

**PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: July 15, 2003**

**REGULAR**  **CONSENT**  **EFFECTIVE DATE** \_\_\_\_\_

**DATE:** July 3, 2003

**TO:** John Savage through Marc Hellman and Rebecca Hathhorn

**FROM:** Michael Dougherty and Thomas D. Morgan

**SUBJECT:** PORTLAND GENERAL ELECTRIC: (Docket No. UI 195 (1)) Application for approval to extend a secured loan to Portland Energy Solutions, LLC.

**STAFF RECOMMENDATION:**

The Commission should approve Portland General Electric's (PGE) application to extend a secured loan to Portland Energy Solutions Company, LLC (PES), an affiliated interest, and include the following conditions:

1. The interest rate to be charged by PGE to PES shall remain at 16% as specified by Commission Order No. 02-280.
2. PGE shall lower the loan cap from \$2.0 million to \$1.5 million with a one-year term. If PGE is requested to loan additional funds to PES beyond the cap, PGE will file a new affiliated interest application with the Commission.
3. PGE shall continue to hold customers harmless and remove the effects of any costs associated with the loan to PES from rates or any regulatory reporting requirement. PGE shall provide the Commission complete, open access to the full books, documents, data, and records of PGH, Portland General Holdings II (PGH II) and PES regarding this transaction.
4. The loan shall be paid in full if any of the following occurs: the sale of PES, the sale of PGE and PGH II or the receipt of a Small Employer Loan Program (SELP) loan. (If the SELP loan amount is not sufficient to refund PGE in full, a maximum partial pay-off should occur.)
5. PGE will continue to place in a deferred account for later dispersal to customers the amount in excess of the principal and interest at PGE's authorized rate of return as of April 1, 2002, paid by PES to PGE, on the loan. PGE will adhere to this condition for any of the scenarios listed in Condition No. 4 above.

6. PGE shall reclassify on its books, the loan from an Accounts receivable from associated companies (Account 146) to a Notes receivable from associated companies (Account 145) by August 1, 2003. If at anytime during the subsequent year PGE suspects the loan will not be paid in the one-year time frame, the loan shall be reclassified from a current asset to a noncurrent asset by recording the loan in Investments in associated companies (Account 123).
7. PGE shall provide the Commission quarterly reports on activity of the loan starting October 1, 2003. A detailed report on the final disposition of the loan will be provided to the Commission on or before April 15, 2004.

## **DISCUSSION:**

### Background

PGE filed this application on April 15, 2003, pursuant to ORS 757.495 and OAR 860-027-0030. PGE seeks a Commission order extending the current secured loan with PES for an additional year to expire March 31, 2004. PGE and PES are both wholly owned subsidiaries of Enron Corporation (Enron) and therefore PGE and PES are affiliated interests under ORS 757.015.

Commission Order No. 02-280 (UI 195) authorized PGE to loan up to \$2.0 million to PES for a term of one-year. The loan enabled PES to complete the first phase of a district cooling system located in the "Brewery Blocks"<sup>1</sup> of northwest Portland. Per PGE, the loan was necessary to complete the project due to the sudden collapse of Enron, which left PES without sufficient time to pursue other sources of funding to pay for the project.

From July 2002 until the present, PES has borrowed approximately \$1.0 million from PGE for capital costs and has accrued approximately \$70,000 interest at a rate of 16%<sup>2</sup>. When the loan was originally made to PES, Phase 1 of the district cooling project was 90% complete. Since that time, Phase 1, which consists of installed capacity of 4,030

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<sup>1</sup> The Brewery Blocks, located at the former site of the Blitz-Weinhard Brewery, is a five-block project in the SW section of Portland's post-industrial neighborhood known as the Pearl District. The Brewery Blocks provides approximately 1.7 million sq. ft. of urban retail, creative Class A office space, and residential housing in addition to parking. The total value is expected to be roughly \$200 million.

<sup>2</sup> Pursuant to Commission Order No. 02-280, the difference between the 16% interest and PGE's authorized cost of capital of 9.083% was to be placed in a deferred account for later return to customers.

refrigeration tons to cool the five blocks under contract, has been completed. During the year, PES used fewer funds than originally expected and does not require the full loan amount of \$2.0 million.

PES is currently receiving revenue from four of the seven cooling contracts; however, PES is expecting a net loss (includes depreciation expenses) of \$250,000 for the time period from April 1, 2003, to March 31, 2004. As a result, PES revenues are not sufficient to pay the loan or interest on the loan. To date, PES has not made any principal or interest payments on the loan to PGE.

