Report on Formation of Pioneer People's Utility Districts No. 1 and no. 02 (Multnomah County Ballot Measures 26-7 and 26-8)

City Club of Portland (Portland, Or.)
The City Club membership will vote on this report on May 13, 1988. Until the membership vote, the City Club does not have an official position on this report. The outcome of the membership vote will be reported in the City Club Bulletin (Vol. 68, No. 52) dated May 27, 1988.
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REPORT ON FORMATION OF PIONEER PEOPLE'S UTILITY
DISTRICTS 1 AND 2
MULTNOMAH COUNTY BALLOT MEASURES 26-7 AND 26-8

Question: "Shall Pioneer People's Utility District #1 (#2) be formed with authority to impose a special levy of $50,000 ($75,000) for engineer's report?"

Purpose: "Measure creates Pioneer People's Utility District #1 (#2) governed by five district residents elected to the board of directors. Measure also authorizes special property tax levy of $50,000 ($75,000), estimated at $.03 ($.04) per $1,000 of assessed property valuation, for an engineer's report. Report would study the costs of acquisition or construction of an electric utility system. If district voters approve in a future election, District could condemn existing electric utility properties and issue revenue or general obligation bonds."

Note: The question and purpose statements for the two proposed districts, #1 and #2, are identical except for the references to the district number and to the amounts of the property tax levy. These references for district #2 are shown in parentheses above.

To the Board of Governors,
City Club of Portland:

I. INTRODUCTION

On May 17, 1988, voters in some parts of Portland will be asked to decide whether public utility districts should be formed to provide electric power service. Pioneer People's Utility District (PUD) #1 and #2 would have the power to condemn transmission and distribution facilities currently owned by Portland General Electric (PGE), the private utility now providing electric service to these areas. Only voters within each district will decide whether to form the district, and one district can be approved even if the other is defeated.

Each measure provides for a one-time property tax levy to finance an engineer's report of the feasibility and cost of acquiring or constructing power distribution facilities. The two measures are identical except for the amount of the tax levy.

In separate ballot items, voters will elect five directors for each district, and if formation of the district is approved, these directors will act as the governing board of the new district.
The Pioneer PUD measures were placed on the ballot by initiative petition. Leaders of the proponents are a group of citizens who have been active for many years in supporting public power and challenging private utility rates and policies before the state Public Utility Commission. The primary opponent of the measure is PGE, currently the sole provider of electric service in the proposed PUD areas.

A yes vote on these measures creates a functioning new government entity, but does not necessarily create an operating utility. In a practical sense, the district's powers are limited by its lack of funding. Beyond the initial levy to fund the engineer's report, the district has no taxing authority until issuance of bonds is approved by voters in a subsequent election. In the strict view, then, the decision faced by voters is a limited one: whether to create a new district with the authority and limited funds to study the potential benefits of a public utility.

Your committee has chosen to review, to the extent possible, the broader issues associated with the measures. These include the availability of power supplies to the new utility, the potential for lower electric rates in a PUD, and the impact on the political and economic climate of the entire metropolitan area. Although these issues go beyond the scope of the immediate ballot question, they are the basis of the debate being waged by proponents and opponents of the measure.

II. BACKGROUND

A. Proposed PUD Boundaries

Only voters residing within the boundaries of the two proposed PUDs will vote on the district formation issue.

Pioneer PUD #1 is proposed for an area on the east side of the Willamette River stretching from the Fremont Bridge through North Portland to Hayden Island, and on the west side of the Willamette from West Burnside Street to Sauvie Island.

