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August 14, 2006

Via Electronic and U.S. Mail

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of PORTLAND GENERAL ELECTRIC COMPANY
Request for a General Rate Revision
Docket Nos. UE 180/UE 181/UE 184

Dear Filing Center:

Enclosed please find an original and six copies of the Direct Testimony of Michael P. Gorman on behalf of the Industrial Customers of Northwest Utilities (“ICNU”) and the Citizens’ Utility Board of Oregon (“CUB”) in the above-referenced docket numbers.

Please return one file-stamped copy of the document in the self-addressed, stamped envelope provided. Thank you for your assistance.

Sincerely yours,

/s/ Ruth A. Miller
Ruth A. Miller

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Direct Testimony of Michael P. Gorman on behalf of the Industrial Customers of Northwest Utilities and the Citizens' Utility Board of Oregon upon the parties, on the official service list, by causing the same to be electronically served, to those parties with an email address, as well as mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 14th day of August, 2006.

/s/ Ruth A. Miller
Ruth A. Miller

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 180/UE 181/UE 184

In the Matter of)
)
PORTLAND GENERAL ELECTRIC)
COMPANY)
)
Request for a General Rate Revision)
(UE 180),)
_____)

In the Matter of)
)
PORTLAND GENERAL ELECTRIC)
COMPANY)
)
Annual Adjustments to Schedule 125 (2007)
RVM Filing) (UE 181),)
_____)

In the Matter of)
)
PORTLAND GENERAL ELECTRIC)
COMPANY)
)
Request for a General Rate Revision relating)
to the Port Westward plant (UE 184).)
_____)

DIRECT TESTIMONY OF

MICHAEL P. GORMAN

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

AND THE CITIZENS' UTILITY BOARD OF OREGON

August 14, 2006

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A.** My name is Michael Gorman, and my business address is 1215 Fern Ridge Parkway,
3 Suite 208, St. Louis, MO 63141-2000.

4 **Q. WHAT IS YOUR OCCUPATION?**

5 **A.** I am a consultant in the field of public utility regulation and a principal in the firm of
6 Brubaker & Associates, Inc., energy, economic, and regulatory consultants.

7 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
8 **EXPERIENCE.**

9 **A.** These are set forth in Exhibit ICNU-CUB/301.

10 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

11 **A.** I am appearing on behalf of the Industrial Customers of Northwest Utilities (“ICNU”)
12 and the Citizens’ Utility Board of Oregon.

13 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

14 **A.** I will recommend a fair return on common equity and an overall rate of return for
15 Portland General Electric Company (“PGE” or the “Company”).

16 **Q. PLEASE SUMMARIZE YOUR RATE OF RETURN RECOMMENDATIONS.**

17 **A.** I recommend the Public Utility Commission of Oregon (“Commission”) award PGE a
18 return on common equity of 9.9% and overall rate of return of 8.3%, as shown on my
19 Exhibit ICNU-CUB/302. My return on common equity recommendation would result in
20 a \$15.9 million reduction to PGE’s filed revenue requirement.

21 I recommend the rejection of PGE’s projected capital structure. The Company’s
22 projected capital structure is overweighted with common equity and therefore is too
23 expensive and unreasonable for rate setting purposes. I recommend a capital structure
24 composed of 50.0% common equity, 0.29% preferred stock, and 49.71% debt be used to

1 develop PGE's overall rate of return in this proceeding. Adoption of the recommended
2 capital structure would reduce PGE's requested revenue requirement by \$11.6 million.

3 My total rate of return adjustments, if adopted, would reduce PGE's revenue
4 requirement by \$27.5 million.

5 My recommended return on equity for PGE is based on constant growth
6 Discounted Cash Flow ("DCF"), Risk Premium ("RP"), and Capital Asset Pricing Model
7 ("CAPM") analyses.

8 I demonstrate that my recommended return on equity and proposed capital
9 structure will provide PGE an opportunity to realize cash flow financial coverages and a
10 balance sheet strength that support PGE's current bond rating. Consequently, my
11 recommended return on equity represents fair compensation for PGE's investment risk
12 and will preserve PGE's financial integrity and credit standing.

13 I respond to the Joint Testimony of PGE witnesses Patrick G. Hager and William
14 J. Valach (Hager-Valach) and their recommended 10.75% return on equity. The PGE
15 witnesses estimate PGE's return on equity flow within the range of 9.25% to 11.30%.
16 They rely on several versions of the discounted cash flow analysis and a risk premium
17 study to support their positions. As set forth below, the PGE witnesses' studies include
18 return estimates that far exceed PGE's current market cost of common equity. Excluding
19 these extreme investments, the PGE witnesses' own analyses support a return on equity
20 in the range of 9.7% up to approximately 10.4%.

1 **I. ELECTRIC UTILITY INDUSTRY MARKET PERSPECTIVE**

2 **Q. PLEASE DESCRIBE THE MARKET’S PERCEPTION OF THE ELECTRIC UTILITY**
3 **INDUSTRY OVER THE LAST SEVERAL YEARS.**

4 **A.** I believe Standard & Poor’s (“S&P”) captures the sentiment of the investment market
5 toward the electric utility industry over the last several years. In 2001, S&P stated it
6 recorded 81 downgrades to utility credit ratings, with only 29 upgrades. Exhibit ICNU-
7 CUB/315, Gorman/2. S&P stated in 2002 that the credit rating activity in the electric
8 utility industry was negative due to: 1) weakening financial profiles; 2) loss of investor
9 confidence which affected the industry’s liquidity and financial flexibility; 3) heightened
10 business risk derived from more investments outside the traditional regulated utility
11 business; 4) corporate restructuring and mergers and acquisitions; and 5) certain
12 regulatory difficulties. Id.

13 S&P attributed most of the 2002 liquidity and credit erosion in the industry to
14 heavy debt-funded investments in higher risk non-regulated activities, and the loss of
15 management credibility due to accounting and trading irregularities. Id.

16 Importantly, this negative perception of the energy industry over the last several
17 years has been improved considerably because the industry has reverted to a “back to
18 basics” business model. As part of the back to basics business model, utilities have been
19 shedding non-regulated activities and using the asset sale proceeds to retire debt. Also,
20 utilities have adopted corporate governance policies that have helped regain the
21 confidence of the market.

22 In 2005, S&P revised its industry outlook by stating that the industry’s leading
23 indicators of credit rating trends show that there are nearly twice as many stable outlooks

1 as negative outlooks. S&P credits this improved credit quality and liquidity enhancement
2 to improving credit rating metrics resulting primarily from a reduction of high-cost debt
3 and elimination of higher risk non-utility investments, and the industry's shift to a back
4 to basics business model, which concentrates on regulated utility operation, i.e., core
5 competencies, debt reduction and risk management. Exhibit ICNU-CUB/316, Gorman/1-
6 2.

7 **II. PROJECTED INTEREST RATES AND CAPITAL MARKET COSTS**

8 **Q. AT PAGE 17 OF PGE/1100, THE PGE WITNESSES STATE THAT UTILITIES**
9 **ARE FACING INCREASING RISK BECAUSE INTEREST RATES ARE**
10 **INCREASING. DO THE PGE WITNESSES OFFER SOUND REASONS TO**
11 **INCREASE PGE'S AUTHORIZED RETURN ON EQUITY RELATIVE TO**
12 **THAT MEASURED FROM CONTEMPORARY MARKET DATA?**

13 **A.** No. The PGE witnesses primarily referenced increases to short-term interest rates in
14 support of a higher return on equity. While short-term interest rates have increased
15 significantly, long-term interest rates have not increased significantly. However, at the
16 Federal Reserve meeting on August 8, 2006, the Feds declined to increase the interest
17 rates. It is likely that we will see a stabilizing of short-term interest rates. Long-term
18 interest rates are the more reasonable barometer of changes to a utility's cost of equity.
19 Short-term rates are typically impacted by Federal Reserve monetary financial policy and
20 not purely on the basis of market expectations of capital market costs. As such, short-
21 term interest rates are impacted by governmental policy actions, whereas long-term
22 interest rates are driven purely by market valuations. Hence, long-term interest rates are
23 better reflected in market actions than are short-term interest rates.

1 Further, long-term interest rates have similar investment horizons and similar
2 risk-free rate and inflation expectations, as do common equity returns. Hence, from a
3 fundamental investment return perspective, long-term interest rates are keenly more
4 relevant in establishing potential changes to common equity return costs than are short-
5 term interest rates. For all these reasons, the PGE witnesses have simply failed to
6 properly assess potential changes to return on equity through changes in market interest
7 rates.

8 **Q. SINCE LONG-TERM INTEREST RATES HAVE BEEN INCREASING, SHOULD**
9 **THE COMMISSION EXPECT THAT INTEREST RATES WILL CONTINUE TO**
10 **INCREASE AS SOME ECONOMISTS ARE PROJECTING?**

11 **A.** No, the accuracy of projected interest rates is highly problematic. Therefore, using only
12 projected interest rates is not a reasonable method of estimating the utility's cost of
13 capital during the period rates are in effect.

14 While projected interest rates should be given some consideration, the
15 determination of PGE's cost of capital today should be based primarily on observable and
16 verifiable actual current market costs. This is appropriate because projected changes to
17 interest rates are highly uncertain and the accuracy is at best problematic. Indeed, this is
18 evident by a review of projected changes to interest rates made over the last five years, in
19 comparison to how accurate these projections turned out to be. This analysis clearly
20 illustrates that observable interest rates today are as accurate as economists' consensus
21 projections of future interest rates.

22 An analysis supporting this conclusion is illustrated on my Exhibit ICNU-
23 CUB/303. On this exhibit, under Columns 1 and 2, I show contemporary market yields

1 and projected Treasury bond yields, respectively, two years in the future. As shown in
2 Columns 1 and 2, over the last five years Treasury yields were projected to increase
3 relative to the current Treasury yields at the time of the projection. The projected yield
4 change is shown under Column 5. In Column 4, I show what the Treasury yield actually
5 turned out to be two years after the forecast. Under Column 6, I show the actual yield
6 change from the time of the projections.

7 As shown on Exhibit ICNU-CUB/303, over the last five years economists have
8 consistently been projecting increases to interest rates. However, as demonstrated under
9 Column 6, those yield projections have turned out to be overstated in virtually every case.
10 Indeed, Treasury yields have actually decreased or remained flat over the last five years,
11 rather than increase as the economists' projections indicated.

12 The results shown on Exhibit ICNU-CUB/303 illustrate that interest rate
13 projection accuracy is highly problematic. Indeed, current observable interest rates are
14 just as likely a reasonable projection of future interest rates as are economists'
15 projections. Accordingly, while I will use projected interest rates to provide some sense
16 of the market's expectations of future capital market costs in my models, I will not use
17 them exclusively. Rather, my analyses will be based on the combination of current
18 observable interest rates and projected interest rates. Thus, my analyses will capture a
19 return on equity range reflecting a broad range of potential capital market costs during
20 the period rates will be in effect.

1 **III. PGE'S PROPOSED CAPITAL STRUCTURE**

2 **Q. WHAT CAPITAL STRUCTURE IS THE COMPANY REQUESTING TO USE TO**
 3 **DEVELOP ITS OVERALL RATE OF RETURN FOR ELECTRIC OPERATIONS**
 4 **IN THIS PROCEEDING?**

5 **A.** PGE's proposed capital structure is shown below in Table 1.

TABLE 1	
PGE's Proposed Capital Structure	
<u>(Test Year 2007)</u>	
<u>Description</u>	<u>Percent of</u> <u>Total Capital</u>
Common Equity	55.96%
Preferred Equity	0.29%
Long-Term Debt	<u>43.75%</u>
Total Financial Capital Structure	100.00%
Source: UE 180, PGE/1100, Hager-Valach/3.	

6 **Q. IS THE COMPANY'S PROPOSED CAPITAL STRUCTURE FOR SETTING**
 7 **RATES REASONABLE?**

8 **A.** No. PGE's proposed capital structure is excessively weighted with common equity,
 9 which unnecessarily increases its overall rate of return and claimed revenue deficiency in
 10 this proceeding.

11 **Q. WHAT REASONS DO PGE WITNESSES GIVE IN SUPPORT OF ITS**
 12 **PROPOSED CAPITAL STRUCTURE?**

13 **A.** Hager-Valach, at page 44 of their testimony, give four reasons that they assert support
 14 their proposed capital structure, which includes an approximate 56% common equity
 15 ratio. The PGE witnesses state the proposed capital structure will enable PGE to
 16 accomplish the following:

- 1 1. Maintain its financial strength, flexibility and adequate liquidity;
- 2 2. Maintain reliable and economic access to capital markets;
- 3 3. Minimize its overall cost of capital to customers and shareholders; and
- 4 4. Offset debt equivalents of purchased power contracts.

5
6 Id.

7
8 **Q. DO YOU AGREE WITH PGE WITNESSES' PROPOSED CAPITAL**
9 **STRUCTURE?**

10 **A.** No. The PGE witnesses offer little to no support for their claimed capital structure
11 justification, and it should be rejected.

12 **Q. WHY SHOULD THE COMMISSION REJECT PGE'S PROPOSED CAPITAL**
13 **STRUCTURE?**

14 **A.** The proposed capital structure has excessive amounts of common equity, which
15 unnecessarily and unreasonably increases the revenue requirement in this proceeding.
16 The capital structure contains more equity than needed to provide PGE an opportunity to
17 produce a credit rating financial metrics that will preserve PGE's credit rating and access
18 to capital markets under reasonable terms and prices. Hence, PGE's proposed capital
19 structure represents an excessively expensive capital structure and should be rejected.

20 **Q. WHAT CAPITAL STRUCTURE DO YOU PROPOSE TO SET PGE'S OVERALL**
21 **RATE OF RETURN IN THIS PROCEEDING?**

22 **A.** As set forth below in Table 2, I propose a capital structure proposed of approximately
23 50% common equity, 0.29% preferred stock, and 49.71% long-term debt.

<u>Description</u>	<u>Percent of Total Capital</u>
Common Equity	50.00%
Preferred Equity	0.29%
Long-Term Debt	<u>49.71%</u>
Total Financial Capital Structure	100.00%

1 **Q. WHY IS YOUR PROPOSED CAPITAL STRUCTURE REASONABLE?**

2 **A.** This capital structure is more reasonable than PGE's proposed capital structure for the
3 following reasons.

4 1. It will result in a lower revenue requirement and lower cost to customers in this
5 proceeding.

6 2. This capital structure, in combination with PGE's off-balance sheet debt
7 equivalence as estimated by S&P, meets S&P's credit rating financial benchmarks
8 adequate to maintain PGE's current credit rating.

9 3. This capital structure is more comparable to industry average capital structures,
10 and specifically the capital structure mix of the proxy group I use to estimate
11 PGE's cost of common equity in this proceeding.

12 **Q. PLEASE EXPLAIN WHY YOUR PROPOSED CAPITAL STRUCTURE WILL**
13 **MAINTAIN PGE'S CURRENT CREDIT RATING.**

14 **A.** I have reached this conclusion based on a comparison of the total debt ratio based on my
15 proposed capital structure for PGE and S&P's estimate of PGE's off-balance sheet debt
16 equivalents to S&P's published credit rating benchmarks. S&P publishes benchmark
17 credit rating financial ratios, which provide guidance on a structure that will support

1 PGE's credit rating. S&P publishes financial benchmarks based on a utility's business
2 profile score on a scale of 1 to 10, with 1 being the lowest risk.

3 PGE's current business risk profile from S&P is 5. Hence, with its off-balance
4 sheet debt equivalence considered, PGE must maintain an adjusted total debt ratio in the
5 range of 50%-60% to maintain its current bond rating. The "adjusted" total debt ratio
6 indicates S&P's practice of adjusting the on-balance sheet debt ratio to reflect off-
7 balance sheet financial obligations. When off-balance sheet debt equivalents are
8 included in my proposed capital structure, PGE's total adjusted debt ratio is 55%. This
9 total debt ratio is solidly at the mid-point range of S&P's financial benchmarks for a
10 "BBB" rated utility company of 50% to 60%. Hence, my proposed capital structure will
11 support PGE's unsecured bond rating of "BBB."

12 Importantly, if off-balance sheet equivalents are excluded from the calculation,
13 PGE's total debt ratio would be 49.7%. This reflects even stronger coverage of PGE's
14 on-balance sheet debt, and in particular, its senior secured debt. Hence, my proposed
15 capital structure provides strong coverages of PGE's total financial obligations, including
16 its off-balance sheet debt equivalent. Further, my proposed capital structure supports
17 PGE's "BBB" unsecured credit rating, and also provides stronger coverage of PGE's
18 senior secured "BBB+" debt rating. Therefore, this proposed capital structure would
19 support PGE's current unsecured and secured bond ratings of "BBB" and "BBB+,"
20 respectively.

21 I will discuss in more detail all of S&P's credit rating financial credit metrics later
22 in this testimony. However, based on my recommended capital structure and return on

1 common equity, PGE will be provided an opportunity to earn strong cash coverages of
2 financial obligations that will support its current bond rating.

3 **Q. DO YOU BELIEVE YOUR PROPOSED CAPITAL STRUCTURE IS MORE**
4 **CONSISTENT WITH CAPITAL STRUCTURES RECENTLY AUTHORIZED**
5 **FOR OTHER ELECTRIC UTILITY COMPANIES?**

6 **A.** Yes. This is evident by a review of recent findings by utilities in rate proceedings in the
7 Pacific Northwest and by utilities across the country. Specifically, PacifiCorp recently
8 has settled with parties in its rate proceeding in Oregon based on a 50% common equity
9 ratio. Re PacifiCorp, OPUC Docket No. UE 179, Joint Stipulation at 6 (Aug. 3, 2006).
10 Further, Avista recently settled its rate proceeding based on a target common equity ratio
11 of 40%. Re Avista Corp., WUTC Docket Nos. UE-050482 and UG-050483, Order No.
12 05 (Dec. 21, 2005). Finally, Puget Sound Energy recently made a filing and requested an
13 equity ratio of 45% in Washington. Re Puget Sound Energy, WUTC Docket Nos. UE-
14 060266 and UG-060267, Exhibit No. ___ (DEG-ICT) at 3. All of these settlements and
15 utility requests show that PGE's currently requested common equity ratio of 56% in this
16 proceeding is significantly out of line with other utilities, and unnecessarily increases its
17 overall rate of return and revenue requirement.

