STATE OF OREGON
OREGON PUBLIC UTILITY COMMISSION

	)	
Pole and Conduit Attachments	)	Docket No. 860-028-0020
	)	

COMMENTS OF THE NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION ON BEHALF OF THE OREGON RURAL ELECTRIC COOPERATIVE ASSOCIATION

The National Rural Utilities Cooperative Finance Corporation (CFC) hereby files its comments on behalf of the Oregon Rural Electric Cooperative Association (ORECA) in the above referenced docket. CFC's comments are limited to the cost of capital method(s) that should be applied to cooperatives in the determination of rates for Pole and Conduit Attachments in this docket.

I. Description of CFC and its Interest

CFC's exact name is National Rural Utilities Cooperative Finance Corporation and it principal place of business is 2201 Cooperative Way, Herndon, Virginia, 20171-3025. CFC requests that the following persons be included on any official service list, upon whom service is to be made and to whom communications are to be addressed in this proceeding:

Mr. William K. Edwards
Vice President of Regulatory Affairs
National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, Va. 20171-3025
Telephone: (703) 709-6809

Facsimile: (703) 709-6778
Email: bill.edwards@nrucfc.coop

CFC is a private, not-for-profit cooperative association incorporated under the laws of the District of Columbia in April 1969. The principal purpose of CFC is to provide its members with a source of financing to supplement the loan programs of the Rural Utilities Service ("RUS") of the United States Department of Agriculture. CFC makes loans to its rural utility system members ("utility members") to enable them to acquire, construct and operate electric distribution, generation, transmission and related facilities. CFC also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations.

The Company's consolidated membership was 1,547 as of May 31, 2006 including 898 electric utility members, the majority of which are consumer-owned electric cooperatives, 514 telecommunications members, 67 service members and 68 associates in 49 states, the District of Columbia and two U.S. territories. The utility members included 829 distribution systems and 69 generation and transmission ("power supply") systems.

Set forth below is a table showing loans outstanding to borrowers and the weighted average interest rates thereon and loans committed but unadvanced to borrowers by loan program and by segment at May 31st of the years shown in Table 1 below.

Table 1
CFC's Outstanding Loans

(Dollar amounts in thousands)	2006 Loans outstanding and Weighted average interest rates thereon		2006 Unadvanced Commitments	2005 Loans outstanding and weighted average interest rates thereon		2005 Unadvanced Commitments
Total by loan type:						
Long-term fixed rate loans	$ 14,546,850	5.76%	$ -	$ 12,724,758	5.52%	$ -
Long-term variable rate loans	2,524,722	4.78%	6,146,618	4,961,397	4.47%	5,537,121
Loans guaranteed by RUS	261,330	5.50%	591	258,493	5.16%	8,491
Intermediate-term loans	5,605	7.43%	21,741	10,328	5.91%	25,714
Line of credit loans	1,022,398	6.38%	6,610,963	1,017,092	4.75%	6,122,693
Total loans	18,360,905	5.66%	12,779,913	18,972,068	5.19%	11,694,019
Less: Allowance for loan losses	(611,443)		-	(589,749)		-
Net loans	$ 17,749,462		$ 12,779,913	$ 18,382,319		$ 11,694,019
Total by segment:						
CFC:						
Distribution	$ 12,859,076	5.61%	$ 8,905,434	$ 12,728,866	5.05%	$ 8,821,217
Power supply	2,810,663	5.97%	2,635,502	2,640,787	5.72%	2,059,350
Statewide and associate	124,633	6.72%	110,839	135,513	5.58%	124,539
CFC total	15,794,372	5.68%	11,651,775	15,505,166	5.17%	11,005,106
RTFC	2,162,464	5.26%	550,990	2,992,192	5.21%	518,514
NCSC	404,069	6.84%	577,148	474,710	5.96%	170,399
Total	$ 18,360,905	5.66%	$ 12,779,913	$ 18,972,068	5.19%	$ 11,694,019

The Company's loan portfolio is widely dispersed throughout the United States and its territories, including 48 states, the District of Columbia, American Samoa and the U.S. Virgin Islands. At May 31, 2006, 2005 and 2004, loans outstanding to borrowers located in any one state or territory did not exceed 16%, 16% and 18%, respectively, of total loans outstanding. CFC's goal as a private not-for-profit cooperatively-owned finance company is to set rates at levels that will provide its members with the lowest cost financing while maintaining sound financial results as required to obtain high credit ratings on its debt instruments. CFC sets its interest rates primarily based on its cost of funding, as well as general and administrative expenses, the loan loss provision and a reasonable net margin. Various discounts, which reduce the stated interest rates, are available to borrowers meeting certain criteria related to business type, performance, volume and whether they borrow exclusively from CFC.

CFC provides cooperatives with a comprehensive portfolio of versatile financial products. Long-term loans are generally for terms of up to 35 years and can be either amortizing or bullet loans with serial payment structures. These loans finance electric plant and equipment, which typically have a useful life equal to or in excess of the loan maturity. A borrower can select a fixed interest rate for periods of one to 35 years or a variable rate. Upon the expiration of the selected fixed interest rate term, the borrower must select the variable rate or select another fixed rate term for a period that does not exceed the remaining loan maturity.