Pioneer PUD #2 is proposed to encompass most of southeast Portland from approximately SE 50th Avenue on the east to the Willamette River on the west, and from East Burnside Street on the north to the Sellwood neighborhood on the south. The Eastmoreland neighborhood has been excluded from the proposed boundaries. Pioneer PUD #2's boundaries also include a small area of northeast Portland between East Burnside Street on the south and Interstate 84 on the north and between NE 32nd Avenue on the east and the Willamette River on the west. (See Appendix A for map of proposed districts)

B. Direct Effect of a Yes Vote

Oregon law allows the formation of public utility districts by a vote of a majority of voters within the proposed
district boundaries. A yes vote on either Pioneer PUD #1 or #2 would establish the district as an operating public entity. Five-member boards of directors will also be chosen on the May 17 ballot for each of the districts and if formation of the district is approved, these directors will take over operation of the district's affairs. As with any other special service district in Oregon, the PUD boards will be subject to provisions of state ethics and open meeting laws, and all other laws pertaining to the operation of such government units.

Oregon Revised Statutes (ORS) 261.355 requires that the district obtain certification from a qualified engineer that net annual revenues of the district will be sufficient to pay the annual principal and interest costs of all bonds issued by the district. This certification is referred to in the ballot measures as an "engineer's report." The measures for Pioneer PUDs #1 and #2 include authorization for a one-time property tax levy to pay for the engineer's report. In Pioneer PUD #1, a yes vote will authorize the district to levy $50,000 in property taxes. This is estimated to be three cents per $1,000 of assessed valuation in the district, or $1.80 on a $60,000 home. In Pioneer #2, a yes vote will authorize a levy of $75,000. This is estimated to be four cents per $1,000 of assessed valuation, or $2.40 on a $60,000 home.

Based on results of the engineer's report, the board of directors of the district will decide whether to proceed with actual creation of a functioning electric utility. If the decision is made to proceed, district voters will then be asked to approve the issuance of revenue bonds or general obligation bonds to finance the acquisition and operation of the utility system.

Under ORS 261.385, the district would have the power to levy a property tax before the second vote not to exceed one-twentieth of one percent of the true cash value of the district annually for a period of up to ten years to pay its operating costs prior to acquisition of distribution facilities.

C. History of Public Power in the Northwest

Public power issues as well as conflicts between public power advocates and private electric utilities have been present in the Pacific Northwest for most of the past 50 years, particularly during the last ten years. As an economic development strategy of the Roosevelt New Deal, the federal government began constructing huge hydroelectric dams on the Columbia River in the 1930's. The legislation that implemented this program, the Bonneville Project Act of 1937, contained a "preference clause" which gave priority in the purchase of federally-generated power to public utilities. This act also established the Bonneville Power Administration (BPA) as a federal agency to market the power generated by the federal dams.

Hydro power from the federal projects was used to encourage distribution of electricity to under-developed rural areas
and was generally provided to these areas by public utilities or customer-owned electric co-ops. Hydro power also was supplied at low cost directly to aluminum smelters in the region to encourage development of that industry. Investor-owned utilities, which primarily served urbanized areas such as Portland, raised some objections to the federally subsidized competition of the public utilities. But the two groups co-existed in relative harmony because the supply of inexpensive hydro power from the system of dams was so vast that both public and private utilities were able to buy the cheap electricity for their customers.

2. Projected Demand Growth in the 1970's. The situation changed dramatically in the 1970's. Rapid growth in the Pacific Northwest caused power planners to project that, for the first time, demand for electric power would exceed the available supply of hydro power. Thus, it became apparent that, under the preference clause, BPA would no longer be able to meet the demand for power by private utility customers as well as its preference customers, the public utilities. BPA issued official notice in 1976 that private utility loads could not be met beyond 1983.

To offset the projected loss of power supplied by BPA, private utilities continued a program of building thermal generating plants begun in the late 1960's. PGE, the utility serving most of the Portland area, constructed the Trojan Nuclear Plant at Rainier, Oregon and made plans for other nuclear plants at Pebble Springs, near Arlington, Oregon. PGE constructed a coal-fired plant at Boardman, Oregon and participated in other projects as well. Although rates charged by private utilities historically had been comparable to those charged by public utilities, the rates charged by private utilities began to soar by the late 1970's. The costs of construction and the much higher production cost of thermal power resulted in private utility rates that were two to three times those of the public utilities.