18 This is further evident by a review of approved commission capital structure
19 across the country. In calendar year 2005 and the first six months of 2006, the average
20 common equity ratios used to develop a regulated utility's overall rate of return were
21 47.5% and 46.7%, respectively.^{1/} Again, PGE's proposed capital structure is
22 significantly out of line with other utilities' approved capital structures for ratemaking
23 purposes.

^{1/} Regulatory Research Associates, Major Rate Case Decisions, July 6, 2006.

1 **Q. WHY DO YOU BELIEVE THAT YOUR PROPOSED CAPITAL STRUCTURE IS**
2 **MORE CONSISTENT WITH THE PROXY GROUP YOU WILL USE TO**
3 **ESTIMATE PGE'S COST OF COMMON EQUITY?**

4 **A.** As set forth below, I rely on a proxy group with an average common equity ratio of 49%.
5 Indeed, PGE's own witnesses relied on proxy groups with capital structures with
6 common equity ratios in the range of 45% to 52% or lower.^{2/} Again, these proxy groups
7 clearly show that PGE's capital structure is too expensive and out of line with industry
8 standards.

9 **Q. WHY WOULD RELYING ON A CAPITAL STRUCTURE TOO HEAVILY**
10 **WEIGHTED WITH COMMON EQUITY UNNECESSARILY INCREASE PGE'S**
11 **REVENUE REQUIREMENT AND DELIVERY SERVICE RATES?**

12 **A.** This happens because common equity is the most expensive form of capital, and it is
13 subject to income tax expense. Consider, for example, the difference between the
14 revenue requirement cost of common equity and that of debt. At an authorized return of
15 10%, and a consolidated income tax rate of 40%, the revenue requirement cost of
16 common equity capital would be 16.7%. In comparison, at a "BBB" bond rating, PGE's
17 marginal cost of debt currently is about 6%. Hence, the revenue requirement cost of
18 common equity is more than two and one-half times as expensive as that of debt. Thus,
19 increasing the weight of common equity, and decreasing the weight of debt capital
20 supporting the utility's delivery service rate base, will unnecessarily increase the revenue
21 requirement.

22 As discussed below, an appropriate capital structure should reflect a reasonable
23 balance of equity and debt capital. The balance should be based on the appropriate

^{2/} UE 180 PGE/400 Workpapers 3-5.

1 financial risk and operating risk of the underlying utility, and a capital structure that is
2 reasonably consistent with maintaining its current or target bond rating.

3 **Q. HAS PGE'S CAPITAL STRUCTURE ALWAYS REFLECTED SUCH A HIGH**
4 **COMPONENT OF COMMON EQUITY TO TOTAL CAPITAL?**

5 **A.** No. PGE's above industry average component of common equity seems to have been
6 created during the period Enron owned PGE. Specifically, prior to Enron acquiring PGE,
7 in an S&P report dated July 1997, just after Enron acquired PGE, S&P reviewed PGE
8 with a stable outlook, at which time it had a total debt ratio of 51.2%, which was low in
9 comparison to PGE's debt ratio over the period 1993 through 1996. UE-180, PGE
10 response to OPUC Data Request No. 060, Attachment 060-A at 182, 191. More recently,
11 PGE's debt ratio was approximately 52% in its last case in UE-115. PGE/1100,
12 Workpapers 2.

13 PGE's significant increase in its common equity balance occurred during the
14 period Enron owned PGE, which is important in determining whether the capital structure
15 was designed to support PGE's low risk regulated operations, or was the result of Enron's
16 ownership and later PGE's management efforts to isolate PGE from its bankrupt parent.
17 Indeed, the PGE witnesses in this proceeding state that PGE suspended dividends to
18 Enron in an effort to preserve the utility's liquidity during the bankruptcy proceedings.
19 PGE/1100, Hagar-Valach/13. Thus, the increase in its common equity balance appears
20 related to Enron's ownership. Ratepayers must be protected from any increase in costs
21 associated with Enron's ownership and bankruptcy.

22 As described above, and discussed in more detail below, based on an assessment
23 of PGE's current credit standing, and a review of industry average capital structures and

1 capital structure of utilities in the Pacific Northwest, all indicate that PGE's proposed
2 capital structure in this proceeding is excessively weighted with common equity and
3 unnecessarily increases PGE's cost of service and claimed revenue deficiency.

4 IV. RETURN ON COMMON EQUITY

5 **Q. PLEASE DESCRIBE THE FRAMEWORK FOR DETERMINING A**
6 **REGULATED COMPANY'S COST OF COMMON EQUITY.**

7 **A.** In general, determining a fair cost of common equity for a regulated utility has been
8 framed by two decisions of the U.S. Supreme Court: Bluefield Water Works &
9 Improvement Co. v. Public Serv. Comm'n of W. Va., 262 U.S. 679 (1923), and Federal
10 Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

11 These decisions identify the general standards to be considered in establishing the
12 cost of common equity for a public utility. Those general standards are that the
13 authorized return should: 1) be sufficient to maintain financial integrity; 2) attract capital
14 under reasonable terms; and 3) be commensurate with returns investors could earn by
15 investing in other enterprises of comparable risk.

16 **Q. PLEASE DESCRIBE WHAT IS MEANT BY "UTILITY'S COST OF COMMON**
17 **EQUITY."**

18 **A.** The utility's cost of common equity is the return investors expect, or require, in order to
19 make an investment. Investors expect to achieve their return requirement from receiving
20 dividends and from stock price appreciation.

21 **Q. PLEASE DESCRIBE THE METHODS YOU HAVE USED TO ESTIMATE THE**
22 **COST OF COMMON EQUITY FOR PGE.**

23 **A.** I have used several models based on financial theory to estimate PGE's cost of common
24 equity. These models are: 1) the constant growth discounted cash flow model ("DCF");

1 2) the bond yield plus equity risk premium model; and 3) a capital asset pricing model
2 (“CAPM”). I have applied these models to a group of publicly traded utilities that I have
3 determined represent the investment risk of an electric utility similar to PGE. I selected
4 these companies by first starting with all the companies followed by the Value Line
5 Investment Survey. I then limited these companies to those that meet the following
6 selection criteria:

- 7 1. Have bond ratings from Standard & Poor’s in the "BBB" and "A" category, and
8 "Baa" and "A" category, respectively;
- 9 2. Have common equity ratios in the range of 40% to 60%;
- 10 3. Have S&P business profile scores in the range of 3 to 6;
- 11 4. Not involved in significant merger or acquisition activities;
- 12 5. Had not suspended their dividends over the last two years; and
- 13 6. Were not currently involved in industry restructuring transition initiatives, or
14 liquidating investments in non-regulated businesses to reduce debt and shed non-
15 regulated exposure.

16 **Q. IS YOUR PROXY GROUP COMPARABLE IN RISK TO PGE?**

17 A. Yes. As shown on the attached Exhibit ICNU-CUB/304, this group is a reasonable risk
18 proxy for PGE. As shown on this schedule, the group average bond rating from Standard
19 & Poor’s and Moody’s is identical to PGE’s. Also, the group’s average business profile
20 score is 5, which is also identical to PGE’s. Finally, the group average Value Line total
21 debt to common equity ratio of 49% is nearly identical to the 50% common equity ratio I
22 recommend for PGE. For these reasons, this proxy group is a reasonable risk proxy in
23 terms of both financial and business risk, and can reasonably be used to estimate PGE’s
24 cost of common equity in this proceeding.

1 **Discounted Cash Flow Model**

2 **Q. PLEASE DESCRIBE THE DCF MODEL.**

3 **A.** The DCF model posits that a stock price is valued by summing the present value of
 4 expected future cash flows discounted at the investor's required rate of return ("ROR") or
 5 cost of capital. This model is expressed mathematically as follows:

$$6 \quad P_0 = \frac{D_1}{(1+K)^1} + \frac{D_2}{(1+K)^2} + \dots + \frac{D_\infty}{(1+K)^\infty} \quad \text{where} \quad \text{(Equation 1)}$$

7
 8 P_0 = Current stock price
 9 D = Dividends in periods 1 - ∞
 10 K = Investor's required return

11 This model can be rearranged in order to estimate the discount rate or investor
 12 required return, "K." If it is reasonable to assume that earnings and dividends will grow
 13 at a constant rate, then Equation 1 can be rearranged as follows:

$$14 \quad K = D_1/P_0 + G \quad \text{(Equation 2)}$$

15 K = Investor's required return
 16 D_1 = Dividend in first year
 17 P_0 = Current stock price
 18 G = Expected constant dividend growth rate

19 Equation 2 is referred to as the "constant growth" annual DCF model.

20 **Q. PLEASE DESCRIBE THE INPUTS TO YOUR CONSTANT GROWTH DCF**
 21 **MODEL.**

22 **A.** As shown under Equation 2 above, the DCF model requires a current stock price,
 23 expected dividend, and expected growth rate in dividends.

1 **Q. WHAT STOCK PRICE AND DIVIDEND HAVE YOU RELIED ON IN YOUR**
2 **CONSTANT GROWTH DCF MODEL?**

3 **A.** I relied on the average of the weekly high and low stock prices over a 13-week period
4 ending July 7, 2006. An average stock price is less susceptible to market price variations
5 than is a spot price. Therefore, an average stock price is less susceptible to aberrant
6 market price movements, which may not be reflective of the stock's long-term value.

7 A 13-week average stock price is short enough to contain data that reasonably
8 reflects current market expectations, but is not too short a period to be susceptible to
9 market price variations that may not be reflective of the security's long-term value.
10 Therefore, in my judgment, a 13-week average stock price is a reasonable balance
11 between the need to reflect current market expectations and to capture sufficient data to
12 smooth out aberrant market movements. I used the most recently paid quarterly
13 dividend, as reported in the Value Line Investment Survey. This dividend was
14 annualized (multiplied by 4) and adjusted for next year's growth to produce the D1 factor
15 for use in Equation 2 above.

16 **Q. WHAT DIVIDEND GROWTH RATES HAVE YOU USED IN YOUR DCF**
17 **MODEL?**

18 **A.** There are several methods one can use in order to estimate the expected growth in
19 dividends. However, for purposes of determining the market required return on common
20 equity, one must attempt to estimate what the consensus of investors believe about the
21 dividend or earnings growth rate, and not what an individual investor or analyst may use
22 to form individual investment decisions.

1 Security analysts' growth estimates have been shown to be more accurate
2 predictors of future returns than growth rates derived from historical data^{3/} because they
3 are more reliable estimates, and, assuming the market generally makes rational
4 investment decisions, analysts' growth projections are the most likely growth estimates
5 that are built into stock prices.

6 For my constant growth DCF analysis, I have relied on a consensus, or mean, of
7 professional security analysts' earnings growth estimates as a proxy for the investor
8 consensus dividend growth rate expectations. I used the average of three sources of
9 customer growth rate estimates, including Zack's Advisor, Reuters, and Thomson
10 Financial or First Call. All consensus analyst projections used were available on July 11,
11 2006, as reported on the internet. Each consensus growth rate projection is based on a
12 survey of security analysts. The consensus estimate is a simple arithmetic average or
13 mean of surveyed analysts' earnings growth forecasts. A simple average of the growth
14 forecast gives equal weight to all surveyed analysts' projections. It is problematic as to
15 whether any particular analyst's forecast is most representative of general market
16 expectations. Therefore, a simple average, or arithmetic mean, of analyst forecasts is a
17 good proxy for market consensus expectations. The growth rates I used in my DCF
18 analyses are shown on Exhibit ICNU-CUB/305.

19 **Q. WHAT ARE THE RESULTS OF YOUR ANNUAL CONSTANT GROWTH DCF**
20 **MODEL?**

21 **A.** As shown on Exhibit ICNU-CUB/306, the DCF return for my comparable group is 9.5%.

^{3/} See, e.g., David Gordon, Myron Gordon, and Lawrence Gould, Choice Among Methods of Estimating Share Yield, The Journal of Portfolio Management (Spring 1989).

1 **Q. DO YOU HAVE ANY COMMENTS CONCERNING THE RESULTS OF YOUR**
2 **DCF ANALYSIS?**

3 **A.** Yes. I believe the results of my constant growth DCF analysis, and a DCF analysis in
4 general in today's marketplace, reflect rational investment financial metrics and reflect
5 today's very low cost capital market. Therefore, the DCF results are reasonable.

6 **Q. WHY DO YOU BELIEVE YOUR DCF REFLECTS CONSERVATIVE GROWTH**
7 **PROJECTIONS?**

8 **A.** The consensus analysts' growth rate for my comparable group is 4.63%. First, this
9 growth rate is reasonably consistent with the five-year projected Gross Domestic Product
10 ("GDP") growth of 5.2%, and considerably higher than the five-year projected CPI
11 inflation growth of 2.4%.^{4/}

12 Utilities' dividend growth cannot sustain a growth rate that exceeds the growth
13 rate of the overall economy. The growth rate of the utility's service territory is the proxy
14 for the sustainable long-term growth rate of earnings. Utilities invest in plant to meet
15 sales growth, and sales growth in turn is tied to economic activity. Hence, nominal GDP
16 growth is a proxy for the highest sustainable long-term growth rate of the utility.

17 However, growth of utility companies has historically been tied to the growth rate
18 of inflation. This is because utilities typically pay out a very high percentage of earnings
19 as dividends, thus limiting the reinvestment of earnings and the growth to their company
20 business platforms. The growth rate used in my DCF analysis is much higher than
21 expected inflation rates, and nears the maximum sustainable growth estimate as proxied
22 by the GDP growth factor. This clearly indicates a very strong and relatively high
23 growth rate used in my DCF estimate.

^{4/} Exhibit ICNU-CUB/317, Gorman/2.

1 Moreover, my projected growth rate of 4.63% is considerably higher than the
2 historical growth rate the proxy group has achieved over the last five to ten years, and
3 that projected over the next three to five years. As shown on Exhibit ICNU-CUB/307,
4 the historical dividend growth of my proxy group is substantially lower than the nominal
5 GDP growth.

6 **Q. WHY DO YOU BELIEVE THE DCF YIELD REFLECTS CURRENT LOW COST**
7 **CAPITAL MARKETS?**

8 **A.** The DCF yield for my utility group is 4.84%. This yield is higher than the current five-
9 year Treasury note yield of 4.96%, and slightly lower than the projected five-year
10 Treasury note yield of 5.1%.^{5/} Hence, the DCF yield reasonably reflects both current and
11 projected interest rates.

12 **Q. WHY DO YOU BELIEVE YOUR DCF REFLECTS RATIONAL COMPANY**
13 **FINANCIAL METRICS AND DIVIDEND EXPECTATIONS?**

14 **A.** The dividend fundamentals of companies included in my comparable groups show strong
15 and consistent earnings strength in relation to dividends. This indicates that current and
16 projected earnings support dividends and permit the continued predictable growth in
17 dividends.

18 For example, my comparable group has a 2005 dividend payout ratio of
19 approximately 75%, and dividend to book ratios of approximately 6.2%. The dividend
20 payout ratio represents the percentage of earnings paid out as dividends. Traditionally,
21 utility companies have paid out approximately 70% of their earnings as dividends. Value
22 Line's projected dividend to book and payout ratio for my comparable group is 6.2% and
23 64%, respectively. Hence, a payout ratio of 64% suggests that the companies' earnings

^{5/} Exhibit ICNU-CUB/318, Gorman/2.

1 will support dividends and retain earnings to produce earnings and dividend growth
2 going forward.

3 Also, a dividend to book ratio of 6.2% indicates that these dividend payments are
4 affordable in today's low capital cost environment. In essence, companies need to earn
5 6.2% on their book value in order to produce earnings to pay their dividends. With
6 authorized returns dropping in response to significant declines in capital market costs,
7 these low cost dividends will be supported by today's lower authorized equity returns.

8 **Risk Premium Model**

9 **Q. PLEASE DESCRIBE YOUR BOND YIELD PLUS RISK PREMIUM MODEL.**

10 **A.** This model is based on the principle that investors require a higher ROR to assume
11 greater risk. Common equity investments have greater risk than bonds because bonds
12 have more security of payment in bankruptcy proceedings than common equity and the
13 coupon payments on bonds represent contractual obligations. In contrast, companies are
14 not required to pay dividends on common equity, or to guarantee returns on common
15 equity investments. Therefore, common equity securities are considered to be more risky
16 than bond securities.

17 This risk premium model is based on two estimates of an equity risk premium.
18 First, I estimated the difference between the required return on utility common equity
19 investments and Treasury bonds. The difference between the required return on common
20 equity and the bond yield is the risk premium. I estimated the risk premium on an annual
21 basis for each year over the period 1986 through June 2006. The common equity
22 required returns were based on regulatory commission-authorized returns for electric

1 utility companies. Authorized returns are typically based on expert witnesses' estimates
2 of the contemporary investor required return.

3 The second equity risk premium method is based on the difference between
4 regulatory commission-authorized returns on common equity and contemporary "Baa"
5 rated utility bond yields. This time period was selected because over the period 1986
6 through June 2006, public utility bond yields have consistently traded at a premium to
7 book value. This is illustrated on my Exhibit ICNU-CUB/308, where the market to book
8 ratio since 1986 for the electric utility industry was consistently above 1.0. Therefore,
9 over this time period, regulatory authorized returns were sufficient to support market
10 prices that at least exceeded book value. This is an indication that regulatory authorized
11 returns on common equity supported a utility's ability to issue additional common stock,
12 without diluting existing shares. This further indicates that utilities were able to access
13 equity markets without a detrimental impact on current shareholders.

