



Oregon

Theodore R. Kulongoski, Governor

Public Utility Commission

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Filing Center
Public Utility Commission of Oregon
550 Capitol Street NE, #215
PO Box 2148
Salem, Oregon 97301

Re: Docket No. UE 180 – Errata Filing

Dear Filing Center:

Enclosed for filing are five pages that replace staff testimony in this case.

The pages and a brief description of the changes are:

Staff/1000, Morgan/25; the last sentence on the page was removed.

Staff/1003, Morgan/24; the footnote referenced incorrect testimony and page.

Staff/1003, Morgan/34; the second two sentences in the second paragraph were removed.

Staff/1003, Morgan/35; the letter “A” on the sixth line of the first paragraph was removed.

Staff/1003, Morgan/41; the word “its” was changed to “their” on the second to last line of the page.

The replacement pages will be sent to the parties in this case.

Sincerely,

Judy Johnson

Program Manager

Electric and Natural Gas

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cc: Service List

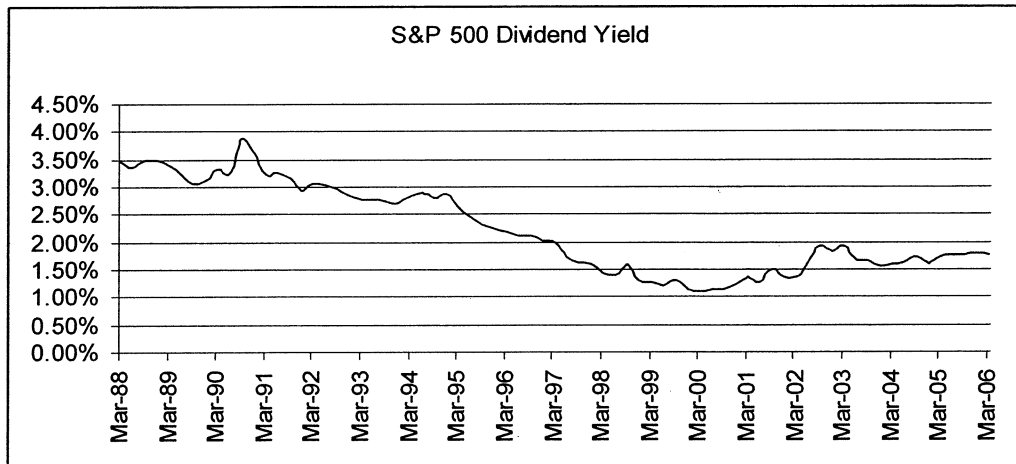


1 Capital market conditions, not regulatory decisions, determine
2 a utility's cost of equity. While we agree that regulatory
3 agencies generally make every effort to capture those market
4 conditions, a review of past decisions cannot replace an
5 independent analysis of current market conditions and how
6 they affect the particular utility. Moreover, ROE
7 determinations are made not just in the traditional rate cases,
8 but also in a range of other proceedings, such as industry
9 restructuring plans, merger approval cases, or performance-
10 based regulatory plans. Thus, the ROE awards may have
11 been based, in part, on other unknown parameters relevant in
12 that particular docket.

13 The Commission correctly rejected the generic analysis of determining
14 ROE based upon other state commission rulings and they should again reject
15 the Company's request to establish circular ROE decisions that do not consider
16 current market conditions.

17 **Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING THIS RISK-**
18 **POSITIONING MODEL?**

19 Yes. First, the model suggests that interest rates experienced in the early
20 1980's are going to re-occur in the future. The interest rates during the early
21 1980's were extremely high. This is clearly problematic considering that
22 interest rates are, and are expected to remain, at much lower levels than much
23 of the period analyzed by this model. Since there is evidence that the risk
24 premium varies with interest rates, using a period that contains wide variations
25 in interest rates may weaken the results of the analysis.

1988-2006 S&P 500 Dividend Yield Trend**Forecast GDP Growth**

Looking forward, for the period from now through 2030, the expected annual growth rate in real GDP is expected to be about 2.5 to 3.0 percent.²³ If we assume a 2.0 to 2.5 percent inflation rate over that period²⁴ total GDP growth would be above 4.5 percent and no greater than 5.5 percent, significantly lower than the 6.757 percent growth the Company's historic analysis calculates for GDP growth on a looking-forward basis.

This high growth, if applied to the utility industry, would be inconsistent with the past, and the Company does not include a discussion of the divergence from earnings growth for the earnings growth for individual companies and that from the overall economy. The company appears to imply that there is no difference.

²³ See the Annual Energy Outlook with Projections to 2025 from the USA Dept. of Energy, on Page 2, "Economic Growth" at <http://www.eia.doe.gov/oiaf/aeo/index.html>. Also see Welch's (1998) survey of leading professors and financial economists. The results of Dr. Welch's survey indicate that the highest long-run growth forecasts for real gross domestic product are on the order of 2.5% per year.