It was projected that this electric rate gap would continue, raising concern that areas like Portland, which were supplied by private utilities, would be at a significant competitive disadvantage. In addition, because much of Oregon's population was served by private utilities, while much of Washington's population received public power, it appeared that Oregon as a whole might be at a disadvantage. This gave rise to numerous efforts to increase the role of public power in Oregon with the intent of keeping electric rates in the state competitive with those in neighboring states.

3. Public Power Proposals for Oregon. In 1977, the Oregon Legislature approved creation of an Oregon Domestic and Rural Power Authority (DRPA), in essence a statewide public utility that would qualify as a BPA preference customer. DRPA was to take effect in 1981, if federal legislation reforming the BPA power system had not been enacted by that time. DRPA
would have purchased inexpensive hydro power from BPA for resale to the various local utilities for distribution to residential and commercial customers. Passage by Congress of the Northwest Power Act of 1980 preempted implementation of DRPA.

In 1980, a proposal was placed before Multnomah County voters to create a public utility district for all of Multnomah County. The PUD was intended to purchase low-cost hydro power from BPA and result in lower rates for customers in the county. Increased public accountability, better management efficiency and more emphasis on conservation and alternative energy also were promised.

A majority of the City Club committee which studied the 1980 measure concluded that either the Northwest Regional Power Act or enactment of DRPA would be a "reasonable alternative to PUD formation without causing the tax burden and other uncertainties associated with the start-up of a PUD." The majority also concluded that the availability and wholesale cost of electric power for new PUDs could not be predicted accurately, and that formation of a PUD "would not guarantee a lowering of electric rates."

The majority opinion was supported by the Club membership and the measure was defeated by county voters, 56% to 44%. The boundaries for Pioneer PUDs #1 and #2 were drawn in part to include those areas which voted in favor of the 1980 measure, and to exclude those areas which voted against the measure.

There are currently six operating PUDs in Oregon (as well as 11 municipal utilities and 16 electric co-ops). Most Oregon public power entities were established many years ago when the politics of electric power in the state were much different. Only two PUDs in recent years have completed the process of formation and acquisition of private utilities. The Emerald PUD took over the distribution network of Pacific Power and Light Company in 1983. The Columbia River PUD was formed in rural areas of Columbia County in 1940. The district remained inactive for many years until district voters passed bond authorization in 1980. Columbia River PUD took over the distribution system of PGE in its area and began providing power to customers in 1984.

4. The Northwest Power Act of 1980. The conflicts between public and private power interests, and those between Oregon and Washington brought on by rate disparities in the late 1970's, prompted negotiations among various regional interests in hopes of achieving a comprehensive revision of the regional power marketing system. The result was the Pacific Northwest Electric Power Planning and Conservation Act enacted by Congress in 1980. The Act expanded the BPA's role in energy conservation and development of new energy resources. The Act established the Northwest Power Planning Council, an eight-member body of representatives appointed by the states in the region (Oregon, Washington, Idaho, Montana), to project future electricity demand and to plan development of new resources.
The Act also established a power exchange system whereby utilities could sell higher cost power to BPA and purchase lower-cost power from the federal system for residential and small farm customers. The effect of this exchange mechanism is to provide a subsidy to private utilities like PGE that generate thermal power in order to reduce rate disparities. Witnesses stated that BPA pays approximately $200 million annually to purchase power from various utilities under this system.

5. Electricity Demand Changes Since 1980. The circumstances have changed considerably since 1980. Most significantly, the expected power supply deficit never materialized. Slower economic and population growth during the recession of the early 1980's, and major cutbacks in aluminum production resulted in a dramatic shift in the regional energy demand picture. Where annual demand growth of seven percent had been predicted, demand for electricity in the Northwest has remained virtually unchanged since 1980.