14 Based on this analysis, as shown on Exhibit ICNU-CUB/309, the average
15 indicated equity risk premium of authorized electric utility common equity returns over
16 U.S. Treasury bond yields has been 5.03%. Of the 21 observations, 15 indicated risk
17 premiums fall in the range of 4.4% to 5.9%. Since the risk premium can vary depending
18 upon market conditions and changing investor risk perceptions, I believe using an
19 estimated range of risk premiums provides the best method to measure the current return
20 on common equity using this methodology.

21 As shown on Exhibit ICNU-CUB/310, the average indicated authorized electric
22 utility common equity returns over contemporary Moody's utility bond yields over the

1 period 1986 through June 2006 was 3.65%. Removing the three highest and lowest risk
2 premium estimates produces an electric equity risk premium in the range of 3.0% to
3 4.5%.

4 **Q. HOW DID YOU ESTIMATE PGE'S COST OF COMMON EQUITY WITH THIS**
5 **MODEL?**

6 **A.** I added a projected long-term Treasury bond yield to my estimated equity risk premium
7 over Treasury yields. Blue Chip Financial Forecasts projects the 30-year Treasury bond
8 yields to be 5.3%, and a 10-year Treasury bond to be 5.3%.^{6/} Using the projected 30-year
9 bond yield of 5.3%, and an electric equity risk premium of 4.4% to 5.9%, produces an
10 estimated common equity return in the range of 9.7% to 11.2%, with a mid-point estimate
11 at 10.4%.

12 I next added my equity risk premium over utility bond yields to a current 13-week
13 average yield on "Baa" rated utility bonds for the period ending June 7, 2006 of 6.60%.
14 These current "Baa" utility bond yields are developed on Exhibit ICNU-CUB/311.
15 Adding the utility bond equity premium of 3.0% to 4.5% to an "Baa" rated bond yield of
16 6.60% produces a cost of equity in the range of 9.6% to 11.1%, with a mid-point of
17 10.4%.

18 My risk premium analyses produce an average return estimate of 10.4%.

19 **Capital Asset Pricing Model**

20 **Q. PLEASE DESCRIBE THE CAPM.**

21 **A.** The CAPM method of analysis is based upon the theory that the market-required ROR
22 for a security is equal to the risk-free ROR, plus a risk premium associated with the

^{6/} Exhibit ICNU-CUB/318, Gorman/2.

1 specific security. This relationship between risk and return can be expressed
2 mathematically as follows:

3 $R_i = R_f + B_i \times (R_m - R_f)$ where:

4 R_i = Required return for stock i

5 R_f = Risk-free rate

6 R_m = Expected return for the market portfolio

7 B_i = Beta - Measure of the risk for stock

8 The stock specific risk term in the above equation is beta. Beta represents the investment
9 risk that cannot be diversified away when the security is held in a diversified portfolio.
10 When stocks are held in a diversified portfolio, firm-specific risks can be eliminated by
11 balancing the portfolio with securities that react in the opposite direction to firm-specific
12 risk factors (e.g., business cycle, competition, product mix and production limitations).

13 The risks that cannot be eliminated when held in a diversified portfolio are
14 nondiversifiable risks. Nondiversifiable risks are related to the market in general and are
15 referred to as systematic risks. Risks that can be eliminated by diversification are
16 regarded as nonsystematic risks. In a broad sense, systematic risks are market risks, and
17 nonsystematic risks are business risks. The CAPM theory suggests that the market will
18 not compensate investors for assuming risks that can be diversified away. Therefore, the
19 only risk that investors will be compensated for are systematic or nondiversifiable risks.

20 The beta is a measure of the systematic or nondiversifiable risks.

21 **Q. PLEASE DESCRIBE THE INPUTS TO YOUR CAPM.**

22 **A.** The CAPM requires an estimate of the market risk-free rate, the company's beta, and the
23 market risk premium.

1 **Q. WHAT DID YOU USE AS AN ESTIMATE OF THE MARKET RISK-FREE**
2 **RATE?**

3 **A.** I used Blue Chip Financial Forecasts' projected 30-year Treasury bond yield of 5.3%.
4 The current 30-year bond yield is 5.12%.^{7/}

5 **Q. WHY DID YOU USE LONG-TERM TREASURY BOND YIELDS AS AN**
6 **ESTIMATE OF THE RISK-FREE RATE?**

7 **A.** Treasury securities are backed by the full faith and credit of the United States
8 government. Therefore, long-term Treasury bonds are considered to have negligible
9 credit risk. Also, long-term Treasury bonds have an investment horizon similar to that of
10 common stock. As a result, investor-anticipated long-run inflation expectations are
11 reflected in both common stock required returns and long-term bond yields. Therefore,
12 the nominal risk-free rate (or expected inflation rate and real risk-free rate) included in a
13 long-term bond yield is a reasonable estimate of the nominal risk-free rate included in
14 common stock returns.

15 Treasury bond yields, however, do include risk premiums related to unanticipated
16 future inflation and interest rates. Therefore, a Treasury bond yield is not a risk-free rate.
17 Risk premiums related to unanticipated inflation and interest rates are systematic or
18 market risks. Consequently, for companies with betas less than one, using the Treasury
19 bond yield as a proxy for the risk-free rate in the CAPM analysis can produce an
20 overstated estimate of the CAPM return.

21 **Q. WHAT BETA DID YOU USE IN YOUR ANALYSIS?**

22 **A.** I relied on a beta estimate of 0.80. I arrived at this beta estimate from a review of the
23 current and historical trend in beta estimates for my comparable group, as shown on page

^{7/} Exhibit ICNU-CUB/318, Gorman/2.

1 1 of 1 my Exhibit ICNU-CUB/313. The current beta for my group is 0.84. However, the
2 group beta has been increasing meaningfully over the last five years as illustrated on this
3 exhibit. This increase in the utility group beta has not been the result of an increase in
4 utility risk, but rather a result of utility stock outperforming the market index over the last
5 5 years. This stock performance is shown on page 2 of Exhibit ICNU-CUB/312.

6 A utility beta is based on the correlation of utility stocks relative to the market
7 index. Normally, the market outperforms utility stocks and has greater return volatility
8 or risk than do utility investments. However, over the last five years, utility stocks have
9 outperformed the market thus increasing utility betas and giving the false impression that
10 utility risk has increased. In reality, utility risk has not increased. Rather, utility stocks
11 have held their value better than the market, thus outperforming the market. This
12 indicates that utility stocks are still low risk investments. For this reason, a beta estimate
13 of 0.80 is reasonable compared to historical betas, and reflects utility stocks below
14 market risk. Therefore, in my CAPM analysis I will use a beta of 0.80.

15 **Q. HOW DID YOU DERIVE YOUR MARKET PREMIUM ESTIMATE?**

16 **A.** I derived two market premium estimates, a forward-looking estimate and one based on a
17 long-term historical average.

18 The forward-looking estimate was derived by estimating the expected return on
19 the market (S&P 500) and subtracting the risk-free rate from this estimate. I estimated
20 the expected return on the S&P 500 by adding an expected inflation rate to the long-term
21 historical arithmetic average real return on the market. The real return on the market
22 represents the achieved return above the rate of inflation.

1 The Ibbotson and Associates' Stocks, Bonds, Bills and Inflation 2006 Year Book
2 publication estimates the historical arithmetic average real market return over the period
3 1926-2005 as 9.1%. A current five-year consensus analyst inflation projection, as
4 measured by the Consumer Price Index, is 2.3%.^{8/} Using these estimates, the expected
5 market return is 11.6%.^{9/} The market premium then is the difference between the 11.6%
6 expected market return, and my 5.3% risk-free rate estimate, or 6.3%.

7 The historical estimate of the market risk premium was also estimated by
8 Ibbotson and Associates in the Stock, Bonds, Bills and Inflation 2006 Year Book. Over
9 the period 1926 through 2005, Ibbotson's study estimated that the arithmetic average of
10 the achieved total return on the S&P 500 was 12.3%, and the total return on long-term
11 Treasury bonds was 5.8%. The indicated equity risk premium is 6.5% (12.3% - 5.8% =
12 6.5%).

13 **Q. WHAT ARE THE RESULTS OF YOUR CAPM ANALYSIS?**

14 **A.** As shown on Exhibit ICNU-CUB/313, based on the prospective market risk premium of
15 6.5%, and historical market risk premium estimate of 6.3%, a risk free rate of 5.3%, and a
16 beta of 0.80, the CAPM estimated return on equity is 10.4%.

^{8/} Exhibit ICNU-CUB/318, Gorman/2.
^{9/} $(1.023) * (1.096) - 1 = 11.6\%$.

1 **Return on Equity Summary**

2 **Q. BASED ON THE RESULTS OF YOUR RATE OF RETURN ON COMMON**
 3 **EQUITY ANALYSES DESCRIBED ABOVE, WHAT RETURN ON COMMON**
 4 **EQUITY DO YOU RECOMMEND FOR PGE?**

5 **A.** Based on my analyses, I estimate PGE's current market cost of equity to be 9.9%.

TABLE 3	
<u>Return on Common Equity Summary</u>	
<u>Description</u>	<u>Percent</u>
Constant Growth DCF	9.5%
Risk Premium	10.4%
CAPM	10.4%

6 My recommended return on equity of 9.9% is at the mid-point of my estimated
 7 return on equity range for PGE of 9.5% to 10.4%. The high end of my estimated range is
 8 based on my CAPM and risk premium analyses, and the low end of my estimated range
 9 is based on my DCF analysis.

10 **VI. FINANCIAL INTEGRITY**

11 **Q. WILL YOUR RECOMMENDED OVERALL RATE OF RETURN SUPPORT**
 12 **PGE'S CURRENT BOND RATING FROM S&P?**

13 **A.** Yes. I have reached this conclusion by comparing the key credit rating financial ratios
 14 for PGE at my proposed capital structure and return on equity to S&P's benchmark
 15 financial ratios for an "A" rated utility and "BBB" rated utility with a business profile
 16 score of 5.

1 **Q. PLEASE DESCRIBE S&P'S USE OF THE FINANCIAL BENCHMARK RATIOS**
2 **IN ITS CREDIT RATING REVIEW.**

3 **A.** S&P evaluates a utility's credit rating based on an assessment of its financial and
4 business risks. A combination of financial and business risks equates to the overall
5 assessment of the Company's total credit risk exposure. S&P publishes a matrix of
6 financial ratios that defines the level of financial risk as a function of the level of business
7 risk.

8 S&P rates a utility's business risk based on a business profile score of 1, lowest
9 risk, up to 10, highest risk. Integrated electric utilities typically have a business profile
10 score from S&P of 4, 5 or 6, while transmission and distribution electric utilities' profile
11 scores primarily range from 2 to 4.

12 S&P publishes ranges for three primary financial ratios that it uses as guidance in
13 its credit review for utility companies. The three primary financial ratio benchmarks it
14 relies on in its credit rating process include: 1) funds from operations ("FFO") to debt
15 interest expense; 2) FFO to total debt; and 3) total debt to total capital.

16 **Q. HOW DID YOU APPLY S&P'S FINANCIAL RATIOS TO TEST THE**
17 **REASONABLENESS OF YOUR RATE OF RETURN RECOMMENDATIONS?**

18 **A.** I calculated each of S&P's financial ratios based on PGE's cost of service for retail
19 operations and PGE's off-balance sheet debt for the 2007 test year.

20 While S&P would be concerned with total PGE consolidated financial ratios in its
21 credit review process, my investigation in this proceeding is to judge the reasonableness
22 of my proposed cost of capital for setting rates in PGE's Oregon utility operations.
23 Hence, I am attempting to determine whether the rate of return and cash flow generation

1 opportunity reflected in my proposed utility rates for PGE will support PGE's current
2 secured "A-" and unsecured "BBB+" investment grade bond ratings and financial
3 integrity.

4 **Q. PLEASE DESCRIBE THE RESULTS OF THIS CREDIT METRIC ANALYSIS**
5 **FOR PGE.**

6 **A.** The S&P financial metric calculations for PGE are developed on my Exhibit ICNU-
7 CUB/314.

8 As shown on my Exhibit ICNU-CUB/314, based on an equity return of 9.9%,
9 PGE will be provided an opportunity to produce a FFO to debt interest expense of 4.3x.
10 This FFO to interest coverage ratio is within the S&P benchmark ratio guideline of 4.5x
11 to 3.8x for an "A" rated utility company with a business profile score of 5.

12 At my proposed capital structure, PGE's total debt ratio to total capital is 55.0%.
13 This is within the S&P "BBB" rated utility range of 50% to 60%.

14 Finally, PGE's retail operations FFO to total debt coverage at a 9.9% equity
15 return would be 24%, which is again within S&P's financial metric range of 22% to 30%
16 for a "A" rated utility company with a business profile score of 5.

17 At my proposed capital structure and return on equity, PGE's financial metrics
18 are supportive of a strong "BBB" and a weak "A" utility bond rating at PGE's current
19 business profile score of 5.

1 **VII. RESPONSE TO PGE WITNESSES HAGER-VALACH**

2 **Q. WHAT RETURN ON COMMON EQUITY IS PGE PROPOSING FOR THIS**
3 **PROCEEDING?**

4 **A.** PGE is proposing to set rates based on a return on equity of 10.75%. The Hager-Valach
5 witnesses relied on several proxy groups to construct DCF analyses, and risk premium
6 studies that they referred to as a risk positioning method.

7 Based on their studies, the PGE witnesses conclude that PGE's current market
8 required return on equity falls within the range of 9.25% to 11.3%. However, as set forth
9 below, the PGE witnesses have provided many cost estimates that significantly overstate
10 PGE's current cost of equity. As discussed below, the PGE witnesses' own studies
11 illustrate that PGE's current cost of equity falls within my recommended range of 9.5%
12 to 10.4%.

13 **Q. PLEASE DESCRIBE THE COMPANY'S DISCOUNTED CASH FLOW**
14 **ANALYSIS.**

15 **A.** As summarized at page 40 of the PGE witnesses' testimony, they estimate a multi-stage
16 DCF return in the range of 8.1% to 9.6%, based on a growth rate derived from a "br+vs,"
17 which is normally referred to as the internal growth methodology, and a multi-stage DCF
18 using GDP growth projections.

19 The PGE witnesses provide very little detail and description supporting their
20 multi-stage DCF growth. Nevertheless, what is clearly evident from the PGE witnesses'
21 findings, is that the majority of the returns fall in the range of 8.1% to 9.6%. Only one
22 estimate is above that, and it is 11.2%, which is based on a GDP growth rate estimate.
23 This high-end DCF return number should be rejected outright for several reasons.

1 First, GDP growth rate is not a reasonable long-term sustainable growth proxy to
2 use for utility companies. Specifically, utilities pay out a relatively high percentage of
3 their earnings as dividends. Indeed, utilities' dividend payout ratios are approximately
4 70% of earnings, where the S&P 500 or market index payout ratios are about 30%.
5 Companies that pay out a higher percentage of their earnings have higher dividend yields,
6 but have lower growth prospects because they are not reinvesting the majority of their
7 earnings in their companies to grow future earnings and dividends. Consequently, it not
8 reasonable to expect that a utility can have both high dividend yields and strong growth
9 projections, as the PGE witnesses are assuming based on their DCF model using GDP
10 growth projections. As such, this high-end estimate is unreasonable, flawed, and
11 overstates a reasonable DCF return for PGE.

12 Second, this high-end DCF return estimate is unreasonable because it simply
13 reflects extraordinarily high growth projections for the utility companies, and even
14 exceeds GDP growth. Specifically, utility companies' dividend yields currently are
15 below 5%, as illustrated above in my DCF schedule (Exhibit ICNU-CUB/306). A DCF
16 return of 11.2% implies a weighted average long-term growth rate of approximately
17 6.2%. This growth rate exceeds the consensus economists' GDP growth forecast of
18 approximately 5.2%, as referenced above in my testimony. Hence, this 11.2% multi-
19 stage growth rate reflects excessively high growth that is irrational in comparison to the
20 overall growth of the economy in which utilities will sell their goods and services. This
21 growth rate is simply not sustainable or achievable, and therefore the DCF return is
22 excessive and should be rejected.

1 **Q. PLEASE DESCRIBE THE COMPANY'S RISK POSITIONING ANALYSIS.**

2 **A.** The Company's risk positioning analysis is a risk premium study based on a selection of
3 authorized returns on equity relative to the contemporary corporate bond yields and
4 seven-year Treasury bond yields. The PGE witnesses then performed a regression
5 analysis to estimate what the current risk premium would be for a utility company's
6 common equity investment relative to contemporaneous corporate bond yields and seven-
7 year Treasury bond yields.

8 **Q. ARE THE PGE WITNESSES' RISK POSITIONING RESULTS REASONABLE?**

9 **A.** No. The Company's risk premium over seven-year Treasury bonds should be rejected
10 because this is not a reasonable interest rate proxy to use to estimate an equity risk
11 premium for an equity security. Also, the Company's regression analysis implies
12 precision in identifying a point estimate for an equity risk premium that is flawed and
13 unreliable.