²⁴ Support for which is included in my discussion of growth. See Staff/1003 Morgan/51.

statistic that is calculated over a historic period of time and therefore assumes that the period analyzed will be representative of the future forecast.

Other, qualitative factors may include the amount of non-regulated activities, the historic regulator-company relationship and bond ratings.

The following excerpt is from the State of Oregon's Savings Growth Plan and provides insight into investor risk:

"Investors typically associate the term "risk" with market risk, meaning the possibility that a particular investment may fluctuate in value... It seems much easier to assume market risk in investing when the market is performing well, because the reality of the market risk we are assuming may not be apparent. Today's market shows the true meaning of market risk in investing."³⁴

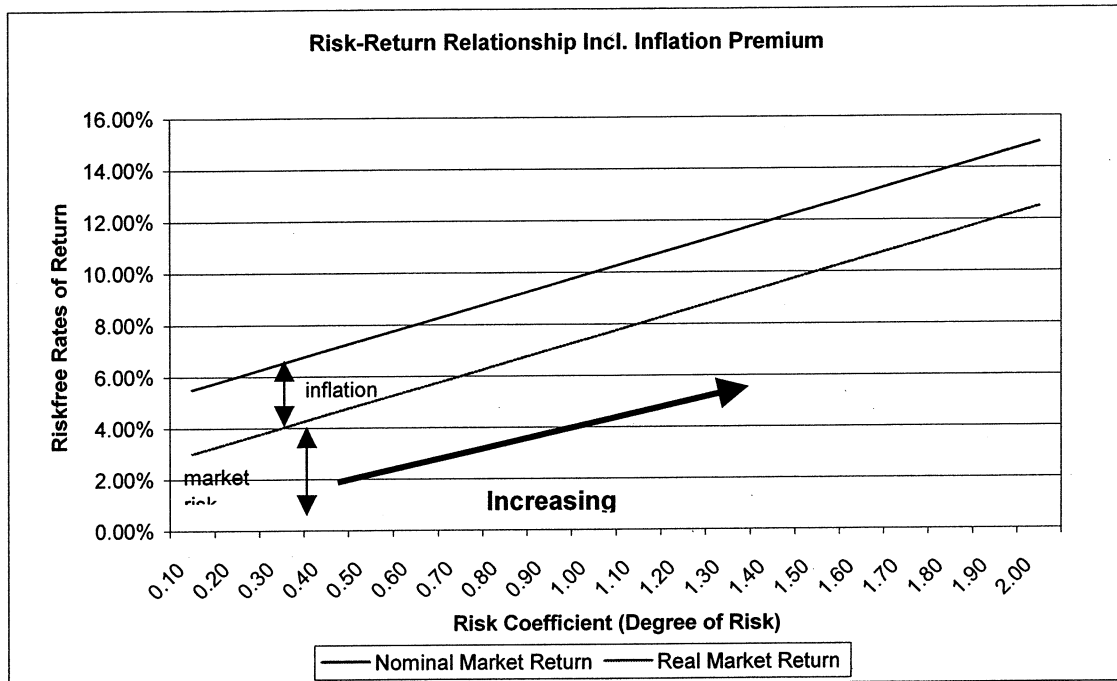
Further, the Bluefield Waterworks decision provided insight into the volatility of earnings and the impact on the perception of risk:

"Investors take into account the result of past operations, especially in recent years, when determining the terms upon which they will invest in such an undertaking. Low, uncertain, or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors."³⁵

The following table provides a graphic representation of the dynamics of the risk-return tradeoff that underlies financial analysis:

³⁴ Plan Update, Oregon Savings Growth Plan, Winter 2003

³⁵ Bluefield Water Works Co. V. Public Service Commission, 262 U.S. 679 (1923)



Bond ratings measure the potential of default on the underlying debt held by a company. Most pure play public utilities, for instance, have been able to maintain strong investment-grade ratings, which helps these companies attract borrowed capital on reasonable terms. As a measure of risk, bond ratings can be considered to capture the inherent impact of both systematic and unsystematic risk. The rating will last as long as rating agencies have confidence in the regulatory climate in which the Company operates.

An additional component that can be considered is the level of Regulatory Risk. Oregon has a favorable regulatory environment that responds quickly to changing market conditions that affect its regulated enterprises. Strong regulatory support is considered very favorable in the market:

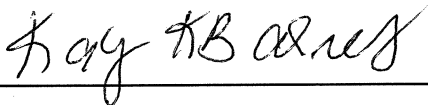
"Other states' regulatory bodies may also be very adept at providing quick and fair revenue relief in changing times. Research has

CERTIFICATE OF SERVICE

UE 181/UE 181/UE 184

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to the following parties or attorneys of parties.

Dated at Salem, Oregon, this 25th day of August, 2006.



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UE 180
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