The construction of new generating plants during the time that demand growth stopped has resulted in a power supply surplus that is predicted to last through the turn of the century. In addition to new generating facilities built by private utilities, many public utilities also began construction of new generating facilities during the 1970's. The most highly publicized of these efforts was the Washington Public Power Supply System (WPPSS), a consortium of public utilities in the Northwest that planned construction of five nuclear plants. One of the five plants was completed and is now operating. Two of the plants were "mothballed" after construction was partially finished. BPA has accepted responsibility for the costs of preserving the mothballed plants so that they can be completed when electricity demand increases.

The reduced demand for power has resulted in revenue below projected levels for BPA at the same time that costs have been rising. Thus, rate increases have been necessary to finance the expensive construction programs and to make up for reduced operating income. Wholesale power rates which BPA charges to its public and private utility customers increased 600% between 1973 and 1983. These increases eliminated much of the rate disparity between public and private utilities that developed during the 1970's.

III. ARGUMENTS ADVANCED IN FAVOR OF THE MEASURES

The following arguments in favor of the measures were presented by proponents of the PUDs:

1. PUDs can sell power at lower rates than private utilities. Residential rates will be from 12 to 28 percent lower under a PUD.

2. BPA can provide a sure, reliable and stable source of power.
3. Hydro power from Columbia River dams is a public resource which is not now available to residents of the PUD areas. Formation of a PUD would give these people access to the hydro power resource.

4. PUDs operate efficiently with low management costs, while PGE's management is costly and top heavy.

5. The increased competition between utilities and PUDs would result in lower rates and would enhance economic development.

6. Although PUDs have the right of eminent domain under the Oregon Constitution, all previous condemnations of private utility property by PUDs have been settled out of court.

7. The cost of the engineer's report is insignificant, amounting to only a couple of dollars on the average tax bill.

8. A thorough, reasonable analysis in the engineer's report is assured because purchasers of bonds will require it.

9. PUDs can obtain financing at a lower rate than private utilities through issuance of tax-exempt municipal bonds.

10. PUDs can offer lower electric rates because they do not have to pay income taxes. They do pay property taxes, however, sometimes at rates higher than were previously paid by the private utilities.

11. The proposed PUD boundaries were determined on the basis of maintenance and cost considerations as well as political considerations.

12. Elected government is accountable. In a local service district, the elected officials are your neighbors.

13. The City of Portland will realize substantial savings in electricity costs for such dedicated funds as street lighting, water and wastewater treatment. City officials estimate these savings to be as high as $664,207 annually.

14. The PUDs' rates must be responsive to its customers because they have the direct power to force change through election of directors. As customers of a private utility, rate payers have no influence of the utilities management, rates or policies.

15. A yes vote only initiates the engineer's report and does not commit residents of a PUD to establishment or funding of an operational public utility.

16. If the PUD is successful, the opportunity would be available to residents of other parts of the city to be annexed to the district in order to enjoy its benefits.
17. Providing power through a PUD represents public control of a public resource.

IV. ARGUMENTS ADVANCED IN OPPOSITION TO THE MEASURES

The following arguments against the measures were presented by opponents of the PUDs:

1. It is uncertain whether a PUD can offer lower electric rates, as proponents claim.

2. BPA cannot be relied on indefinitely as a stable source of low-cost power.

3. Private utilities have assumed a heavy financial risk in construction of power generation and distribution facilities and should not now be penalized unfairly.

4. A new PUD probably would not have competent professional management in its initial stages.

5. A firm, stable provider of electric service is necessary to support economic development efforts. Businesses considering location in the area would be driven away by the uncertain situation which may drag out for years during establishment of a new PUD.

6. PUDs take private property without consideration for the damage done to the remaining customers of the private utility. The total of all the actual costs associated with acquisition of PGE's system in the PUD area may be much higher than proponents are suggesting.

7. A property tax assessment will be required to pay for the engineer's report.

8. There is no assurance that the engineer's report will provide dependable, unbiased analysis, since the engineer will be retained by the PUD.