14 **Q. PLEASE DESCRIBE WHY THE COMPANY'S RISK POSITIONING METHOD**
15 **OVER SEVEN-YEAR TREASURY BOND YIELDS SHOULD BE REJECTED.**

16 **A.** Short-term interest rates are significantly more volatile than are long-term interest rates.
17 Short-term interest rates are impacted by Federal Reserve policy to control inflation,
18 money supply, and other macro-economic factors. Hence, short-term interest rates'
19 volatility is largely the result of government interventions. In contrast, long-term interest
20 rates reflect the market's assessment of long-term inflation expectations, interest rate
21 changes, and relative investment risk. Common equity valuations in the market are more
22 reflective of long-term Treasury bonds than they are of short-term Treasury bonds.
23 Indeed, Federal Reserve policies do not directly impact common equity securities of

1 utility companies like they impact short-term interest rate instruments, such as seven-year
2 Treasury bonds. Accordingly, it is much more reliable and accurate to use a longer term
3 Treasury bond, such as a 20-year or 30-year bond, in estimating a utility's equity risk
4 premium. Treasury bond maturity reflects the market's assessment of long-term
5 inflation, interest rates and investment risk, and is not as directly impacted by Federal
6 Reserve policy objectives. For all these reasons, the Company's risk premium over
7 seven-year Treasury bonds should be rejected.

8 **Q. PLEASE DESCRIBE THE OTHER FLAWS IN THE COMPANY'S RISK**
9 **POSITIONING ANALYSIS.**

10 **A.** The PGE witnesses' regression analysis of authorized returns and yields assumes a
11 simplistic relationship between interest rates and equity risk premiums. In reality, risk
12 premiums do not change unless there is a perceived change in the investment risk of
13 equity investments relative to debt investments. For example, as inflation expectations
14 decline, one would rationally expect that Treasury bond yields and common equity
15 returns would decline in relationship to the lower inflation expectations. This is a
16 rational expectation because the yields on both Treasury bonds and common equity
17 reflect a real risk return that considers both the investment risk and risk free rate, along
18 with an inflation factor to arrive at the total adjusted return. With securities with
19 comparable investment horizons, it is reasonable to believe that the inflation expectation
20 is the same in the two competing investments. Hence, if inflation expectations decline,
21 one would rationally expect that interest rates and common equity required returns would
22 decline in correspondence to the lower inflation expectations. The PGE witnesses'
23 simplistic regression analysis ignores this fundamental factual principle.

1 **Q. BASED ON A REASONABLE ASSESSMENT OF A RISK POSITIONING**
2 **RETURN ON EQUITY ESTIMATE, WHAT SHOULD THE COMMISSION**
3 **CONCLUDE THAT PGE'S COST OF EQUITY IS?**

4 **A.** The Company's risk premium over corporate bonds indicates a return on equity of
5 10.5%. This is very similar to the equity risk premium I estimated above. While this risk
6 premium estimate is within the range of reasonableness, I would note that it reflects a
7 high-end equity risk premium return estimate. Specifically, the Company's equity risk
8 premium is based on approximately a 4.5% risk premium. As I noted above, equity risk
9 premiums for utility equities relative to contemporary utility bond yields range from
10 about 3% to 4.5%. While the utility witnesses' estimate falls within the range of
11 reasonableness, it is nonetheless a high-end estimate of reasonableness. Therefore, the
12 Commission should apply equal weight to the results of their DCF return, as well as their
13 CAPM return, to develop a reasonable mid-point estimate for a return on equity for PGE
14 in this proceeding.

15 **Q. THE PGE WITNESSES ALSO STATE THAT PGE HAS GREATER RISK THAN**
16 **THAT OF OTHER ELECTRIC UTILITY COMPANIES, AND THIS RISK**
17 **SHOULD BE REFLECTED IN ITS RATE OF RETURN. PLEASE COMMENT.**

18 **A.** The PGE witnesses did not provide any quantitative or qualitative assessment of PGE's
19 risk in relationship to other utilities. Therefore it is simply not possible to conclude, as
20 the PGE witnesses did, that PGE has greater risk. To the contrary, PGE's risk appears to
21 be solely reflective of regulated utility operations, and should get nothing more than an
22 average or typical authorized return on equity in today's low-cost capital environment for
23 the following reasons:

1 1. PGE is principally a regulated utility operation. It is not affiliated with higher
2 risk non-regulated entities and, therefore, its risk is based solely on its regulated
3 operations.

4 2. PGE now has access to capital markets, both debt and equity, on its own.
5 Therefore, its access to capital is no longer constrained based on its affiliation
6 with a higher risk parent company.

7 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

8 **A. Yes.**

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 180/UE 181/UE 184

In the Matter of)
)
PORTLAND GENERAL ELECTRIC)
COMPANY)
)
Request for a General Rate Revision)
(UE 180),)
_____)

In the Matter of)
)
PORTLAND GENERAL ELECTRIC)
COMPANY)
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Annual Adjustments to Schedule 125 (2007)
RVM Filing) (UE 181),)
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In the Matter of)
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PORTLAND GENERAL ELECTRIC)
COMPANY)
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Request for a General Rate Revision relating)
to the Port Westward plant (UE 184).)
_____)

**QUALIFICATIONS OF
MICHAEL P. GORMAN**

August 14, 2006

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A.** Michael P. Gorman. My business mailing address is P. O. Box 412000, 1215 Fern Ridge
3 Parkway, Suite 208, St. Louis, Missouri 63141-2000.

4 **Q. PLEASE STATE YOUR OCCUPATION.**

5 **A.** I am a consultant in the field of public utility regulation with Brubaker & Associates, Inc.
6 (“BAI”), energy, economic and regulatory consultants.

7 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**

9 **A.** In 1983 I received a Bachelors of Science Degree in Electrical Engineering from
10 Southern Illinois University, and in 1986, I received a Masters Degree in Business
11 Administration with a concentration in Finance from the University of Illinois at
12 Springfield. I have also completed several graduate level economics courses.

13 In August of 1983, I accepted an analyst position with the Illinois Commerce
14 Commission (“ICC”). In this position, I performed a variety of analyses for both formal
15 and informal investigations before the ICC, including: marginal cost of energy, central
16 dispatch, avoided cost of energy, annual system production costs, and working capital.
17 In October of 1986, I was promoted to the position of Senior Analyst. In this position, I
18 assumed the additional responsibilities of technical leader on projects, and my areas of
19 responsibility were expanded to include utility financial modeling and financial analyses.

20 In 1987, I was promoted to Director of the Financial Analysis Department. In this
21 position, I was responsible for all financial analyses conducted by the staff. Among other
22 things, I conducted analyses and sponsored testimony before the ICC on rate of return,

1 financial integrity, financial modeling and related issues. I also supervised the
2 development of all Staff analyses and testimony on these same issues. In addition, I
3 supervised the Staff's review and recommendations to the Commission concerning utility
4 plans to issue debt and equity securities.

5 In August of 1989, I accepted a position with Merrill-Lynch as a financial
6 consultant. After receiving all required securities licenses, I worked with individual
7 investors and small businesses in evaluating and selecting investments suitable to their
8 requirements.

9 In September of 1990, I accepted a position with Drazen-Brubaker & Associates,
10 Inc. ("DBA"). In April 1995 the firm of BAI was formed. It includes most of the former
11 DBA principals and Staff. Since 1990, I have performed various analyses and sponsored
12 testimony on cost of capital, cost/benefits of utility mergers and acquisitions, utility
13 reorganizations, level of operating expenses and rate base, cost of service studies, and
14 analyses relating industrial jobs and economic development. I also participated in a study
15 used to revise the financial policy for the municipal utility in Kansas City, Kansas.

16 At BAI, I also have extensive experience working with large energy users to
17 distribute and critically evaluate responses to requests for proposals ("RFPs") for electric,
18 steam, and gas energy supply from competitive energy suppliers. These analyses include
19 the evaluation of gas supply and delivery charges, cogeneration and/or combined cycle
20 unit feasibility studies, and the evaluation of third-party asset/supply management
21 agreements. I have also analyzed commodity pricing indices and forward pricing
22 methods for third party supply agreements. Continuing, I have also conducted regional
23 electric market price forecasts.

1 In addition to our main office in St. Louis, the firm also has branch offices in
2 Phoenix, Arizona; Chicago, Illinois; Corpus Christi, Texas; and Plano, Texas.

3 **Q. HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

4 **A.** Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of service
5 and other issues before the regulatory commissions in Arizona, California, Delaware,
6 Georgia, Illinois, Indiana, Iowa, Michigan, Missouri, New Mexico, New Jersey,
7 Oklahoma, Oregon, Tennessee, Texas, Utah, Vermont, Washington, West Virginia,
8 Wisconsin, Wyoming, and before the provincial regulatory boards in Alberta and Nova
9 Scotia, Canada. I have also sponsored testimony before the Board of Public Utilities in
10 Kansas City, Kansas; presented rate setting position reports to the regulatory board of the
11 municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial
12 customers; and negotiated rate disputes for industrial customers of the Municipal Electric
13 Authority of Georgia in the LaGrange, Georgia district.

14 **Q. PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR**
15 **ORGANIZATIONS TO WHICH YOU BELONG.**

16 **A.** I earned the designation of Chartered Financial Analyst (“CFA”) from the Association
17 for Investment Management and Research (“AIMR”). The CFA charter was awarded
18 after successfully completing three examinations which covered the subject areas of
19 financial accounting, economics, fixed income and equity valuation and professional and
20 ethical conduct. I am a member of AIMR’s Financial Analyst Society.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 181/UE 184

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ICNU-CUB/302

RATE OF RETURN AT 9.9% ROE

August 14, 2006

Portland General Electric

Rate of Return at 9.9% ROE

<u>Line</u>	<u>Description</u>	<u>Amount</u> (1)	<u>Weight</u> (2)	<u>Cost</u> (3)	<u>Weighted</u> <u>Cost</u> (4)
1	Long-Term Debt	\$ 1,133,067	49.71%	6.69%	3.33%
2	Preferred Stock	\$ 6,633	0.29%	8.43%	0.02%
3	<u>Common Equity</u>	<u>\$ 1,139,700</u>	<u>50.00%</u>	9.90%	<u>4.95%</u>
4	Total	\$ 2,279,400	100.00%		8.30%

Source:
Hager-Valach / Exhibit 1101.

BEFORE THE PUBLIC UTILITY COMMISSION

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ICNU-CUB/303

ACCURACY OF INTEREST RATE FORECASTS

August 14, 2006

Portland General Electric

Accuracy of Interest Rate Forecasts

(Long-Term Treasury Bond Yields - Projected Vs. Actual)

Line	Date	Publication Data			Actual Yield in Projected Quarter	Analysis	
		Current Yield (1)	Projected Yield (2)	For Quarter (3)		Projected Yield Change (5)	Actual Yield Change (6)
1	Dec-00	5.8%	5.8%	1Q, 02	5.6%	0.0%	-0.2%
2	Mar-01	5.7%	5.6%	2Q, 02	5.8%	-0.1%	0.1%
3	Jun-01	5.4%	5.8%	3Q, 02	5.2%	0.4%	-0.2%
4	Sep-01	5.7%	5.9%	4Q, 02	5.1%	0.2%	-0.6%
5	Dec-01	5.5%	5.7%	1Q, 03	4.9%	0.2%	-0.6%
6	Mar-02	5.3%	5.9%	2Q, 03	4.7%	0.6%	-0.6%
7	Jun-02	5.6%	6.2%	3Q, 03	5.2%	0.6%	-0.4%
8	Sep-02	5.8%	5.9%	4Q, 03	5.2%	0.1%	-0.6%
9	Dec-02	5.2%	5.7%	1Q, 04	4.9%	0.5%	-0.3%
10	Mar-03	5.1%	5.7%	2Q, 04	5.4%	0.6%	0.3%
11	Jun-03	5.0%	5.4%	3Q, 04	5.1%	0.4%	0.1%
12	Sep-03	4.7%	5.8%	4Q, 04	4.9%	1.1%	0.2%
13	Dec-03	5.2%	5.9%	1Q, 05	4.8%	0.7%	-0.4%
14	Mar-04	5.2%	5.9%	2Q, 05	4.6%	0.7%	-0.6%
15	Jun-04	4.9%	6.2%	3Q, 05	4.5%	1.3%	-0.4%
16	Sep-04	5.4%	6.0%	4Q, 05	4.8%	0.6%	-0.6%
17	Dec-04	5.1%	5.8%	1Q, 06	4.6%	0.7%	-0.4%
18	Mar-05	4.9%	5.6%	2Q, 06	5.1%	0.7%	0.3%
21	Apr-05	4.7%	5.7%	3Q, 06			
22	May-05	4.8%	5.6%	3Q, 06			
23	Jun-05	4.8%	5.5%	3Q, 06			
24	Jul-05	4.6%	5.3%	4Q, 06			
25	Aug-05	4.6%	5.2%	4Q, 06			
26	Sep-05	4.6%	5.2%	4Q, 06			
27	Oct-05	4.5%	5.2%	1Q, 07			
28	Nov-05	4.5%	5.3%	1Q, 07			
29	Dec-05	4.5%	5.3%	1Q, 07			
30	Jan-06	4.8%	5.3%	2Q, 07			
31	Feb-06	4.8%	5.1%	2Q, 07			
32	Mar-06	4.8%	5.1%	2Q, 07			
33	Apr-06	N/A	5.1%	3Q, 07			
34	May-06	4.6%	5.2%	3Q, 07			
35	Jun-06	4.6%	5.3%	3Q, 07			
36	Jul-06	5.1%	5.3%	4Q, 07			

Source:

Blue Chip Financial Forecasts, Various Dates.

BEFORE THE PUBLIC UTILITY COMMISSION

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UE 180/UE 181/UE 184

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ICNU-CUB/304

COMPARABLE UTILITIES

August 14, 2006

Portland General Electric

Comparable Group

<u>Line</u>	<u>Electric Utility</u>	<u>Bond Ratings</u>		<u>Business Profile Rating³</u> (3)	<u>2005 Common Equity Ratios</u>	
		<u>S&P¹</u> (1)	<u>Moody's¹</u> (2)		<u>Value Line²</u> (4)	<u>AUS</u> (5)
1	Ameren Corp.	A-	A3	6	53%	50%
2	DTE Energy	BBB+	A3	6	45%	43%
3	Empire Dist. Elec.	A-	Baa1	6	49%	46%
4	Energy East Corp.	BBB+	A3	3	44%	42%
5	FirstEnergy Corp.	BBB	Baa1	6	52%	45%
6	IDACORP, Inc.	A-	A3	5	50%	49%
7	NiSource Inc.	BBB	Baa2	4	48%	45%
8	OGE Energy	BBB+	Baa2	5	51%	51%
9	Pepco Holdings	A-	A3	5	42%	41%
10	Pinnacle West Capital	BBB-	Baa1	5	57%	48%
11	Puget Energy Inc.	BBB	Baa2	4	46%	44%
12	Xcel Energy Inc.	A-	A3	5	47%	43%
13	Average	BBB+	Baa1	5	49%	46%
14	Portland General Electric	BBB+	Baa1	5	56% ⁴	

Sources:

¹ AUS Utility Reports; June, 2006.

² The Value Line Investment Survey; May 12, June 2, June 30, 2006.

³ U.S. Utilities and Power Ranking List, March 24, 2006.

⁴ Griffin Direct at 3.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 181/UE 184

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ICNU-CUB/305

GROWTH RATE ESTIMATES

August 14, 2006

Portland General Electric

Growth Rate Estimates

<u>Line</u>	<u>Electric Utility</u>	<u>Zacks Estimated Growth %¹</u> (1)	<u>Zacks Number of Estimates¹</u> (2)	<u>Reuters Estimated Growth %²</u> (3)	<u>Reuters Number of Estimates²</u> (4)	<u>Thomson Estimated Growth %³</u> (5)	<u>Thomson Number of Estimates³</u> (6)	<u>AVG of Growth Rates</u> (7)
1	Ameren Corp.	6.00%	5	5.80%	5	5.00%	4	5.60%
2	DTE Energy	5.50%	4	4.33%	3	4.33%	3	4.72%
3	Empire Dist. Elec.	N/A	N/A	2.50%	2	3.33%	3	2.92%
4	Energy East Corp.	4.50%	2	4.33%	3	4.33%	3	4.39%
5	FirstEnergy Corp.	4.86%	7	4.43%	7	4.60%	5	4.63%
6	IDACORP, Inc.	4.67%	3	4.75%	4	4.67%	3	4.70%
7	NiSource Inc.	3.33%	6	3.43%	7	3.33%	6	3.36%
8	OGE Energy	3.00%	1	3.00%	3	3.00%	2	3.00%
9	Pepco Holdings	4.67%	6	5.40%	5	5.20%	5	5.09%
10	Pinnacle West Capital	6.75%	4	7.60%	5	7.20%	5	7.18%
11	Puget Energy Inc.	7.00%	1	5.14%	7	3.67%	3	5.27%
12	Xcel Energy Inc.	4.50%	6	4.50%	6	5.00%	6	4.67%
13	Average	4.98%	4	4.60%	5	4.47%	4	4.63%

Sources:

¹ www.zacksadvisor.com, Detailed Research on July 11, 2006.

² www.investor.reuters.com, Earnings Estimates on July 11, 2006.

³ http://ec.thomsonfn.com, Earnings Estimates on July 11 2006.

BEFORE THE PUBLIC UTILITY COMMISSION

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ICNU-CUB/306

CONSTANT GROWTH DCF MODEL

August 14, 2006

Portland General Electric

Constant Growth DCF Model

<u>Line</u>	<u>Electric Utility</u>	<u>13-Week AVG Stock Price¹</u> (1)	<u>AVG (%) Growth</u>	<u>Annual Dividend²</u> (3)	<u>Adjusted Yield</u> (4)	<u>Constant Growth DCF</u> (5)
1	Ameren Corp.	\$ 49.87	5.60%	\$ 2.54	5.38%	10.98%
2	DTE Energy	\$ 40.33	4.72%	\$ 2.06	5.35%	10.07%
3	Empire Dist. Elec.	\$ 21.78	2.92%	\$ 1.28	6.05%	8.96%
4	Energy East Corp.	\$ 23.68	4.39%	\$ 1.16	5.11%	9.50%
5	FirstEnergy Corp.	\$ 51.96	4.63%	\$ 1.80	3.62%	8.25%
6	IDACORP, Inc.	\$ 33.66	4.70%	\$ 1.20	3.73%	8.43%
7	NiSource Inc.	\$ 21.34	3.36%	\$ 0.92	4.46%	7.82%
8	OGE Energy	\$ 31.35	3.00%	\$ 1.33	4.38%	7.38%
9	Pepco Holdings	\$ 22.92	5.09%	\$ 1.04	4.77%	9.86%
10	Pinnacle West Capital	\$ 39.73	7.18%	\$ 2.00	5.40%	12.58%
11	Puget Energy Inc.	\$ 20.95	5.27%	\$ 1.00	5.02%	10.29%
12	Xcel Energy Inc.	\$ 18.72	4.67%	\$ 0.86	4.81%	9.48%
13	Average	\$ 31.36	4.63%	\$ 1.43	4.84%	9.5%

Sources:

¹ <http://moneycentral.msn.com>, downloaded on July 11, 2006.

