

**REPORT ON THE PROPOSED
WILLAMETTE ELECTRIC PEOPLES' UTILITY DISTRICT
BY THE
OREGON DEPARTMENT OF ENERGY
JUNE 22, 2004**

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Introduction

This is the Oregon Department of Energy's report on the proposed Willamette Electric People's Utility District (PUD). Under ORS 261.151, the Department of Energy must hold a hearing and issue a report not less than 30 days and not more than 60 days after receipt of a petition to form a PUD.

The statute provides that the report should be concise and should address the availability and cost of power or water resources, potential tax consequences and any other information relevant to the proposed formation of the PUD. In preparing the report, the Department of Energy is to obtain the advice and the assistance of the Public Utility Commission. A copy of the report is to be provided to the county governing body.

This report is not intended to take the place of a detailed feasibility or engineering study. The time provided by law for the Department of Energy to conduct a hearing and to issue a report precludes a more in-depth analysis which an engineering study or a detailed feasibility study could provide. Upon completion of this report the Department of Energy has no further role in this process.

The Department of Energy consulted with the Public Utility Commission in the preparation of this report as required by law. The contents and conclusion of the report, however, are solely those of the Department of Energy. The Public Utility Commission provided a letter through its Assistant Attorney General on a prior PUD proposal, which it also submitted in this proceeding. The letter discusses the role of the Commission to protect regulated ratepayers in the event of an attempted condemnation by a publicly-owned utility of utility property owned by an investor-owned utility. A copy of that letter is included as an attachment to this report.

Background

A petition to form the Willamette Electric PUD was filed with Multnomah County, certified by the county and received by the Department of Energy on April 29, 2004.

The proposed area of the PUD would include a small portion of Northeast and Southeast Portland. The area of the proposed PUD is generally bounded by the Willamette River on the West, the Steel Bridge, Oregon Street and Lloyd Boulevard on the North, as far as 52nd Street on the East, and Holgate Street on the South. A complete description of the boundary is attached as an appendix to this report.

Currently, the electricity providers in Multnomah County covered by the proposed PUD are Portland General Electric (PGE) for most customers and PacifiCorp for a few customers. PacifiCorp also has some substations and other facilities in the area which would be covered by the proposed PUD.

Pursuant to ORS 261.113, the PUD chief petitioners also propose the question of whether the proposed PUD would be authorized to impose a one-time special levy of 3 mills per one thousand dollars of assessed valuation (equal to \$3 per million of assessed valuation) to finance an engineer's report and the election under ORS 261.355(1)

Summary of the Hearing

The Department of Energy held a hearing on June 15, 2004, at the Children's Service Center Building in Portland, Oregon. Approximately, 50 people attended the hearing. Twenty-four people testified at the hearing. A list of those who testified is attached.

In addition, written comment was accepted through Friday, June 18, 2004. Nearly thirty written comments were received. A list of those who provided written comments is also attached.

Supporters of the proposed PUD explained the purpose of forming a PUD and their reasons for supporting it. These reasons included, among others, the following:

PUD supporters believe that there are many advantages which would result from local control over electricity service which a PUD would provide; there are potential advantages in the price of electricity through access to BPA power; there are reduced operating costs by a PUD being a non-profit governmental entity; and there are tax savings to the customers of a PUD from the absence of corporate income taxes which a PUD would not have to pay. In addition, the PUD supporters believe that the PUD could acquire through condemnation any generating and distribution assets it needed to serve its load. They also believe that the absence of privately-held stock would assure that decisions made by a PUD on electricity service are made only with the interests of consumers in mind.

The PUD supporters also believe that the PUD would have financial advantages over an investor-owned utility by being able to issue tax-exempt bonds and to acquire resources through condemnation at "book value". In addition, they believe that removing PGE ratepayers from the Enron corporate entity is in the interests of electric ratepayers and consumers. In the case of PGE, PUD proponents believe that a

bankruptcy court could order sale of PGE assets to pay off Enron creditors and that the interest of ratepayers would not be considered in such a sale. They also believe that questions of funds withheld for income taxes but not paid by Enron provide additional reasons to form a PUD. They also believe that the pending sale of PGE to the Texas Pacific Group would be no better than ownership by Enron.

