Portland General Electric
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August 24, 2018

Via Electronic Filing
puc.filingcenter@state.or.us

Public Utility Commission of Oregon
Attn: Filing Center
PO Box 1088
Salem OR 97308-1088

Re: UI 405 - Portland General Electric Company's Reply to Staff Public Meeting Memo

Filing Center,

Enclosed for filing in the above captioned docket are PGE's comments in reply to Staff's Public Meeting Memo for the Public Meeting being held August 28, 2018.

Thank you,

Stefan Brown
Manager, Regulator Affairs

SB: np

PGE Reply to Staff Public Meeting Memo
UI 405

PGE appreciates Staff's effort to evaluate the proposed affiliated interest transaction within the requested timeline. PGE offers the following comments in reply to Staff's Public Meeting Memo.

PGE agrees with Staff's recommendation that the Commission approve PGE's Application Requesting Approval of an Affiliate Interest Transaction with 121 SW Salmon Street Corporation (121 SW Salmon). PGE also agrees to the three conditions specific to that recommendation:

1. The Company shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to any transactions with 121 SW Salmon.

2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or alternative form of regulation.

3. PGE shall notify the Commission in advance of any substantive changes to the lease agreement, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

In addition, PGE agrees that a Commission decision in this docket would not involve setting retail prices but would only relate to approval of the proposed lease agreement between PGE and 121 Salmon for the occupancy of the World Trade Center complex (WTC). PGE's prices, as they relate to this lease agreement, would be determined in PGE's next general rate case.

Staff's memo, however, does not solely address the proposed lease agreement. Staff also evaluates the purchase of the WTC by 121 Salmon, even though the WTC has never been in PGE's regulated rate base. Based on their evaluation, Staff makes additional assertions and recommendations. PGE believes that Staff's analysis and the assumptions used in that analysis are flawed and should be disregarded for the following reasons:

The proposed lease agreement will allow PGE to continue its uninterrupted occupancy of the WTC at an annual lease rate that remains unchanged from current levels and is well below current market rates. Absent Commission approval of the proposed lease agreement, PGE would simply continue its occupancy of the WTC at the existing Commission-approved sublease agreement with 121 Salmon. This means that for customers, the existing sublease and proposed new lease between PGE and 121 Salmon will entail the same below-market cost for the same length of time. Staff is incorrect in noting that "Under PGE's assumptions, the optimal choice for ratepayers was to purchase through an affiliate."[1] In short, both the current sublease or new lease provide identical beneficial outcomes for customers.

[1] Staff Memo, UI 450, page 3.

PGE customers benefit from the below-market lease rate, which currently reflects a 50% reduction, relative to the prior lease rate, that will be valid for 25 years beginning October 2018. This reduced lease rate, however, came about solely because PGE shareholders have assumed all the market and occupancy risk for the WTC during the initial 40-year sublease agreement and would continue to do so in the same manner under the new lease agreement. At no time during the existing sublease have the customers borne any of the market or occupancy risk nor would the customers bear any such risk under the new lease agreement. Instead, customers have received the benefit of stable, below-market costs over a prolonged period of time (previous 40 years) followed by significantly-reduced, stable, below-market costs over a prolonged period of time (subsequent 25 years). In addition, and as stated above, customers will receive this benefit equally with either the new lease agreement or with a continuation of the existing sublease agreement.

Staff, however, does not limit their analysis of the proposed affiliated interest transaction based on the costs and benefits associated directly therewith. Instead, Staff also introduces elements of 121 Salmon's purchase of the WTC and incorrectly imputes additional benefits to PGE customers. Their process can be summarized as follows:

- A cost-based lease rate[2] would be significantly higher than the current/proposed lease rate between PGE and 121 Salmon. This is also indicative of the benefit that PGE customers are deriving and would continue to derive from either the existing sublease or proposed new lease agreement (i.e., the current/proposed lease rate is both below-market and below-cost).
- Staff, however, modifies the cost-based analysis by introducing a "terminal value" that is "equal to the expected market value, less any related sale costs."[3] Staff calculates the "terminal value" as the current market price (based on Multnomah County Property Tax Records) escalated at two percent annually until the end of the 25-year lease. Introducing the "terminal value" is extremely inappropriate for the following reasons:
  - Staff assumes that the current market value will hold and escalate consistently for 25 years. Staff has no basis or expertise for making such a prediction.
  - The low purchase price (which would allow for the assumed gains to Staff's "terminal value") only exists because it is encumbered by the current lease agreement under which PGE shareholders have assumed all the market and occupancy risk for the length of the lease. The sole alternative for the WTC owner is for 121 Salmon to continue with the current low-rate lease for an additional 25 years.

[2] A cost-based lease rate would reflect the purchase price of the WTC and associated financing costs.
[3] Staff Memo, UI 450, page 7.

  - Terminal value is an ownership concept. No lease rate, whether cost- or market-based, will include a "terminal value" because: 1) the party assuming all the risk will legitimately record that benefit, but only if and when it is realized; and 2) no proper accounting specifies the calculation or recording of such gains before they are realized.
  - Under the existing and proposed agreements, the WTC has never been, and would not be, in PGE's rate base. Consequently, customers would have no claim to any potential terminal value.
  - Staff explains that including a "terminal value" in their analysis is appropriate because "An investor evaluating a *short term* purchase of a property will include the future sale value of the property in the financial analysis" (emphasis added).[4] Because the purchase of the WTC by 121 Salmon will entail a 25-year lease between PGE and 121 Salmon, the transaction is long-term in nature.
- Staff also incorrectly adjusts PGE's cost-based analysis by using PGE's current debt cost rather than PGE's overall cost of capital. This is inconsistent with other PGE analyses, which assume no change in capital structure to finance significant expenditures.

The only basis under which the <u>realized</u> gains, if any, of the sale of the WTC could apply to customers would be for PGE to purchase the complex and the Commission authorize the asset be placed into rate base. PGE would be agreeable to this alternative. However, if the WTC were placed in rate base in PGE's next general rate case, the eventual gains to customers would arguably need to be prorated to at most 38.5% of the total because:

- The low purchase price exists because of the transaction that PGE originated 40 years ago and from which PGE assumed all the market and occupancy risk since then.
- Customers will have contributed at most only 25 (2018 – 2043) of the 65 years (1978 – 2043) of bearing risk.

In summary, Staff's derivation of additional benefits is incorrect. PGE shareholders <u>alone</u> have assumed all the market and occupancy risk associated with the WTC. Because PGE customers have derived, and will continue to derive, the benefit of stable, below-market lease rates over the life of the lease agreements (i.e., for 65 years), there is no legitimate reason for Staff to capture additional benefits based on assumed, unrealized gains from some hypothetical sale 25 years in the future. It is even more inappropriate for Staff to suggest that this standard should apply whether PGE continues to sublease the WTC from 121 Salmon or PGE leases the WTC pending a 121 Salmon purchase of the complex.

[4] Ibid.

For these reasons, PGE requests that the Commission approve the proposed affiliated interest agreement as supported by Staff, but disregard Staff's additional recommendations because they are incorrect and flawed.

/s/ Stefan Brown
Manager, Regulator Affairs