² The Value Line Investment Survey; May 12, June 2, June 30, 2006.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 181/UE 184

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ICNU-CUB/307

GDP AND DIVIDEND GROWTH RATES

August 14, 2006

Portland General Electric

GDP and Dividend Growth Rates

Line	Electric Group	Dividend Growth			Inflation (CPI)			Nominal GDP	
		Past 5 Years ¹ (1)	Past 10 Years ¹ (2)	3-5 Years Projection ¹ (3)	Past 5 Years ² (4)	Past 10 Years ² (5)	3-5 Years Projection ² (6)	Past 5 Years ¹ (7)	Past 10 Years ¹ (8)
1	Ameren Corp.	N/A	0.5%	N/A					
2	DTE Energy	N/A	N/A	0.5%					
3	Empire Dist. Elec.	N/A	N/A	N/A					
4	Energy East Corp.	5.0%	1.5%	4.5%					
5	FirstEnergy Corp.	2.5%	1.5%	5.0%					
6	IDACORP, Inc.	-6.0%	-3.0%	-2.0%					
7	NiSource Inc.	1.0%	3.0%	0.5%					
8	OGE Energy	N/A	N/A	2.0%					
9	Pepco Holdings	N/A	N/A	3.0%					
10	Pinnacle West Capital	6.5%	11.0%	5.0%					
11	Puget Energy Inc.	-11.5%	-6.0%	1.5%					
12	Xcel Energy Inc.	-11.0%	-5.0%	5.5%					
13	Average	-1.9%	0.4%	2.6%	2.7%	2.5%	2.2%	5.2%	5.3%

Sources:

¹ The Value Line Investment Survey; May 12, June 2, June 30, 2006.

² The Value Line Investment Survey; July 7, 2000 and March 17, 2006.

BEFORE THE PUBLIC UTILITY COMMISSION

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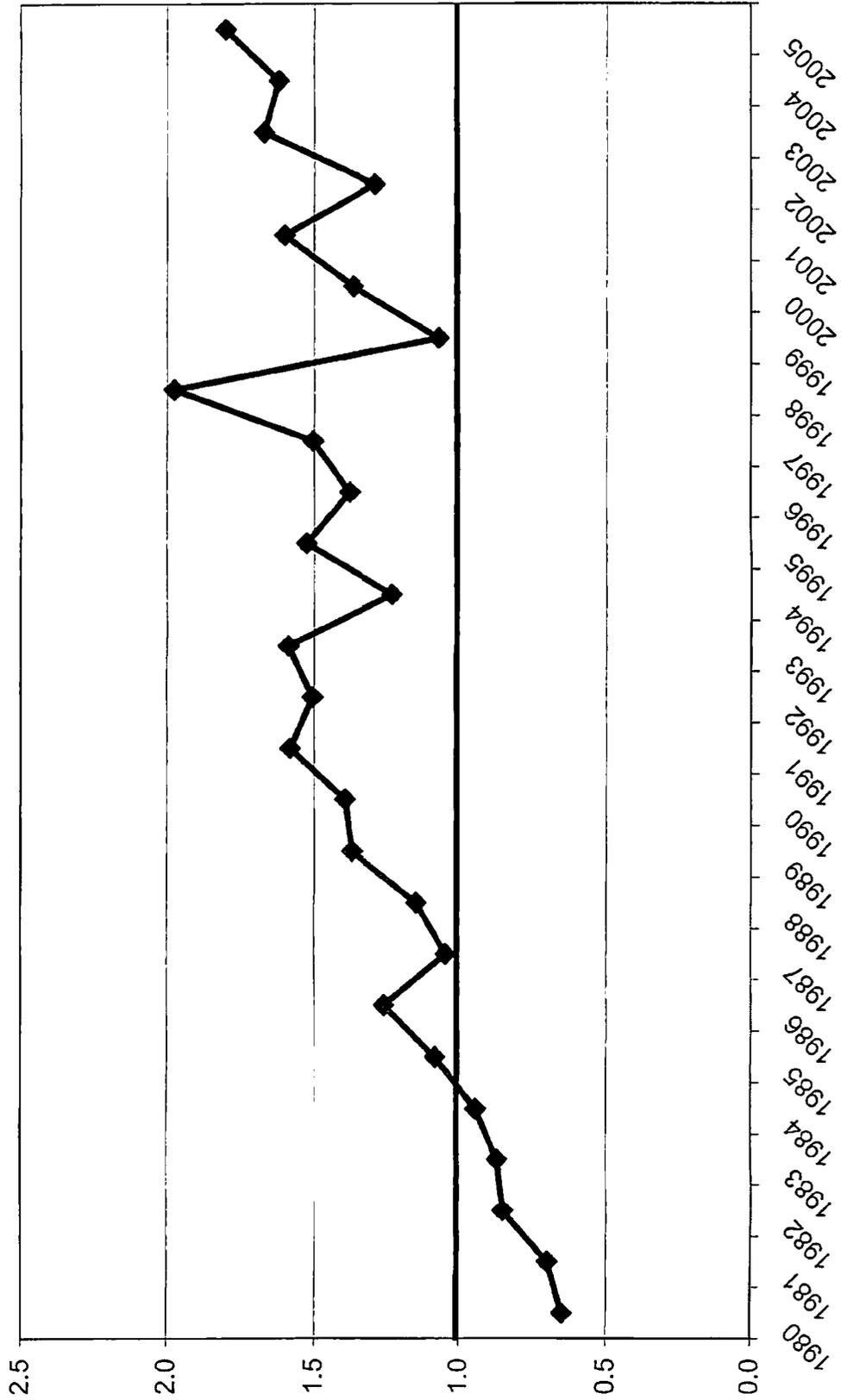
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_____)

ICNU-CUB/308

ELECTRIC COMMON STOCK MARKET/BOOK RATIO

August 14, 2006

Portland General Electric Electric Common Stock Market/Book Ratio



Sources:
2002-2005: AUS Utility Reports.
1980 - 2000: Mergent Public Utility Manual, 2003; at a15, and a17.

BEFORE THE PUBLIC UTILITY COMMISSION

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In the Matter of)
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ICNU-CUB/309

EQUITY RISK PREMIUM – TREASURY BOND

August 14, 2006

Portland General Electric

Equity Risk Premium - Treasury Bond

<u>Line</u>	<u>Date</u>	<u>Treasury Bond Yield¹</u> (1)	<u>Authorized Electric Returns²</u> (2)	<u>Indicated Risk Premium</u> (3)
1	1986	7.78%	13.93%	6.15%
2	1987	8.59%	12.99%	4.40%
3	1988	8.96%	12.79%	3.83%
4	1989	8.45%	12.97%	4.52%
5	1990	8.61%	12.70%	4.09%
6	1991	8.14%	12.55%	4.41%
7	1992	7.67%	12.09%	4.42%
8	1993	6.59%	11.41%	4.82%
9	1994	7.37%	11.34%	3.97%
10	1995	6.88%	11.55%	4.67%
11	1996	6.71%	11.39%	4.68%
12	1997	6.61%	11.40%	4.79%
13	1998	5.58%	11.66%	6.08%
14	1999	5.87%	10.77%	4.90%
15	2000	5.94%	11.43%	5.49%
16	2001	5.49%	11.09%	5.60%
17	2002	5.42%	11.16%	5.74%
18	2003	5.02%	10.97%	5.95%
19	2004	5.05%	10.73%	5.68%
20	2005	4.65%	10.54%	5.89%
21	2006 ³	5.03%	10.57%	5.54%
22	Average	6.69%	11.72%	5.03%

Sources:

¹ Economic Report of the President, January, 2001 and the St. Louis Federal Reserve Bank Website.

² Regulatory Research Associates, Inc., Regulatory Focus, Jan.90-Dec.05.

³ The data for 2006 includes the period Jan-Jun, 2006.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 181/UE 184

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ICNU-CUB/310

EQUITY RISK PREMIUM – UTILITY BOND

August 14, 2006

Portland General Electric

Equity Risk Premium - Utility Bond

<u>Line</u>	<u>Date</u>	Average "A" Rating Utility <u>Bond Yield</u> ¹ (1)	Authorized Electric <u>Returns</u> ² (2)	Indicated Risk <u>Premium</u> (3)
1	1986	9.58%	13.93%	4.35%
2	1987	10.10%	12.99%	2.89%
3	1988	10.49%	12.79%	2.30%
4	1989	9.77%	12.97%	3.20%
5	1990	9.86%	12.70%	2.84%
6	1991	9.36%	12.55%	3.19%
7	1992	8.69%	12.09%	3.40%
8	1993	7.59%	11.41%	3.82%
9	1994	8.31%	11.34%	3.03%
10	1995	7.89%	11.55%	3.66%
11	1996	7.75%	11.39%	3.64%
12	1997	7.60%	11.40%	3.80%
13	1998	7.04%	11.66%	4.62%
14	1999	7.62%	10.77%	3.15%
15	2000	8.24%	11.43%	3.19%
16	2001	7.78%	11.09%	3.31%
17	2002	7.36%	11.16%	3.80%
18	2003	6.57%	10.97%	4.40%
19	2004	6.01%	10.73%	4.72%
20	2005	5.66%	10.54%	4.88%
21	2006 ³	6.11%	10.57%	4.46%
22	Average	8.16%	11.72%	3.65%

Sources:

¹ Mergent Public Utility Manual, Mergent Weekly News Reports, 2003.

² Regulatory Research Associates, Inc., Regulatory Focus, Jan.90-Dec.05.

³ The data for 2006 includes the period Jan-Jun, 2006.

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ICNU-CUB/311

SERIES "A" AND "Baa" UTILITY BOND YIELDS

August 14, 2006

Portland General Electric

Series "A" and "Baa" Utility Bond Yields

<u>Line</u>	<u>Date</u>	<u>"A" Rating Utility Bond Yield</u> (1)	<u>"Baa" Rating Utility Bond Yield</u> (2)
1	07/07/06	6.41%	6.65%
2	06/29/06	6.51%	6.75%
3	06/23/06	6.52%	6.75%
4	06/16/06	6.42%	6.63%
5	06/09/06	6.27%	6.47%
6	06/02/06	6.32%	6.50%
7	05/26/06	6.38%	6.57%
8	05/19/06	6.35%	6.53%
9	05/12/06	6.51%	6.67%
10	05/05/06	6.40%	6.57%
11	04/28/06	6.37%	6.61%
12	04/21/06	6.32%	6.56%
13	04/13/06	6.34%	6.60%
14	Average	6.39%	6.60%

Source:

www.moody.com, Bond Yields and Key Indicators.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

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ICNU-CUB/312

**HISTORICAL BETA ESTIMATES AND
STOCK PRICE PERFORMANCE GRAPH**

August 14, 2006

Portland General Electric

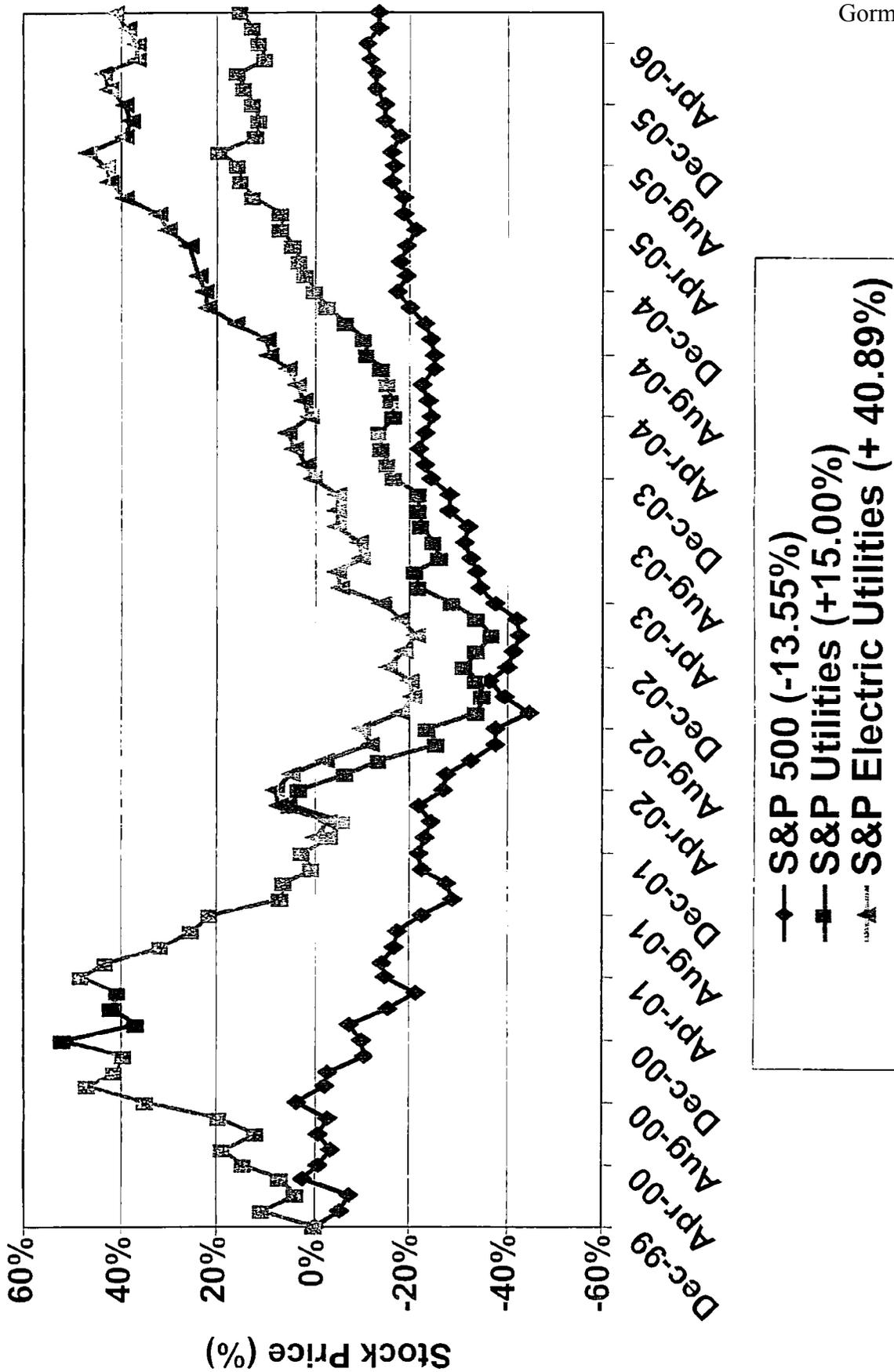
Historical Beta Estimates

<u>Line</u>	<u>Company Name</u>	<u>Historical Beta</u>						<u>Current Beta</u>
		<u>2001</u> (1)	<u>2002</u> (2)	<u>2003</u> (3)	<u>2004</u> (4)	<u>2005</u> (5)	<u>5-Yr. AVG</u> (6)	
1	Ameren Corp.	0.55	0.60	0.65	0.75	0.75	0.66	0.75
2	DTE Energy	0.55	0.60	0.60	0.65	0.70	0.62	0.75
3	Empire Dist. Elec.	0.45	0.50	0.60	0.65	0.70	0.58	0.80
4	Energy East Corp.	0.60	0.65	0.70	0.80	0.80	0.71	0.90
5	FirstEnergy Corp.	0.55	0.55	0.70	0.75	0.75	0.66	0.80
6	IDACORP Inc.	0.50	0.60	0.75	0.85	0.95	0.73	0.95
7	NiSource Inc.	0.45	0.50	0.65	0.75	0.80	0.63	0.90
8	OGE Energy	0.45	0.55	0.60	0.70	0.75	0.61	0.75
9	Pepco Holdings	N/A	N/A	N/A	0.90	0.90	0.90	0.90
10	Pinnacle West Capital	0.45	0.55	0.70	0.85	0.90	0.69	0.95
11	Puget Energy Inc.	0.55	0.60	0.65	0.75	0.80	0.67	0.80
12	Xcel Energy Inc.		0.60	0.70	0.80	0.80	0.73	0.85
13	Average	0.51	0.57	0.66	0.77	0.80	0.68	0.84
14	Median	0.53	0.58	0.65	0.75	0.80	0.66	0.83

Source:

Value Line Investment Analyzer, July, 2006.

Portland General Electric S&P 500 - 12/31/99 - 6/30/06 Stock Price Performance



BEFORE THE PUBLIC UTILITY COMMISSION

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ICNU-CUB/313

CAPM RETURN ESTIMATE

August 14, 2006

Portland General Electric

CAPM Return Estimate

<u>Line</u>	<u>Description</u>	<u>Historical Premium (1)</u>
1	Risk Free Rate ¹	5.3%
2	Risk Premium ²	6.5%
3	Beta ³	0.80
4	CAPM	10.5%

<u>Line</u>	<u>Description</u>	<u>Prospective Premium (1)</u>
5	Risk Free Rate ¹	5.3%
6	Risk Premium ²	6.3%
7	Beta ³	0.80
8	CAPM	10.3%
9	CAPM Average	10.4%

Sources:

¹ Blue Chip Financial Forecasts; July 1, 2006 at 2.