Opponents of the proposed PUD also provided a number of reasons for their opposition. These reasons included, among others the following:

PUD opponents expressed concern about the impact of forming a PUD on PGE customers who are not in the area covered by the proposed PUD; and the impact on the local economy of replacing a private business with a governmental entity including loss of tax base, elimination of private sector jobs, loss of charitable contributions, loss of public purpose funding and other adverse impacts. PUD opponents also believe that forming a PUD sends an anti-business message by replacing a private business with a governmental entity; and the PUD would lack independent regulatory oversight which the Oregon Public Utility Commission currently provides over investor-owned utilities.

Those opposing formation of the PUD also stated that they believed it was unlikely that a new PUD would have access to BPA power at less than market rates; and that the PUD would need to incur a large amount of indebtedness to acquire utility assets. They also expressed concern about the likelihood that a new PUD would have to acquire resources on the volatile open market, which could result in higher rates. They also believe that a PUD does not have condemnation authority over generating power facilities. Concern was also expressed that there would be insufficient private activity bond authority available for a new PUD to issue tax-exempt bonds to finance the acquisition of utility assets needed to provide electric service.

In addition, they believe that the PUD is so small that the technical problems in breaking off the PUD from PGE's system would be extremely difficult and expensive. In fact, PGE argues that because the PUD area is so small and based solely on political boundaries that it would be more difficult to separate electrical systems and transmission lines than forming a county PUD would have caused.

Discussion of Major Issues

Access to BPA Power

Consumer-owned utilities in the Northwest, including PUDs, have traditionally had access to wholesale power from the Bonneville Power Administration (BPA). In the past, such utilities have usually had the option to contract with BPA for as much power as they have needed.

It is not clear whether the proposed slice agreement will be adopted by BPA, but it is likely that BPA will have difficulty in acquiring additional low-cost resources to serve a new load formed by a new PUD. Moreover, BPA's wholesale rates have increased

substantially in the last few years as a result of supply and price problems in the wholesale market. These factors make it difficult to determine whether any substantial rate benefit would occur if a new PUD had access to BPA power for a substantial part of its resource load.

Access to BPA power at BPA's lowest cost-based rate is also uncertain. Currently until October 1, 2006, any new publicly-owned utility would have access to BPA power at prices above BPA's lowest cost-based rate. The higher rate charged by BPA is intended to reflect the additional costs of serving new utility customers. BPA is also considering alternative pricing policies that could affect the price at which a new PUD could buy power from BPA.

Acquisition of Other Resources

ORS 261.305 provides that people's utility districts have the power "...to acquire, develop, and otherwise provide for a supply of water for domestic and municipal purposes, waterpower, and electric energy, or electric energy generated from any utility, and to distribute, sell, or otherwise dispose of water, water power, and electric energy within or without the territory of such districts."

While a PUD can provide either water or electricity service, the PUD proponents indicated that their intent at this time is to provide electric service. The information provided by people who spoke at the hearing both in favor and against formation of a new PUD dealt only with issues regarding electric service.

PGE and PacifiCorp oppose the formation of a PUD in its service areas. Both PGE and PacifiCorp indicated that they would not willingly sell or transfer their facilities, including generating resources and distribution assets, to a new PUD. Thus, the PUD would be required to acquire assets from PGE and PacifiCorp through condemnation. In the absence of agreement between the new PUD and PGE or PacifiCorp, a court would need to determine the value of any property acquired by the new PUD through condemnation.

Valuation of such assets would require a detailed engineering and appraisal study. In addition, while the PUD proponents believe that a PUD would have authority to acquire power generating resources through condemnation, both PGE and Pacific dispute that the PUD would have such authority. Resolution of the limits of PUD condemnation authority would likely also require a determination by a court.