To be eligible for long-term loan advances, distribution systems generally must maintain an average modified debt service coverage ratio ("MDSC"), as defined in the loan agreement, of 1.35 or greater. It is important to understand that the 1.35 MDSC is a minimum coverage ratio and not an acceptable return. The distribution systems must also be in good standing with CFC and their states of incorporation, supply evidence of proper corporate authority, deliver to CFC annual audited financial statements and an annual compliance certificate and be in compliance with all other terms of the loan agreement.

Line of credit loans are generally advanced only at a variable interest rate. The line of credit variable interest rate is set on the first business day of each month. The principal amount of line of credit loans with maturities of greater than one year generally must be paid down to a zero outstanding principal balance for five consecutive days during each 12-month period. To be eligible for a line of credit loan, distribution and power supply borrowers must be in good standing with CFC and demonstrate their ability to repay the loan.

Interim financing line of credit loans are also made available to CFC members that have a loan application pending with RUS and have received approval from RUS to obtain interim financing. CFC anticipates that advances under these interim facilities will be repaid with advances from RUS long-term loans.

CFC is vitally interested in the health of its member systems of which the return on debt and equity are integral. Table 1 illustrates that during its last fiscal year, CFC had total loans outstanding to electric distribution cooperatives of $12.8 billion and G&T loans of $2.8 billion. In Oregon, CFC had loans outstanding in fiscal 2006, 2005, and 2004 in the amounts of $306 million, $314 million, and $311 million respectively. CFC, therefore, has a large interest in the welfare of the Oregon cooperatives.

II. The Need For An Adequate Return

Cooperatives are unique entities that share certain attributes with municipal utilities and public utility districts, and certain attributes with investor owned utilities. Although cooperatives are owned by those they serve, the structure is less like a municipal and more like that of an investor owned utility from a financing perspective. A cooperative is not a governmental entity, it borrows money at given interest rates; however, it also raises equity capital in the form of patronage capital from its members in order to invest in utility plant and equipment. On average, the equity ratio of cooperatives is close to 47%. Therefore, we concur with the Oregon Joint Use Association (OJUA) August 21st comments to the extent that the rate of return for a cooperative should express both the weighted cost of debt and equity.

The cost of debt is the average of the utility's embedded cost of debt as of a specific date. This is similarly calculated by most utilities.

Cooperatives raise equity capital by the retention of margins. This equity represents the equity ownership of the cooperative's members who are the cooperatives retail customers. These margins are held by the cooperative as patronage capital and then returned to the cooperative's member pursuant to a schedule determined by the cooperative's board of directors. Because this equity is invested in plant and equipment, there is a cost of equity associated with its return that should be computed with the debt cost to reflect the weighted cost of capital, or money. Hence, cooperatives do have a cost of equity that needs to be considered in the ratemaking process. The equity owners have made an investment in their own cooperative, and have accepted the risks of equity owners. However, the facts surrounding service to non-members and the equivalence of customers and equity owners raise conceptual questions as well as questions of measurement as to what that equity cost should be.

Although the vast majority of operating revenues in a cooperative are derived from sales to its members, certain sales for resale and miscellaneous revenues (e.g. transmission revenues, or pole and conduit attachment revenues) can come from non-members. With respect to sales to non-members, the cooperative's equity owners (which are also retail customers) are similarly situated to investors in an investor owned utility. CFC suggests to the Commission that they should receive a return on their equity like that of an investor in the investor owned utility for use by third party non-members. They have made the required investment and have assumed the risks associated with building and owning an electric distribution system principally for their own use. In the case for pole and conduit attachment service, they are willing to open their system to third parties who have made no investment in the system and have assumed no risks of ownership, but are seeking economic gain through the use of the cooperative's assets. In these circumstances, to restrict a cooperative to a cost of equity required for the return of patronage capital (or less) would be inconsistent with the traditional Hope and Bluefield standards since it fails to compensate the cooperative member-owners for the risks they have assumed, and may be confiscatory. To somehow treat cooperative investors materially different from other investors is both discriminatory and unfair.

Although cost of capital methods exist that permit an estimation of the cost of equity for a cooperative in this situation, for the purpose of expediency and the minimization of conflict, we suggest that the commission use as a proxy for the cooperative's cost of equity for the purpose of pole and conduit attachment service (or any other service where the cooperative provides service to non-members), either: (1) the most recent cost of equity allowed by the Commission for an investor owned utility, or (2) an average of the most recent cost of equity for the investor owned utilities under the jurisdiction of the commission.

CFC appreciates and thanks the Commission for the opportunity to file comments in this docket on behalf of ORECA. The determination of the appropriate cost of equity is challenging for all parties in any docket, and the cost of equity associated with a cooperative can, under these circumstances, create special challenges.