² SBBi; 2006 at pp. 31 & 120.

³ The Value Line Investment Survey; May 12, June 2, June 30, 2006.

BEFORE THE PUBLIC UTILITY COMMISSION

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ICNU-CUB/314

S&P CREDIT RATING FINANCIAL RATIOS AT ROE OF 9.9%

August 14, 2006

Portland General Electric

S&P Credit Rating Financial Ratios at ROE of 9.9%, (000's)

<u>Line</u>	<u>Description</u>	<u>Ratio at 9.9%</u> <u>Equity Return</u> (1)	<u>S&P</u> <u>"A" Rating</u> (BP: 5) <u>Benchmark*</u> (2)	<u>S&P</u> <u>"BBB" Rating</u> (BP: 5) <u>Benchmark*</u> (3)	<u>Reference</u> (4)
1	Rate Base	\$ 2,027,208			UE 180 / PGE Exhibit 212.
2	Weighted Common Return	4.48%			Page 2, Line 3, Col. 4.
3	Income to Common	\$ 90,726			Line 1 x Line 2.
4	Depreciation/Amortization	\$ 183,899			UE 180 / PGE Exhibit 212.
5	Deferred Income Tax Plus ITC	\$ (10,044)			UE 180 / PGE Exhibit 212.
6	Funds from Operations (FFO)	\$ 264,581			Sum of Line 3 through 5.
7	Weighted Interest Rate	3.97%			Page 2, Line 1 and 2, Col. 4.
8	Interest Expense	\$ 80,388			Line 1 x Line 7.
9	FFO Plus Interest	\$ 344,969			Line 6 + Line 8.
10	FFO Interest Coverage	4.3x	4.5x - 3.8x	3.8x - 2.8x	Line 9 / Line 8.
11	Total Debt Ratio	55%	42% - 50%	50% - 60%	Page 2, Line 1 and 2, Col. 2.
12	FFO to Total Debt	24%	30% - 22%	22% - 15%	Line 6 / (Line 1 x Line 11).

Source:

* Standard and Poors. New Business Profile Scores Assigned to U.S. Utility and Power Companies; Financial Guidelines Revised; June 2, 2004.

Portland General Electric

Rate of Return at 9.9% ROE

<u>Line</u>	<u>Description</u>	<u>Weight</u> (1)	<u>Cost</u> (2)	<u>Weighted</u> <u>Cost</u> (3)
1	Long-Term Debt	44.94%	6.69%	3.01%
2	Off-Balance Sheet Debt*	9.59%	10.00%	0.96%
3	Preferred Stock	0.26%	8.43%	0.02%
4	<u>Common Equity</u>	<u>45.21%</u>	<u>9.90%</u>	<u>4.48%</u>
5	Total	100.00%		8.46%

Source:

Hager-Valach / Exhibit 1101.

*PGE Response to ICNU Data Request 12.156.

BEFORE THE PUBLIC UTILITY COMMISSION

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ICNU-CUB/315

S&P UTILITIES & PERSPECTIVES

August 14, 2006



Standard & Poor's
**UTILITIES &
 PERSPECTIVES**
GLOBAL UTILITIES RATING SERVICE

Last Week's Rating
 Reviews and Activity 18

Did You Know?
 Top-10 Most Cost-Efficient
 U.S. Nuclear Plants 18

Last Week's
 Financing Activity
 Nebraska Public Power
 District's Bonds Are
 Rated 'A' 19
 ESKOM Holdings' €200 Million
 Bonds Are Rated 'BBB-' 20
 Orlando Utilities Commission's
 Bonds Are Rated 'AA-' 20

Utility Credit Rankings
 Electric/Gas/Water 21
 Telecommunications 24
 International 25

Key Contacts 26

Feature Article

Downward Credit Pressure Continues on
 U.S. Power Industry 2

Utility Spotlight

Halt in Arizona Electric Deregulation Appears
 Neutral For Pinnacle West 10

Special Report

Is the Utility the Tail That's Wagging the Dog? 11

News Comments

Allegheny Energy Rating Is Lowered To 'BB', On Watch Negative 13
 Ratings On AES Drax On Watch After TXU Europe Ratings Lowered 13
 Westport Resources Ratings Are Affirmed After Acquisition 14
 Tesoro Petroleum Rating Is Lowered To 'BB-', Off Watch 14
 National Rural Utilities Co-op's Ratings Are Affirmed 15
 AES Subsidiaries On Watch Neg Re: Liquidity Concerns 15
 Sierra Pacific Resources', Subsidiaries' Ratings Still Watch Negative 16
 Edison Mission Energy and Affiliates On Watch Negative 16
 Edison Mission Midwest's \$1.86 Billion Loans Placed On Watch Negative 17

Downward Credit Pressure Continues on U.S. Power Industry

Rating activity was overwhelmingly negative for U.S. utilities (electric, gas, pipeline, and water) in this year's turbulent third quarter, with several companies experiencing numerous downgrades. Since July 1, 2002, there have been 57 downgrades among holding companies and operating subsidiaries, compared with just eight upgrades (three of which relate to Northern Natural Gas Co.). For the same period in 2001, there were only nine downgrades and five upgrades. The torrid pace of the previous six months (78 downgrades and six upgrades) continued in the third quarter, as did the steep credit decline that began in 2001, when Standard & Poor's recorded 81 downgrades and 29 upgrades. In addition, the third quarter witnessed many new CreditWatch listings and outlook revisions, most of which were negative.

Although U.S. power industry creditworthiness began to weaken before 2001, the California energy crisis and the Enron bankruptcy hastened the negative trend. The erosion can be traced mainly to:

- Weakening financial profiles;
- Loss of investor confidence that has affected liquidity and financing flexibility;
- Heightened business risk derived from more investment outside the traditional regulated utility business, particularly unregulated generation and energy trading and marketing;
- Capital and corporate restructuring efforts;
- Regulatory difficulties; and
- Mergers and acquisitions.

These trends, in turn, reflect companies' strategies to deal with an increasingly uncertain and competitive market, while also seeking to enhance shareholder value.

In just 12 months, the number of companies rated 'A' and above has significantly declined, while the number of firms rated 'BBB' and below has risen substantially. In this regard, about 49% of the industry now falls in the 'BBB' category rating, while a full 11% are rated below investment grade, including five companies that are rated 'D', compared with 40% and 5%, respectively, at the end of September 2001. The decline in the 'A' and 'AA' rating category has been precipitous, with just 40% of the industry carrying ratings of 'A' and above, versus 55% one year earlier. Notably, although the average rating for the power sector as a whole has slipped to 'BBB+', companies that continue to emphasize a vertically integrated structure are hanging onto an 'A-' average. But utility holding companies that have ventured too far afield from their core competencies have suffered weakening market capitalization and, in many instances, rating downgrades.

Despite the large number of rating downgrades and ongoing negative pressures on utility credit quality, the sector remains solidly investment grade. This is in line with the large percentage of companies (86%) that have average or above-average business profiles.

Capital Market Update

Financing activity declined in the past 12 months following a significant increase in 2001. The amount of long-term debt, hybrid preferred securities, and preferred stock issued during the first nine months of 2002 was about \$56.9 billion, compared with approximately \$61.2 billion issued in the same period in 2001. The decrease is attributable to a number of factors, among them capital market jitters, especially for those issuers that require access to the capital markets, a consequent heavier reliance on bank debt, sliding wholesale electricity prices, and reduced capital expenditures across all sectors, but most significantly as the result of the postponement or cancellation of planned new power plants.

Subpar Financial Measurements

A heavy debt burden has driven down key measures of bondholder protection in recent years. Total debt as a percentage of total capitalization was an aggressive 59.8% at June 30, 2002 (the latest period in which comparable data is available) compared with 54.9% almost four years earlier at year-end 1998. This debt level, while just one measure of financial health, is characteristic of a 'BB' rating category credit with an average business position. Much of the increase in leverage can be traced to debt raised at the parent or intermediate holding company level to fund unregulated activities. The material increase in leverage has not been offset by strengthening cash flows, and funds from operations to total debt has accordingly steadily declined, falling below 16% in June 2002 from 21% in 1998. This key financial ratio is also typical of a 'BB' category company. Funds flow coverage of interest and pretax interest coverage have also slipped, to 3.3 times (x) and 2.8x, respectively, for the rolling 12 months June 2002, from 3.9x and 3.1x in 1998. These levels are just suitable for companies in the 'BBB' rating group. However, the aforementioned ratios actually rose, although very slightly, in 2001 and June 2002 because of lower interest rates. Of course, there are several other financial and qualitative factors that determine credit quality, but given eroding financial parameters and riskier business profiles the median rating for the utility industry may eventually slip out of the high 'BBB' category.

Feature Article

Looking Ahead

At the end of September 2002, just 48% of all utility rating outlooks were stable, compared with nearly 60% just one year ago. The decline is attributable mainly to the substantial increase in ratings that carry negative outlooks or are listed on CreditWatch. The percentage of outlooks that are negative has reached a high 31%, continuing to strongly overshadow positive outlooks, which stand at just 3%. This results mostly from a proliferation of higher-risk business strategies, constrained access to capital markets due to investor skepticism over accounting practices and disclosure, investigations on various regulatory levels, weak competitive positioning, and an anemic wholesale power market. The remaining 18% of companies are on CreditWatch—84% carry a negative listing, 9% positive, and 7% developing (which indicates that a rating may be raised, lowered, or remain unchanged). These percentages suggest that frequent rating changes will continue.

The Downgraded...

The ratings on Duke Energy Corp., Duke Capital Corp., Westcoast Energy Inc., Union Gas Ltd., and other related subsidiaries were lowered and removed from CreditWatch. The corporate credit rating for Duke Energy Trading and Marketing (DETM), which is 40% owned by Exxon Mobil

Corp., was also lowered. Duke Energy Field Services LLC's rating was affirmed. The outlooks are stable.

Lower ratings reflect a reassessment of Duke Energy's consolidated creditworthiness given the increasing risk of energy trading and merchant generation activities. The CreditWatch negative listing is removed because Standard & Poor's does not expect the outcome of the ongoing FERC and SEC investigations into "round-trip" trades to be onerous. Duke Energy has said that less than 1% of its trading revenues came from round-trip trades.

The downgrades also incorporate the financial implications of the current decline in wholesale electricity prices. This deterioration is mitigated by cash flow stability provided by Duke's regulated electric and gas pipeline businesses. Importantly, Duke continues to reduce capital expenditures commensurate with expected reduced cash flow from Duke Energy North America and DETM.

The ratings on Reliant Resources Inc. (RRI) and related entities remain on CreditWatch with negative implications following two downgrades this quarter, pending the refinancing of holding company debt and credit facilities (\$5.9 billion, including a \$1.4 billion synthetic lease) and debt at RRI subsidiary Orion Power Holdings and its respective subsidiaries (\$1.3 billion net of cash). Ratings on RRI subsidiary Reliant Energy Power Generation Benelux B.V. are affirmed

Chart 1
Third Quarter Rating Actions

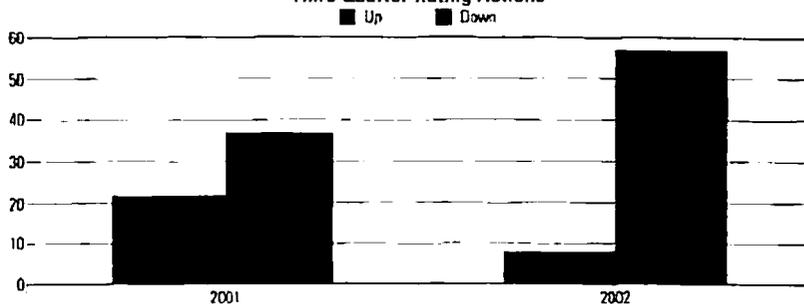
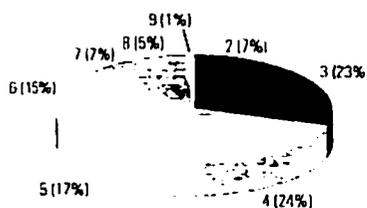


Chart 2
Business Profiles



Business profiles are categorized from "1" (strong) to "10" (weak)

Feature Article

and remain on CreditWatch as RRI may implement a structure that would insulate this subsidiary.

The rating downgrades reflect increased collateral calls, expectations of a material weakening in credit protection mainly due to the likely increased cost of renewing the bank facilities and expected restrictions on upstreaming cash from Orion Power to RRI, which will limit RRI's ability to service holding company debt. RRI's financial profile is also weakened by the decline in wholesale operations, which is expected to be partially mitigated through 2005 by better-than-expected earnings from the company's Texas retail operations.

CenterPoint Energy Inc.'s (formerly Reliant Energy Inc.) board of directors voted to spin off RRI common stock to CenterPoint shareholders at its Sept. 5, 2002 meeting. Legal separation of the two entities occurred Sept. 30. This should facilitate the current refinancing efforts at both companies.

Ratings on The Williams Cos. Inc. and its subsidiaries were lowered twice in July, resulting in an aggregate five-notch downgrade to 'B+' from 'BBB'. The steep credit decline can be traced to the company's deteriorating liquidity position, as well as rating triggers associated with the AES Ironwood, AES Red Oak, and Georgia EMC tolling agreements, which may require Williams to provide LOCs to each entity. The ramifications of these requirements create significant uncertainty in Williams' financial position and

warrant a rating in the 'B' category. These liabilities also add risk to Williams' ability to close on a potential \$1.6 billion secured line of credit in the near term or to execute other options to meet liquidity needs. The ratings remain on CreditWatch with negative implications.

The CreditWatch direction on subsidiary Williams Gas Pipelines Central Inc. (Central) was changed to developing from negative on Sept. 17, reflecting the parent's definitive agreement to sell Central to Southern Star Central Corp., a subsidiary of AIG Highstar Capital L.P., for \$380 million in cash and the assumption of \$175 million in debt. The CreditWatch developing listing reflects the uncertainty surrounding the disposition of the \$175 million of senior notes at Central. Assuming that the transaction closes, the rating could be raised, lowered, or withdrawn, depending on how the new owner structures the acquisition.

Dynergy Inc. and subsidiaries Dynergy Holdings Inc., Illinova Corp., and Illinois Power Co. had ratings lowered twice, resulting in a four-notch downgrade to 'B+'. The first downgrade to 'BB' from 'BBB-' was attributable to continuing erosion in Dynergy's core merchant energy business, difficulties in accessing the capital markets and a strained liquidity position. Despite cost savings and cutbacks in capital expenditures, including a reduction in the common dividend payout, needed incremental cash flow had been slow to

Chart 3
Third Quarter Rating Distributions

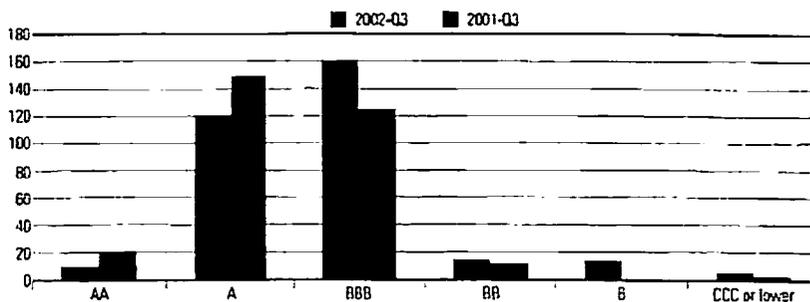
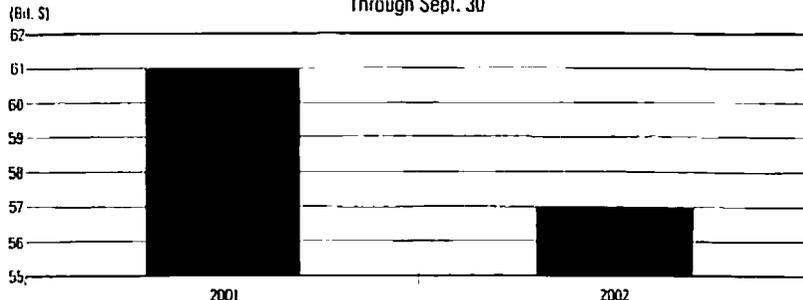


Chart 4
Debt and Preferred Stock Issuance
Through Sept. 30



Feature Article

materialize largely due to decreased marketing opportunities and lower power prices. Standard & Poor's again lowered the ratings to 'B+' following an analysis that cash flow deterioration continues unabated. Cash flow from Dynegy's merchant energy business is expected to decline even further because it is likely industry counterparties are engaging in only low-margin spot gas transactions, a trend that is expected to continue.

The ratings remain on CreditWatch with negative implications, reflecting lingering concerns regarding the firms' ability to access capital markets and/or execute asset sales necessary to preserve an adequate liquidity position to meet its obligations over the next 18 months. Resolution of the CreditWatch listing is predicated on Dynegy's execution of stated business objectives and its ability to meet debt maturities at a level that supports the current rating. A demonstrated ability to achieve these goals could result in ratings stability.

Ratings on Aquila Inc. and its subsidiaries were lowered due to a deteriorating financial profile stemming from its involvement in the energy marketing and trading business. The company's decision to abandon that business to focus on regulated utility operations and efforts to improve its financial condition through asset and equity sales were not sufficient to preserve its prior credit quality. The negative outlook can be attributable to the risk that the company will be unable to timely achieve the amount of asset sales necessary to pay down debt to a level appropriate for the new rating.

Kinder Morgan Energy Partners L.P.'s (KMP) ratings were lowered due to a decline in its business risk profile, as well as greater interdependence between KMP and Kinder Morgan Inc., which holds a general partnership interest in KMP. The outlook is stable.