If the new PUD did not try to acquire PacifiCorp's or PGE's generating assets, it could purchase power on the open market or finance new generating facilities. The open market is very volatile and the price of power, especially for long-term contracts, is very uncertain. The costs of financing new generating resources directly by a PUD are also uncertain. Issuance of bonds by a PUD poses a number of questions requiring further study. These include whether bonds would be tax-exempt or taxable, at what cost such

bonds could be issued, the impact on other public debt issued by state and local governments in Oregon and other issues.

The PUD supporters offered a preliminary feasibility study prepared by D. Hittle and Associates for the recently proposed Clackamas PUD as evidence that a new PUD would be able to become operational, acquire energy resources and could operate at lower rates than PGE. PGE in response offered a study by Sam Van Vactor of Economic Insight, Inc., indicating that a new PUD would likely be unable to acquire power without paying substantially more than PGE now pays to provide service to its existing customers.

To assure that energy conservation and renewable resources play a key part of resource acquisition by Portland General Electric and PacifiCorp, Oregon's restructuring law provides that these two investor-owned utilities pay a 3% public purpose charge to fund energy conservation, renewable resources and other public purposes. A new PUD would not be obligated to pay this 3% public purpose charge. However, the PUD may choose to fund through its rates an equivalent amount of energy conservation and renewable resources, although it would not be required by law to do so. Some publicly-owned utilities dedicate more than 3% to energy conservation and renewable resources; while others pay less.

The disagreements, uncertainties and questions cannot be easily answered without a detailed financial analysis of different scenarios, and an analysis of which scenarios are most likely to bound the range of uncertainty. The analysis required to answer these questions is beyond the scope of this report and cannot be undertaken in the time provided by law to complete this report.

Tax Consequences

Under Oregon law, a PUD has the power to issue revenue bonds (ORS 261.355) and general obligation bonds (ORS 261.360) upon receiving voter approval. Revenues from the bonds may be used for any purpose authorized by law. General obligation bonds must not exceed two and one-half percent (.025) of the real market value of all taxable property within the district.

ORS 261.385 provides that a PUD may also levy and collect property taxes prior to receipt of operating revenues. In any one year, the tax cannot exceed one-twentieth of one percent of the true cash value of all taxable property within the PUD. Over 10 years, the tax cannot exceed in the aggregate one-fourth of one percent of the true cash value of property within the PUD.

A PUD may have access to tax-exempt bond financing for capital acquisition and possibly for some operating costs. Current federal limits on state and local tax-exempt financing make it difficult to determine to what extent a new PUD could use tax-exempt bonds for its financing. Moreover, the U.S. Treasury continues to seek further

restrictions from Congress on the use of tax-exempt bonds by state and local governments, making the future access to this form of financing uncertain.

Taxable bonds, which incur higher interest charges than tax-exempt bonds, could also be issued by a new PUD, but whether they would be less expensive than the current costs of capital of PGE and PacifiCorp is uncertain, given the long history of access to the capital markets of both utilities with a variety of financial instruments.

A PUD pays no state or federal income taxes, but a PUD is subject to property tax assessment under ORS 261.050 to the same extent as property of an investor-owned utility is taxed.

Conclusion

In order to fully evaluate the economic advantages and disadvantages of forming a new PUD, many questions must be analyzed thoroughly. There are also factors which could vary greatly and have significant impact on whether a PUD would have access to a supply of power at reasonable rates. For example, whether a new PUD would have access to BPA power to meet most of its load, how much BPA rates will increase, whether a PUD could condemn PGE's or Pacificorp's resources and if so, at what price, what the cost of financing capital for a new PUD would be and to what extent tax-exempt bonds could be used are all factors which could impact the cost of electric service by a new PUD compared to the cost of service currently provided.

In addition, non-economic questions, such as the value of local control, the benefits of private enterprise, the role of government and other issues involving value judgements as well as economic considerations must be examined. Many of these issues were raised and discussed at the hearing and in the written comments filed in this record.