9. PUDs cannot depend on being able to save financing costs through issuance of tax-exempt municipal bonds. A cap of $150 million each year exists for private activity municipal bonds in Oregon. The PUD would have to apply to be included within the cap.

10. Income tax revenue now paid by PGE would be lost and would have to be made up by other taxpayers.

11. The proposed boundaries of the PUDs have been gerrymandered and are totally political in nature. The boundaries bear no relationship to sound economic or utility planning.

12. Fragmentation of government is bad government. Candidates for the boards of small special districts are often known
only to a small percentage of voters. In addition, business owner's within the PUDs are disenfranchised because only residents are allowed to vote in district elections.

13. The City of Portland's general fund will be negatively impacted by the loss of up to $700,000 in business fees now paid by PGE. This is the portion of the city budget which funds all discretionary government services. The revenue loss cannot be offset by the transfer of funds from the dedicated funds where electric rate savings might be realized.

14. Private utility rates are approved by a three-member Public Utility Commission that is appointed by an elected Governor. Any ratepayer has the right to testify before the commission on rate matters. Rate setting by a PUD board is not subject to any such oversight.

15. Even if the results of the engineer's report are unfavorable, the PUD will continue to exist as a government entity. No one can say how you get rid of a PUD once it is formed.

16. Possible rate inequities resulting from formation of PUDs in only certain parts of the city create the potential for conflict throughout the city.

17. Creation of a PUD amounts to a hostile takeover of a successful private enterprise and results in government involvement in a field that is better left to the private sector.

V. DISCUSSION

A. Availability of BPA Power

The basis for the proposal is that a PUD could obtain power generated from hydroelectric dams through the BPA. All witnesses agreed that the new PUDs could depend on BPA power through at least the end of the century. In part, this is due to the current surplus of power in the BPA system. Figure 1 and Table 1 show that, based on a projection of moderate growth in demand, the surplus will continue until the year 2005.

In addition, under the preference clause, BPA is obligated to provide power to public utilities. The 1980 Northwest Power Act gives BPA the authority to acquire additional power resources if they are needed to meet demand. Thus, BPA officials stated that "BPA can reasonably assure a power supply to Pioneer PUD within the foreseeable future."

B. Cost of BPA Power

The promise of lower electric rates is the mainstay of the argument for formation of a PUD. The factor which most influences rates is the wholesale cost of producing or acquiring
Figure 1
FEDERAL FIRM ENERGY SURPLUS/DEFICIT
Assuming No New Resource Acquisitions

TABLE 1
FEDERAL SYSTEM FIRM ENERGY SURPLUS FOR PLANNING PURPOSES
MEDIUM LOAD FORECAST
ASSUMING NO NEW RESOURCE ACQUISITIONS

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* Note: Operating years 1988 is the year July 1, 1987 through June 30, 1988.

power. Witnesses told your committee that power costs typically account for about 80% of the total retail rate charged for electricity by a PUD. Although PGE currently purchases some power from BPA, PGE primarily gets its power supply from its own production facilities or by purchasing from other utilities. PUD proponents state that, under the preference clause, the PUD would be able to purchase an adequate supply of power from the BPA system at a significant cost savings when compared to the cost of PGE's power.

Opponents state that, although the cost of BPA hydro power is now somewhat lower than the cost of thermal power, BPA's future rate structure is uncertain, at best. A number of factors beyond BPA's control may force the federal agency to increase its charges for the power it sells. These factors include the unknown future costs of WPPSS nuclear plants 1, 2, and 3.

Also uncertain, according to PUD opponents, is the rate at which BPA will have to repay debt to the federal government. The construction of most of the hydro electric dams on the Columbia River system was paid for by the federal government. BPA's revenues from the sale of power are used in part to retire that debt. Concern over the size of the federal budget deficit has led to recent attempts in Congress to speed up the schedule of debt repayment and interest. Opponents to the PUD measure argue that such legislative decisions could dramatically impact BPA's cost of doing business and force steep increases in wholesale power rates. Several witnesses, however, pointed out that many other parts of the country have power systems that have been similarly financed by the federal government, and that Congressional opposition to changes in repayment schedule is widespread. Any significant increase in BPA's annual cost for retirement of system construction debt appears unlikely.