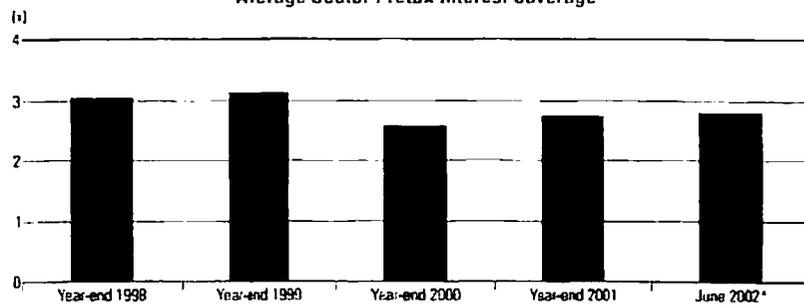
The ratings on CMS Energy Corp.'s subsidiaries Consumers Energy Co. and CMS Panhandle Pipeline Cos. were lowered to 'BB', in line with that of the parent. The downgrade reflects the company's use of the stock of subsidiary CMS Enterprises, which includes CMS Panhandle Pipeline, as security in certain bank facilities to obtain longer-term financing to weather its current liquidity posi-

tion. In Standard & Poor's view, CMS Energy's actions indicate that the risk of default of CMS Energy and its affiliates is the same because the company relied on an operating subsidiary to meet its own financial commitments during a time of financial stress. The outlook is negative owing to the uncertainty posed by the SEC inquiry and CMS Energy's board of directors' special committee investigation into the round-trip trades. Additional challenges for CMS Energy include execution risk in completing planned asset sales, maintaining adequate liquidity over the near term, and generating cash flow and reducing debt sufficient enough to produce financial measures suitable for its current rating.

TECO Energy Inc. and affiliates saw their ratings lowered two notches owing to lower levels of consolidated cash flow, higher debt balances associated with commitments related to its power unit, and expected credit protection measures that are now commensurate with a 'BBB' corporate credit rating. The outlook for all entities is negative. Despite TECO's action plan and previously issued equity, depressed profitability at TECO Power Services (TPS), combined with weak power prices, presents significant challenges for the firm, including weaker interest coverages and execution risk. The outlook for all entities is negative, reflecting substantial execution risk that the company faces as it implements its action plan, and significant challenges related to activity at TPS, including construction commitments. Still, timely completion of TECO's monetization efforts, combined with successful navigation of TPS risks, could lead to ratings stability.

Allegheny Energy Inc. and its subsidiaries' ratings were lowered to 'BBB' from 'BBB+' on August 16 owing to a weakened financial profile caused by increasing debt leverage and a worse-than-expected downturn in the wholesale power market. Shortly after the close of the third quarter, Standard & Poor's again lowered its ratings to 'BB' from 'BBB' following the company's announcement that its principal credit agreements are under technical default. The ratings are on CreditWatch with negative implications, pending the outcome of the company's negotiations with its banks.

Chart 5
Average Sector Pretax Interest Coverage



*Indicates rating 17 months

Feature Article

EOTT Energy Partners L.P. experienced a several notch downgrade this quarter with its corporate credit rating slipping to 'CCC' from 'B+'. On Oct. 1, the company's ratings were lowered to 'D' reflecting its failure to make a bond interest payment. The company will be utilizing the 30-day grace period and a forbearance on its bank credit facilities to attempt to reach an agreement on restructuring its debt and to resolve outstanding issues with Enron Corp. An Enron subsidiary is the general partner of EOTT. Since those efforts have been under way for months and have yet to produce any agreements, Standard & Poor's believes it is questionable whether the company will be able to successfully settle all of the necessary issues that will allow it to resume timely payments on its debt.

Lower ratings for SCANA Corp. and affiliates South Carolina Electric & Gas Co. and Public Service Co. of North Carolina Inc. reflect the parent's high debt leverage and the fact that management's previous plan to strengthen the balance sheet is being prolonged by the company's accelerating capital program and the delay in its ability to monetize all of its Deutsche Telekom shares (currently at a lower price than expected). These factors greatly hinder the company's ability to have its key financial ratios return to former levels of credit quality that support an 'A' ratings profile. The outlook is stable.

The ratings on Peoples Energy Corp. and subsidiaries Peoples Gas Light & Coke Co. and North Shore Gas were lowered several notches owing to deterioration in parent company Peoples Energy's consolidated financial profile, coupled with increasing business risk associated with the company's unregulated activities.

UGI Corp.'s electric utility affiliate UGI Utilities Inc. saw its ratings lowered due to increasing business risk at the parent. The stable outlook mirrors that of parent UGI Corp. and reflects its ability to continue to manage the challenges of a growing propane business while adequately maintaining the utility's financial condition.

Lower ratings for Empire District Electric Co. reflect a downward trend in the company's financial profile that was not adequately stemmed in recent regulatory actions. The outlook is stable.

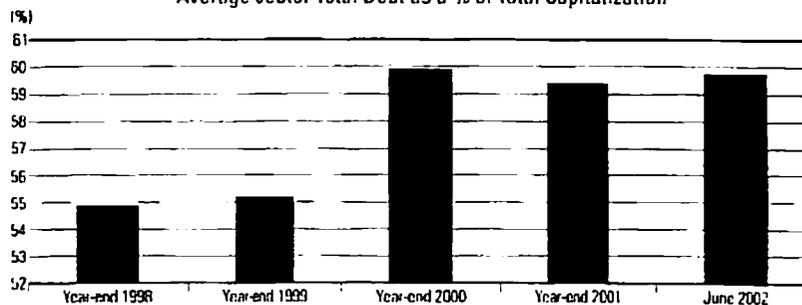
NRG's Precipitous Credit Decline

NRG Energy Inc., the independent power producer subsidiary of Xcel Energy Inc., experienced the most dire credit spiral this quarter, with its corporate credit rating lowered to 'D' from a 'BBB-'.

On June 3, 2002, Xcel completed a tender for the shares of NRG that it did not already own. Xcel's management then began to re-integrate NRG into Xcel. Xcel proposed improving NRG's financial position through significant asset sales and a cash infusion from Xcel. (Before the tender offer, NRG was rated 'BBB-', mainly reflecting its stand-alone credit quality. However, the rating always incorporated some level of implicit support from Xcel.) On June 24, 2002, Standard & Poor's lowered its corporate credit rating on Xcel and its subsidiaries, including NRG, to 'BBB'. The levelization of the ratings reflected repurchase of all NRG shares and the reintegration of the business into Xcel's corporate structure.

Notwithstanding Xcel's restructuring plan, NRG's financial position worsened as a result of low wholesale prices and a heavy debt burden. Exacerbating low operating cash flow was the uncertainty of the timing and amount of asset sales, which were not occurring quickly. NRG's own financial problems began to affect Xcel and its utility subsidiaries' access to capital. Xcel management's support for NRG accordingly began to wane, and with it Standard & Poor's perspective on the levelization of all Xcel's corporate credit ratings. Thus, Standard & Poor's undertook a series of negative rating actions on NRG alone. The downgrades were initially prompted by the poor cash flow position of NRG, and subsequently by the substantial equity calls triggered by the downgrade process (when NRG fell below investment grade, several financing arrangements required capital to be posted). As a result, NRG is currently rated purely on a stand-

Chart 6
Average Sector Total Debt as a % of Total Capitalization



Feature Article

alone basis. On Sept. 16, 2002, NRG's corporate credit rating was lowered to 'D', reflecting a default on four separate issues of corporate and project-level debt service.

The Few Upgrades...

The ratings on LG&E Energy Corp. and its subsidiaries were raised and removed from CreditWatch. The rating action followed the July 1, 2002 acquisition of LG&E's parent company Powergen PLC group by the German utility company E.ON AG, and a review by Standard & Poor's of the operational and financial linkages between the companies. The ratings reflect LG&E's lower stand-alone credit quality, offset by the benefit of being part of the stronger E.ON group. The implied support from E.ON is based on the expectation that LG&E will play an important and long-term role in E.ON's strategy to expand its presence in the U.S. The outlook is stable and reflects the expectation that E.ON will support LG&E's funding requirements, including the refinancing of maturing debt at the E.ON level.

Higher ratings for American Transmission Co. can be traced to favorable FERC rate treatment, organizational efficiencies, and stronger financial measures. The outlook is stable owing to expectations for continued reliable operations and supportive regulation. Also, it is expected that the capital expenditure program will not stress the company's financials and that the member/owner companies will continue to support credit quality.

Mixed Rating Actions

Northern Natural Gas Co. (NNG) experienced numerous rating actions. On July 2, its ratings were raised to 'BBB-' from 'CC' due to the expiration of Enron Corp.'s option to repurchase NNG, which ensured that the firm remained a wholly owned subsidiary of Dynegy Inc. for the time being. Subsequently, on July 25, NNG's ratings were lowered to 'B+', reflecting Dynegy's inability to execute on asset divestitures, including the expected partial monetization of NNG. Because Standard & Poor's viewed the sale as being

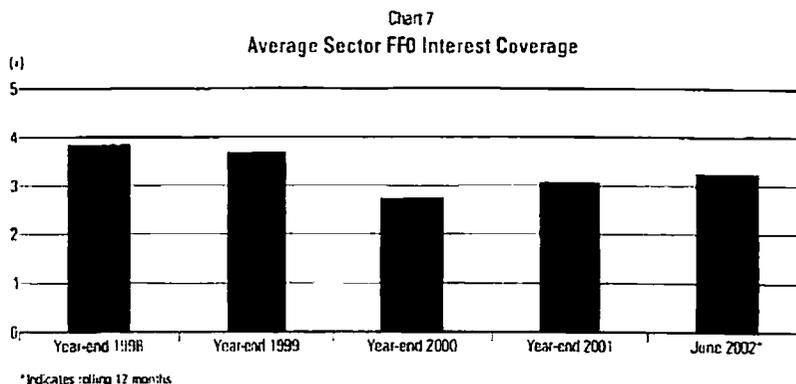
uncertain, NNG's creditworthiness was considered to be commensurate with the consolidated credit rating of Dynegy. On Aug. 23, NNG's ratings were raised back to 'BBB-' following MidAmerican Energy Holdings Co.'s closing on the purchase of the pipeline from Dynegy. Lastly, on Sept. 25, 2002, NNG's ratings were raised three notches to 'A-' following its change of ownership. NNG is now a wholly owned subsidiary of NNGC Acquisition LLC, which in turn is a wholly owned subsidiary of MidAmerican Energy Holdings. Because of a ring-fencing structure that protects NNG from credit events at the MEHC parent, the rating on NNG is higher than that of its parent. The outlook is stable.

CreditWatch Listings Heat Up

Following a revision in its credit outlook to negative from stable early in August, the ratings on El Paso Corp. and its affiliates were placed on CreditWatch with negative implications on Sept. 23 as a result of the FERC Administrative Law Judge's recommendation that fines be imposed for withholding capacity and exercising market power in California. Standard & Poor's will review the firm's response to regulatory pressures, as well as 2003 projected cash flow and capital spending at the pipeline, exploration and production units, and gathering and processing units. The potential for lower credit ratings is possible after Standard & Poor's review, which will be completed before the end of 2002.

The ratings on Cleco Corp. and its utility, Cleco Power LLC, were placed on CreditWatch with negative implications to reflect the worsening credit quality of the counterparties in the company's tolling agreements and financing risk associated with the Acadia power project.

The tolling agreement with Williams Energy Marketing on Cleco's Evangeline project could be affected by the eroding credit quality at The Williams Cos. Inc., which is deeply speculative grade. Cleco also has tolling agreements with other counterparties that are experiencing deteriorating creditworthiness, which could affect the expected cash flows from the projects that contribute support for Cleco's



Feature Article

current ratings. Cross-default provisions in Cleco's corporate credit facility may also be triggered by credit events at one or more of the power projects.

Current ratings are also predicated on the completion of nonrecourse financing of the Acadia power project, which is questionable. If Acadia-related debt remains fully recourse to Cleco, credit protection measures for Cleco would not support current ratings.

Resolution of the CreditWatch listing will occur when the impact of the credit deterioration at Williams on the Evangeline project becomes clearer and when substantial progress has been achieved in Acadia's re-financing.

Nicor Inc. and subsidiary Nicor Gas Co. had their ratings placed on CreditWatch with negative implications following accounting problems and losses related to the Nicor's 50% ownership in Nicor Energy LLC, a retail energy marketing joint venture with Dynegy Inc., possible improper behavior in the company's performance-based rate program, and the immediate and severe negative market reaction to the company's announcements. Although the losses recorded are mainly noncash, relatively small for the consolidated entity, and have not affected the company's robust financial profile and solid liquidity position, the potential for further disclosures could result in subsequent charges and restatements.

The ratings on Pennsylvania Suburban Water Co. were placed on CreditWatch with negative implications owing to parent Philadelphia Suburban Corp.'s agreement to purchase AquaSource Utility Inc., a DQE Inc. subsidiary, for \$205 million. The transaction is expected to close in the second half of 2003. Of credit concern is the potential for consolidated financials to weaken if the transaction is largely debt-financed.

More Negative Outlooks

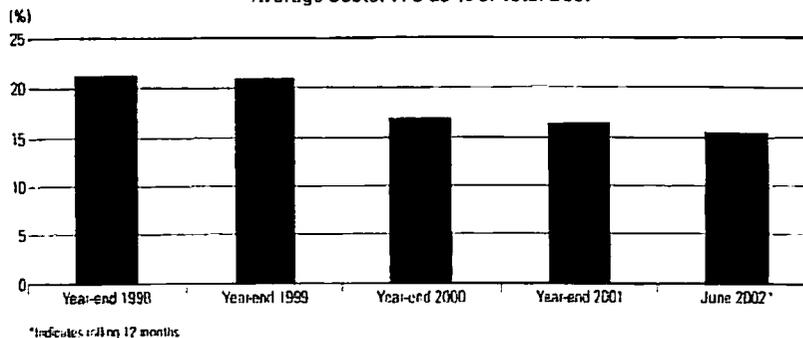
PPL Corp. and its subsidiaries, except PPL Electric Utilities which is structurally ring-fenced, had their outlooks changed to negative from stable, reflecting PPL's deteriorating credit profile that has resulted primarily from declining wholesale

electricity prices and also from setbacks in its international operations, particularly in Brazil. PPL's management will also have to balance the level of debt financing in its capitalization with the pace of its growth strategy.

The credit outlook on TXU Corp. was revised to negative from stable, reflecting a deterioration in TXU Europe Ltd.'s creditworthiness. TXU Europe represents about one-third of TXU Corp.'s global income and has more than one-half of all its customers. TXU Australia Holdings (Partnership) L.P., which represents a much smaller percentage of assets and customers, is also highly leveraged. The ratings of both subsidiaries benefit from the relatively strong cash flow and improving financial profile of TXU US Holdings, which owns the electric and gas distribution businesses in Texas. TXU US Holdings will reduce debt by over \$1 billion when securitized in 2003 and 2004. Debt is also being reduced with proceeds from the sale of generating plants in the U.K. and Texas, and from the issuance of common stock and convertible debt. Debt will continue to be reduced using cash flow and the conversion of existing securities. However, with the diminished prospects for profitability in Europe, and the likelihood of limited returns from the Australian operations in the short-to-medium term, it is less likely that strengthening financials in the U.S. will be sufficient to support the current corporate credit rating for the consolidated company.

The ratings on Puget Energy Inc. and subsidiary Puget Sound Energy Inc. (Puget) were affirmed and removed from CreditWatch, reflecting an agreement among various parties to Puget's interim and general rate requests. Recent resolution of the utility's general rate case with the Washington Utilities and Transportation Commission is considered by Standard & Poor's to be supportive of Puget's credit quality. Yet, the outlook is negative owing to weak financial measures and concern that Puget Energy and the utility might not be able to achieve current projections, which indicate that both entities should achieve financial targets commensurate with current ratings by 2004 and 2005.

Chart 1
Average Sector FFO as % of Total Debt



Feature Article

Rating Stability

The ratings on Northwest Natural Gas Co. were removed from CreditWatch with negative implications, where they were placed Oct. 8, 2001, following the company's announcement that it agreed to purchase Portland General Electric Co., a unit of Enron Corp. On May 17, 2002, Enron and Northwest Natural mutually agreed to terminate the

contract following Enron's inability, following its bankruptcy, to satisfy the terms of the contract as originally agreed upon. The sale contract's termination was subject to bankruptcy court approval, which was formally given on June 20, 2002 and was effective July 1, 2002. The outlook is stable.

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 180/UE 181/UE 184

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ICNU-CUB/316

S&P INDUSTRY REPORT CARD

August 14, 2006

[04-Jan-2005] Industry Report Card: U.S. Electric/Water/Gas

STANDARD & POOR'S	RATINGS DIRECT
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Research:

Return to Regular Format

Industry Report Card: U.S. Electric/Water/Gas

Publication date: 04-Jan-2005
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Commentary/Key Trends

Rating actions in the regulated U.S. utility (electric, gas, pipeline, and water) and merchant power sectors over the past few months were fairly balanced. Since the last report card (for the third quarter of 2004), there were nine upgrades and eight downgrades.

A few noteworthy trends have emerged as important factors for credit quality. These include the rising importance of regulatory decisions in certain states, the acceleration of merger and acquisition activity, a low interest rate regimen, and attractive debt capital markets that allow many issuers to refinance at favorable rates. Despite these trends, challenges associated with weak financial credit measures and stagnant power markets in many regions pressure the financial performance of certain issuers.

Regulatory treatment has become a more prevalent ratings driver in certain jurisdictions. Filings and rulings on rate proceedings in states such as Arizona, Oregon, Missouri, and Texas could affect ratings in the near term. In addition, the opposing views of certain state regulatory bodies and the FERC on issues, such as restructuring the regional transmission systems and incorporating certain merchant plants of affiliated companies in the rate base, will likely lead to a protracted struggle among those regulatory bodies for oversight.