The resolution of the questions raised and the differing perspectives and differing opinions cannot be readily resolved, without more extended study and analysis of these issues. Questions such as the valuation of utility property, what utility property is subject to condemnation, access to BPA power, and the availability or lack of tax-exempt financing are all complex issues requiring extended review and analysis.

Because these issues require extensive investigation and analysis to resolve, no definitive conclusion as to the impact on rates of forming a PUD can be made under the limited time provided by state law to issue this report. In addition, other questions such as the role of private businesses compared to a publicly-owned utility system present value judgements for the voters.

The Department of Energy makes no recommendations as to whether the proposed Willamette Electric PUD should or should not be formed. That is a decision for the voters to make, after evaluating many issues including the issues raised in this report.



DEPARTMENT OF JUSTICE
GENERAL COUNSEL DIVISION

April 11, 2003

Michael Grainey, Director
Office of Energy
625 Marion Street NE, Suite 1
Salem, Oregon 97301-3742

Re: Oregon Office of Energy Report on PUD Formation in Multnomah County

Dear Mr. Grainey;

The Public Utility Commission of Oregon has asked me, as its chief counsel, to submit comments in the Oregon Office of Energy's report regarding PUD formation in Multnomah County. The Commission made its request to me because members of the Oregon Legislative Assembly asked the agency for comments.

The Commission does not have a position regarding the formation of a PUD in Multnomah County, but it has asked me to discuss PUC statutes that may come into play and positions the Commission has taken in the past regarding condemnations by consumer-owned utilities of property owned by investor-owned utilities. The condemnations have involved distribution and generation assets. I will discuss each separately.

Distribution Assets

A Multnomah County PUD would need to acquire the distribution assets that Portland General Electric Company and PacifiCorp now use to serve their customers within the county. In cases in which a consumer-owned utility is condemning distribution assets of a utility regulated by the PUC, and thereby is also taking responsibility to serve some customers, the Commission's duty is to protect remaining customers of the regulated utility.

Under ORS 757.480, a public utility, such as PGE or PacifiCorp, may not dispose of property with a value in excess of \$100,000 unless it has the consent of the Commission. If a Multnomah County PUD condemns assets of an investor-owned utility, then the statute may not apply, as the court's award may supercede the Commission's authority. On the other hand, if there is a settlement, then it would be up to the Commission to approve the price.

There have been two recent court cases involving condemnation by consumer-owned utilities of distribution assets of PacifiCorp, one case in the Halsey area and the other in

Hermiston. The Commission was involved in both cases, taking the position that fair market value, not book value, is the appropriate standard for courts to apply in such cases. In both cases, the market value of the distribution assets was in fact well above book value. When the utility receives more than book value, the Commission's policy is to award the vast majority of the excess (i.e. the capital gain) to the remaining customers. That is precisely what the Commission did after PacifiCorp received settlements well in excess of book value for the Halsey and Hermiston assets.

The Commission gives the vast majority of the capital gain on sales of distribution assets to customers because they pay rates based on the utility's book value. If market value is below book value, customers "lose" because they return the higher book value to the utility, as well as a return on the higher book value. Conversely, when a utility sells an asset that has a market value that is above book value, customers "win" by having the Commission use the capital gain to reduce rates.

Generation Assets

The PUC was also an intervenor in a case in which Emerald People's Utility District attempted to condemn four PacifiCorp hydro-electric facilities on the North Umpqua. The Commission intervened in that case, and along with PacifiCorp, successfully prevented the condemnation. *Emerald People's Utility Dist. v. PacifiCorp*, 100 Or App 79, on reconsideration, 101 Or App 48, review denied 310 Or 121 (1990). The Commission opposed the condemnation because PacifiCorp would have had to replace low-cost hydro-electric resources with more expensive resources, thereby raising the company's rates. The Court prohibited the condemnation, finding that it was not in the public interest, as it would have lowered Emerald's already low rates and would have increased Pacificorp's comparatively high rates.