#### Portland General Holdings Bankruptcy

On June 27, 2003, Portland General Holdings (PGH) declared bankruptcy. PGH is the parent company of Portland General Holdings II, which is the parent company of PES. Currently, PGE represents that they do not expect any effects of the PGH bankruptcy on the status of both PGH II and the PES loan, but there could be pressure from PGH creditors for funds from PGH subsidiaries.

#### Issues

Staff investigated the following issues:

1. Terms and Conditions of the Loan Agreement
2. Public Interest Compliance
3. Records Availability, Audit Provisions and Reporting Requirements

#### Terms and Conditions of the Loan Agreement

As part of the application, PGE submitted an amendment to the original revolving credit agreement. The amendment includes a change in interest rate from 16% to 12% and a reduction in the aggregate outstanding amount of the loan from \$2.0 million to \$1.5 million. As with the original agreement, the amendment does not include a loan repayment schedule.

Although Staff concurs with the reduction in the aggregate principal amount, Staff believes the reasons that resulted in setting the 16% interest rate still apply. The interest premium was set to:

- Offset the risk a commercial lending entity might attribute to PES as a stand-alone entity in its current financial condition;
- Offset other indeterminable risks associated with this transaction; and
- Provide a benefit to PGE customers when risks are fully mitigated.

Since PES does not have sufficient funds to repay the loan or to make interest contributions to PGE, Staff believes that it does not serve the public interest to lower the interest rate. Additionally, since PES is not making any principal or interest payments to PGE, a proposed lowering of the interest rate does not assist PES in fulfilling monthly obligations to PGE in order to meet the loan payment.

#### Public Interest Compliance

Per PGE, the security interest of the loan includes:

- The \$6.5 million cooling system;
- Six 25-year contracts and one 15-year contract that have an estimated net present value (over 20 years) of \$4.2 million in operating income; and
- Enhanced system marketability based on the potential for cooling system expansion at the Brewery Blocks site.

As a result of the possible scenarios of PES obtaining a SELP loan, the sale of PES or the sale of PGE and PGH II, Staff agrees with PGE that extending the loan is preferable to foreclosure on the security interest as any foreclosures of the loan could be complicated due to potential claims on the security interest by Enron's creditor committee and other affected parties.

Although Staff agrees that PES should be given an extension of the loan by PGE, Staff also recognizes that PES does not have adequate cash flow to make principal or interest payments on the loan. PES projects a net loss of \$250,000 for the period from April 2003 to April 2004. Contributing to the loss are high operations and maintenance (O&M) costs, as compared to revenue, being experienced by PES. A large part of the high O&M costs are attributable to payments made to Affiliated Building Services (ABS) which are projected at \$250,000 for the April 2003 to April 2004 time period. PES did not use a competitive bid process in selecting ABS, which is an affiliate of Enron, for the operations and maintenance of the cooling system.

Because PES does not have sufficient liquidity to pay the loan without an infusion of capital, Staff believes that the loan should not be extended beyond the one-year period requested in this application. As a result of proposed ordering condition No. 5, PGE customers will maintain the right to receive interest in excess of PGE's authorized rate-regulated cost of capital.

Additionally, the loan should be reclassified from an account receivable to a note receivable in PGE's books. If payment of the loan does not appear probable within a year, the loan should be reclassified as a noncurrent asset in FERC Account 123, Investment in associated companies.

As previously mentioned, PGE represents that they do not expect any effects of the PGH bankruptcy on the status of the PES loan, but there could be pressure from PGH creditors for funds from PGH subsidiaries.

Records Availability, Audit Provisions and Reporting Requirements

The proposed ordering condition Nos. 3 and 7 provide the necessary records access to PGE's relevant books and records.

Based on review of the application, Staff concludes the following:

1. The loan agreement contains no unusual or restrictive terms that would harm customers;
2. PGE has met the requirements of the Commission's transfer pricing policy for affiliate transactions and failure to collect will not harm PGE's financial position;
3. Customers are not harmed by this transaction because PGE is charging a fair and reasonable interest rate and customers maintain the right to receive interest in excess of PGE's authorized rate regulated cost of capital;
4. The Commission will have the necessary records access to PGE's books and records; and,
5. The application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.

**PROPOSED COMMISSION MOTION:**

PGE's application to enter into an affiliated transaction with PES, including the seven recommended conditions, be approved.