Regulatory decisions were meaningful factors in the downgrades of DTE Energy Co. (BBB/Stable/A-2) and IDACORP Inc. (BBB+/Stable/A-2). In the case of IDACORP, a disappointing regulatory decision compounded by weak credit measures led to the downgrade. For Detroit Edison Co., a unit of DTE Energy, despite the granting of a rate order that provided a substantial increase in rates and contained many favorable characteristics, the credit measures would not improve enough in the near term to be commensurate with the ratings.

Another development that has become a more prominent ratings issue is merger and acquisition activity. Recently, Exelon Corp. (A-/Watch Neg/A-2) announced a merger with Public Service Enterprise Group Inc. (BBB/Watch Dev/A-3) that would create the industry's largest utility holding company. Exelon's ratings were placed on CreditWatch with negative implications while PSEG's ratings were placed on CreditWatch with developing implications. The ratings on NUI Utilities Inc. (A-/Negative/-) and the outlook on AGL Resources Inc. (A-/Negative/A-2) were also affected by their transaction, which was completed in December. In addition, Illinois Power Co. (A-/Negative/-) was upgraded, upon the completion of its acquisition by Ameren Corp. (A-/Negative/A-2). While it is unclear whether these transactions presage a rise in merger and acquisition activity, there apparently is increasing interest.

The number of rating actions during 2004 declined dramatically from the past few years. The number of rating actions (upgrades and downgrades) is only about one-third of the previous two years. This is

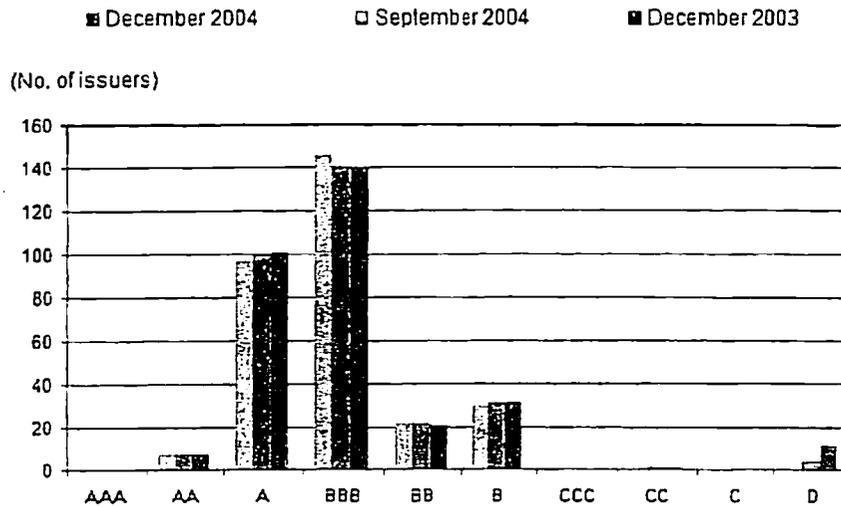
indicative of a measure of rating stability, which is indeed apparent in rating outlooks, 56% of which are stable. This is also a reflection of slowly stabilizing credit measures as many management teams have made "balance sheet repair" a key business objective. For example, Duke Energy Corp.'s outlook was revised to positive in recognition of significant debt reduction in 2004 and improved credit measures.

Still, weak credit measures and financial performance leave certain issuers susceptible to rating downgrades. The existing financial weakness of many utilities results primarily from high debt levels and cash flow stress associated with unsuccessful forays into more competitive businesses. Consequently, 37% of rating outlooks are negative or on CreditWatch with negative implications. Moreover, despite the current industry trend of "back-to-basics," it is very possible in the longer term that the competition for capital and investor interest will embolden companies to embrace growth strategies that could erode credit quality.

Companies with merchant exposure continue to experience volatile cash flows and regulatory uncertainty. The operating environment remains challenging. The creditworthiness of many purely merchant power companies is constrained by burdensome debt levels and insufficient cash flow from operations. Faced with the prospect of stagnant power markets in many regions, cash flow measures are likely to remain weak until wholesale electricity margins materially improve. The only bright spot in this otherwise dim market are merchant coal and nuclear plants that are benefiting from their lower cost of generation in markets, where elevated gas prices set power prices.

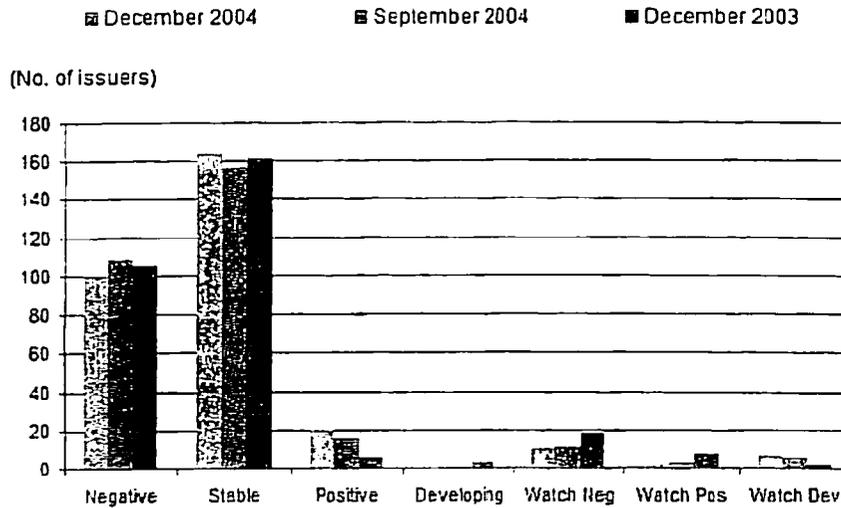
Chart 1

U.S. Utilities Long-Term Ratings Distribution



Note: Dates represent current and previously published report card data.

Chart 2
U.S. Utilities Outlook Distribution



Note: Dates represent current and previously published report card data.

■ Issuer Review

Issuer	Corporate credit rating*	Analyst	Comment
AES Corp. (The)	B+/Positive/--	Taylor	Standard & Poor's expects AES to continue on its path of parent level debt reduction going forward and that the company can lower parent level debt to about \$4.5 billion over the next 12 to 18 months, in which case an upgrade to 'BB-' is likely. Fairly sizable distributions from developing economies such as Venezuela, Nigeria, and Argentina in 2004 are helpful, but expectations of continuing dividends from these economies present risk. AES may begin to ramp up equity investment in new projects in the near future.
Indianapolis Power & Light Co.	BB+/Positive/--	Eiseman	See The AES Corp.
IPALCO Enterprises Inc.	BB+/Positive/--	Eiseman	See The AES Corp.
AGL Resources Inc.	A-/Negative/A-2	Messer	The negative outlook reflects AGL's challenge of successfully realizing cost savings at NUI and Standard & Poor's expectation that cash flow to total debt and debt leverage are likely to remain weak for the 'A-' category through 2007. Standard & Poor's estimates that interest coverage ratios will be between 3.5x and 3.7x in 2005 and remain appropriate for the 'A-' rating category; however, funds from operations to average total debt is expected to remain weak (between 18% and 20%) through 2007.
Atlanta Gas Light Co.	A-/Negative/--	Messer	See AGL Resources Inc.
Allegheny Energy Inc.	B+/Positive/--	Hsieh	Allegheny has stabilized its credit profile and paved the way for financial recovery in the coming years. The company continues to make progress bolstering its balance sheet. The company's stated goal is to pay down \$1.5 billion of debt by the end of 2005. With \$200 million of equity issued in October, the company has paid down \$900 million of debt to date, and is likely to pay down another \$200 million of debt in the first quarter of 2005 with proceeds from asset sales.

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ICNU-CUB/317

BLUE CHIP ECONOMIC INDICATORS – MARCH 10, 2006

August 14, 2006

Blue Chip Economic Indicators

Top Analysts' Forecasts Of The U.S.
Economic Outlook For The Year Ahead

Vol. 31, No. 3

March 10, 2006

Long-Range Consensus U.S. Economic Projections

II. For comparison, this table includes some of the long-range consensus projections found on the preceding page, plus the latest long-range projections from the Bush Administration¹ and the Congressional Budget Office (CBO)².

ECONOMIC VARIABLE		YEAR					Five-Year Averages	
		2008	2009	2010	2011	2012	2008-12	2013-17
		Percent Change, Full Year-Over-Prior Year						
1. Real GDP (chained, 2000 dollars)	CONSENSUS	3.1	3.1	3.1	2.9	3.0	3.1	3.0
	Bush Admin. ^{1,3}	3.3	3.1	3.1	3.1	na	3.2	na
	CBO ^{2,3}	3.4	3.3	3.0	2.8	2.7	3.0	2.6
2. GDP Chained Price Index	CONSENSUS	2.1	2.1	2.1	2.1	2.1	2.1	2.1
	Bush Admin. ^{1,3}	2.1	2.1	2.1	2.1	na	2.1	na
	CBO ^{2,3}	1.8	1.8	1.8	1.8	1.8	1.8	1.8
3. Nominal GDP (current dollars)	CONSENSUS	5.3	5.3	5.2	5.1	5.2	5.2	5.2
	Bush Admin. ^{1,3}	5.5	5.3	5.5	5.3	na	5.4	na
	CBO ^{2,3}	5.3	5.2	4.9	4.6	4.5	4.9	4.4
4. Consumer Price Index (for all urban consumers)	CONSENSUS	2.3	2.3	2.3	2.3	2.3	2.3	2.4
	Bush Admin. ^{1,3}	2.4	2.4	2.4	2.5	na	2.4	na
	CBO ^{2,3}	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Annual Average								
5. Treasury Bills, 3-Month (percent per annum)	CONSENSUS	4.7	4.7	4.7	4.5	4.6	4.6	4.6
	Bush Admin. ^{1,3}	4.3	4.3	4.3	4.3	na	4.3	na
	CBO ^{2,3}	4.4	4.4	4.4	4.4	4.4	4.4	4.4
6. Treasury Notes, 10-Year (yield per annum)	CONSENSUS	5.4	5.5	5.5	5.4	5.5	5.5	5.5
	Bush Admin. ^{1,3}	5.5	5.6	5.6	5.6	na	5.6	na
	CBO ^{2,3}	5.2	5.2	5.2	5.2	5.2	5.2	5.2
7. Unemployment Rate (% of civilian labor force)	CONSENSUS	4.8	4.8	4.9	4.9	5.0	4.9	4.9
	Bush Admin. ^{1,3}	5.0	5.0	5.0	5.0	na	5.0	na
	CBO ^{2,3}	5.1	5.2	5.2	5.2	5.2	5.2	5.2

III. In this table, we compare the results of our most recent survey with those of our survey in October 2005⁴.

ECONOMIC VARIABLE		YEAR					Five-Year Averages	
		2008	2009	2010	2011	2012	2008-12	2013-17
		Percent Change, Full Year-Over-Prior Year						
1. Real GDP (chained, 2000 dollars)	March Consensus	3.1	3.1	3.1	2.9	3.0	3.1	3.0
	October Consensus	3.2	3.1	3.3	3.2	na	na	na
2. GDP Chained Price Index	March Consensus	2.1	2.1	2.1	2.1	2.1	2.1	2.1
	October Consensus	2.3	2.2	2.3	2.2	na	na	na
3. Nominal GDP (current dollars)	March Consensus	5.3	5.3	5.2	5.1	5.2	5.2	5.2
	October Consensus	5.5	5.4	5.5	5.4	na	na	na
4. Consumer Price Index (for all urban consumers)	March Consensus	2.3	2.3	2.3	2.3	2.3	2.3	2.4
	October Consensus	2.5	2.5	2.4	2.5	na	na	na
Annual Average								
5. Treasury Bills, 3-Month (percent per annum)	March Consensus	4.7	4.7	4.7	4.5	4.6	4.6	4.6
	October Consensus	4.4	4.3	4.4	4.4	na	na	na
6. Treasury Notes, 10-Year (yield per annum)	March Consensus	5.4	5.5	5.5	5.4	5.5	5.5	5.5
	October Consensus	5.3	5.3	5.4	5.4	na	na	na
7. Unemployment Rate (% of civilian labor force)	March Consensus	4.8	4.8	4.9	4.9	5.0	4.9	4.9
	October Consensus	4.9	4.9	5.0	4.9	na	na	na

¹Budget of the United States Government, Fiscal Year 2007, Office of Management and Budget, February 2006. ²The Budget and Economic Outlook: Fiscal Years 2007-2016; Congressional Budget Office, February 2006. ³The Bush Administration's forecast only extends through 2011, so averages for the 2008-2012 period are based on the forecast for the four-year period 2008-2012. CBO's forecast only extends through 2016, so averages for the 2013-2017 period are based on the forecast for the four-year period 2013-2016. ⁴Blue Chip Economic Indicators, October 10, 2005.

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BLUE CHIP FINANCIAL FORECASTS – JULY 1, 2006

August 14, 2006

Aspen Publishers

Blue Chip Financial Forecasts

**Top Analysts' Forecasts Of U.S. And Foreign Interest Rates, Currency Values
And the Factors That Influence Them**

Vol. 25, No. 7 July 1, 2006

Wolters Kluwer
Law & Business

2 ■ BLUE CHIP FINANCIAL FORECASTS ■ JULY 1, 2006

Consensus Forecasts Of U.S. Interest Rates And Key Assumptions¹

Interest Rates	History								Consensus Forecasts-Quarterly Avg.						
	Average For Week Ending				Average For Month				Latest Q*	3Q	4Q	1Q	2Q	3Q	4Q
	June 16	June 9	June 2	May 26	May	Apr	Mar	2Q 2006	2006	2006	2007	2007	2007	2007	
Federal Funds Rate	5.00	4.99	5.01	4.98	4.94	4.79	4.59	4.91	5.3	5.4	5.4	5.2	5.1	4.9	
Prime Rate	8.00	8.00	8.00	8.00	7.93	7.75	7.53	7.89	8.3	8.4	8.4	8.2	8.1	8.0	
LIBOR, 3-mo.	5.34	5.28	5.25	5.21	5.18	5.07	4.92	5.18	5.5	5.6	5.5	5.4	5.2	5.1	
Commercial Paper, 1-mo.	5.10	5.02	4.99	4.98	4.95	4.80	4.61	4.93	5.4	5.5	5.4	5.3	5.1	5.0	
Treasury bill, 3-mo.	4.89	4.86	4.84	4.83	4.84	4.72	4.63	4.81	5.2	5.3	5.2	5.1	4.9	4.8	
Treasury bill, 6-mo.	5.16	5.06	5.05	5.01	5.01	4.90	4.79	5.00	5.3	5.4	5.4	5.2	5.1	5.0	
Treasury bill, 1 yr.	5.13	5.04	5.03	4.99	5.00	4.90	4.77	4.99	5.3	5.4	5.4	5.3	5.2	5.1	
Treasury note, 2 yr.	5.09	5.00	5.00	4.96	4.97	4.89	4.73	4.96	5.3	5.3	5.3	5.2	5.1	5.0	
Treasury note, 5 yr.	5.02	4.95	4.99	4.95	5.00	4.90	4.72	4.96	5.3	5.3	5.3	5.2	5.2	5.1	
Treasury note, 10 yr.	5.05	5.01	5.08	5.05	5.11	4.99	4.72	5.05	5.3	5.3	5.3	5.3	5.3	5.3	
Treasury note, 30 yr.	5.09	5.07	5.18	5.15	5.20	5.06	4.73	5.12	5.3	5.4	5.4	5.4	5.4	5.3	
Corporate Aaa bond	5.83	5.81	5.91	5.90	5.95	5.84	5.53	5.88	6.2	6.3	6.3	6.3	6.3	6.2	
Corporate Baa bond	6.71	6.67	6.75	6.72	6.75	6.68	6.41	6.71	7.1	7.2	7.2	7.2	7.2	7.1	
State & Local bonds	4.58	4.48	4.57	4.52	4.59	4.58	4.44	4.57	4.9	5.0	5.0	5.0	5.0	5.0	
Home mortgage rate	6.63	6.62	6.67	6.62	6.60	6.51	6.32	6.58	6.8	6.9	6.9	6.9	6.8	6.8	

Key Assumptions	History								Consensus Forecasts-Quarterly Avg.					
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q*	3Q	4Q	1Q	2Q	3Q	4Q
	2004	2004	2005	2005	2005	2005	2006	2006	2006	2006	2007	2007	2007	2007
Major Currency Index	86.5	81.9	81.3	83.5	84.7	85.8	84.9	82.1	81.9	81.1	80.6	79.9	79.6	79.5
Real GDP	4.0	3.3	3.8	3.3	4.1	1.7	5.3	2.9	2.9	2.9	2.8	2.9	3.0	3.1
GDP Price Index	1.5	2.7	3.1	2.6	3.3	3.5	3.3	3.0	2.4	2.4	2.5	2.3	2.2	2.2
Consumer Price Index	2.1	3.6	2.3	3.8	5.5	3.3	2.2	4.4	2.7	2.5	2.5	2.4	2.4	2.3

¹Individual panel members' forecasts are on pages 4 through 9. Historical data for interest rates except LIBOR is from Federal Reserve Release (FRSR) H.15. LIBOR quotes available from *The Wall Street Journal*. Definitions reported here are same as those in FRSR H.15. Treasury yields are reported on a constant maturity basis. Historical data for the U.S. Federal Reserve Board's Major Currency Index is from FRSR H.10 and G.5. Historical data for Real GDP and GDP Chained Price Index are from the Bureau of Economic Analysis (BEA). Consumer Price Index (CPI) history is from the Department of Labor's Bureau of Labor Statistics (BLS). *Interest rate data for 2Q 2006 based on historical data through the week ended May 16th. Data for 2Q 2006 Major Currency Index also is based on data through week ended May 16th. Figures for 2Q 2006 Real GDP, GDP Chained Price Index and Consumer Price Index are consensus forecasts based on a special question survey this month of the panel members.