If a Multnomah County PUD is formed, and it wishes to condemn generation assets that either PGE or PacifiCorp uses to serve its customers, and if the utilities have to replace those resources with more expensive ones, then the Commission will likely oppose such a condemnation because it would not be in the interest of customers whom the Commission must protect.

Please do not hesitate to contact me if you have any questions.

Sincerely,

Paul A. Graham
Attorney-in-Charge
Regulated Utility & Business Section

cc: Lee Beyer, Commission
Roy Hemmingway, Commission
Joan Smith, Commission
John Savage, Utility Director – PUC
Lee Sparling, Utility – PUC
Marc Hellman, ERFA – PUC

Legal Description of the Boundaries of the Proposed Willamette Electric PUD

The following legal description of the boundaries of the proposed Willamette PUD is taken from the petition filed to form the PUD.

“A portion of Multnomah County, within the City of Portland, as follows: starting at the midpoint of the Steel Bridge, south along the centerline of the Willamette River to the midpoint of the Ross Island Bridge, then east along the centerline of Ross island bridge to the east bank of the Willamette River, then south along the east bank of the Willamette River to a westerly extension of SE Holgate Blvd, then east along the centerline of SE Holgate Blvd (and its westerly extension) to the centerline of SE 42nd Ave, then north along the centerline of SE 42nd Ave to the centerline of SE Powell Blvd, then east along the centerline of SE Powell Blvd to the centerline of SE 52nd Ave, then north along the centerline of SE 52nd Ave to the centerline of SE Division St, then west along the centerline of SE Division St to the centerline of SE 50th Ave, then north along the centerline of SE 50th Ave to the centerline of SE Hawthorne Blvd, then west along the centerline of SE Hawthorne Blvd to the centerline of SE 49th Ave, then north along the centerline of SE 49th Ave to the centerline of SE Stark St, then west along the centerline of SE Stark St to the centerline of 32nd Ave, then north along the centerline of SE 32nd Ave to the centerline of SE Ankeny Street, then east along the centerline of SE Ankeny St to the centerline of 32nd Ave, then north along the centerline of 32nd Ave to the centerline of Interstate-84, then west along the centerline of Interstate-84 to the centerline of Interstate-5, then north along the centerline of Interstate-5 to the centerline of Lloyd Blvd, then west along the centerline of Lloyd Blvd to the centerline of NE Oregon St, then west along the centerline of NE Oregon St to the midpoint of the Steel Bridge.”

“It is the intent of the Chief Petitioners that the description above specifies the area currently included Multnomah County voting precincts 3274, 4022, 4027, 4041, 4049, 4065, 4106 and 4167.”

List of Those Who Made Statements at the Hearing

Jeff Cropp
Fergus Pilon
Jeff Shupe
Dan Meek
Pamela Lesh
Steve Hawke
Jim Piro
Paul Capell
Bernie Bottomly
Kris Nelson
Anne Snyder
Gary Coe
Chris Kerchum
Thor Hinkley
Dave Johnson
Sam Van Vactor
Liz Trojan
Ernest Delmazzo
Bob Hedlund
Christopher Henry
Eulia Mishima
Theressa Mason
Nancy Newell
Norris Tomlinson

List of Those Who Provided a Written Statement

Bill Miller, IBEW Local 125
Walter E. Pollock
Jeff Cropp
Fergus Pilon
D. Hittle Associates, Clackamas PUD Feasibility Study
Dan Meek
Pamela Lesh
Stephen Hawke
Jim Piro
Kris Nelson
Anne Snyder
Gary Coe
Chris Kerchum
Thor Hinkley
Dave Johnson
Sam Van Vactor
Liz Trojan
Ernest Delmazzo
Eulia Mishima
Theresa Mason
Norris Tomlinson
Gary Duell
Wayne Lei
Annette L. Mattson
Randall Edwards, State Treasurer
Gregory R. Mowe
Curt Sommer
Bernie Bottomly
Ron Eachus
Jim Litchfield