

² For PGE, these funds generally come from long-term debt or internally generated funds.

Blended Treasury Rate. In recent years, PGE's short-term financing has been in the form of commercial paper payable anywhere from 1 to 270 days; however, it is typically issued from 1 to 60 days. In December 2006, the weighted average interest rate for PGE's commercial paper issued during the month was 5.48%, and the Blended Treasury Rate as calculated according to Staff's proposal was 4.36%. In August 2007, the weighted average interest rate for PGE's commercial paper issued during the month was 5.85%, and the Blended Treasury Rate as calculated according to Staff's proposal was 4.75%.³ In fact, these substantial differences between PGE's commercial paper rate and the proposed Blended Treasury Rate *underestimate* the actual spread between Staff's proposed Blended Treasury Rate and PGE's comparable borrowing costs because the term for PGE's commercial paper is only between 1 to 270 days, well less than the three-year average for the Blended Treasury Rate or the typical recovery period for deferred accounts. In other words, PGE's actual financing costs for a one- to three-year term would be higher than PGE's commercial paper rates identified above.

None of the parties supporting a Blended Treasury Rate offer any evidence that such a rate will make utilities whole for their investments in deferred accounts, which the final order in Phase II identified as an appropriate test. PGE's experience with short-term financing shows that a Blended Treasury Rate will not.

Finally, it is noteworthy that the use of a Blended Treasury Rate will harm, not benefit, PGE's customers. In PGE's current deferred accounts, PGE owes customers more than customers owe PGE. As of August 2007, deferred amounts in regulatory assets (for which customers owe PGE) equal approximately \$51 million whereas deferred amounts in regulatory liabilities (for which PGE owes customers) equal approximately \$69 million. *See* Exhibit 1 to PGE's Opening Comments. Reducing the interest rate applicable to deferred amounts to levels

³ These two dates (December 2006 and August 2007) are the only two data points for which comparable data are available. Before 2006, PGE did not issue short term debt or commercial paper for a considerable period of time.

unavailable to PGE, and clearly unavailable to our customers, will cause a reduction in the interest income customers earn on PGE's regulatory liabilities. This loss in interest income to customers is greater than the offsetting loss in interest income to PGE on PGE's regulatory assets.

PGE recommends that the Commission adopt a long-term interest rate, such as the utility's embedded long-term cost of debt or the Blended Treasury Rate plus a spread, as the appropriate standard. A long-term rate reflects the utility's actual financing costs and is readily verifiable and transparent. If the Commission rejects a long-term debt interest rate and adopts an interest rate based on the Blended Treasury Rate, the Commission should add a spread of at least 150 basis points in order to reflect the actual financing costs associated with utility investments in deferred accounts.

II. CONCLUSION

PGE appreciates the opportunity to participate in these proceedings and submit written comments. PGE respectfully requests that the Commission adopt policies in this phase consistent with PGE's recommendations in its opening and reply comments.

DATED this 3rd day of October, 2007.

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CERTIFICATE OF SERVICE

I hereby certify that on this day I served the foregoing **PORTLAND GENERAL ELECTRIC COMPANY'S REPLY COMMENTS (PHASE III)** by e-mail or by mailing a copy thereof to each party that has not waived paper service, in a sealed, first-class postage prepaid envelope, addressed to each party listed below and depositing in the US mail at Portland, Oregon.

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DATED this 3rd day of October, 2007.



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