The disparity in power cost between BPA and the private utilities is now offset somewhat by the power exchange system for residential customers implemented under the Northwest Power Act of 1980. BPA purchases power from the private utilities at the average system cost for the private utility's resources. BPA then sells an equivalent amount of power back to the private utility at BPA's normal rate, which is typically lower than the cost of the power which was purchased from the utility. (Witnesses told the committee that, in reality, no electricity changes hands in the process, since all of the power is comingled in the BPA system anyway. Accounting transactions occur that result in BPA paying money to the private utilities in an amount equal to the difference between the costs of the private utility resource and BPA's normal wholesale rates.) This power exchange formula permits the private utilities to maintain residential electric rates at an artificially lower level.

Simple supply and demand issues also impact the rates charged by BPA for power. With a substantial power supply surplus expected to continue through the turn of the century,
rates are generally held down. However, when BPA revenues are down, it is conceivable that wholesale power rate increases may be necessary to cover BPA's costs of operations, debt service and the WPPSS plants.

C. PUD Costs for Acquiring Distribution System

If the Pioneer PUDs measures are approved, the new PUDs would have the option of constructing a new electric distribution system to provide power to its customers, or acquiring the existing PGE distribution system in the district. It is assumed that the latter option would be chosen, since it is generally agreed that construction of a new system would be far more expensive than acquiring the existing one.

As a government entity, the PUDs would have the power of condemnation to acquire PGE's poles, lines, substations and other distribution equipment. Under this process, the ultimate price which the PUD would pay to PGE for these facilities would be determined by a jury trial. However, no PUD condemnation process in Oregon has ever gone to trial. Instead, the PUD and the private utility have reached negotiated, out-of-court settlements of the purchase price. Both the Emerald and Columbia River PUDs, the only Oregon PUDs to actually begin operation during the past decade, acquired distribution systems through a negotiated settlement with the private utilities that had been serving the areas.

The costs to the Pioneer PUDs of acquiring PGE's distribution equipment are unknown. Proponents contend that, based on the experience in the Emerald and Columbia River districts, the purchase cost would be about 1.2 times the current book value of the systems (estimated by proponents to be a purchase cost of $60-80 million for Pioneer PUD 1 and 2 combined). Both Emerald and Columbia River negotiated settlements of approximately 1.2 times the book value of the systems. PGE contends, however, that it is entitled to a far higher price, based on the potential lost income from this part of its system. PGE claims the costs to the PUD will be more like $450-550 million.

Examination of recent situations of a similar nature (such as the cases of Emerald and Columbia River PUDs) ordinarily would be a useful way to predict the outcome of negotiations over purchase price of the distribution system in the Pioneer PUDs. However, both Emerald and Columbia River were formed in lightly populated rural areas with a much less dense concentration of electrical equipment. Further, the proposed Pioneer PUDs represent a much larger portion of the private utility's customer base than was the case in either Emerald or Columbia River. Thus, presumably, the stakes are much higher in this instance, and PGE may be less likely to agree to a negotiated compromise. If a negotiated settlement could not be reached, condemnation proceedings in court and possible appeals could take up to eight years to complete. Your committee could not determine to what extent the different circumstances of the Pioneer PUD proposal might impact the eventual cost to the PUD of acquiring PGE's system.
It is not known whether the Pioneer PUDs would attempt to acquire all of the PGE electrical system within the district boundaries, or only that portion which is necessary for serving PUD customers. For example, PGE representatives stated that several major substations located within the proposed PUDs serve customers both in and out of the PUD areas and that costly, major modifications to the system would be required if the Pioneer PUDs are established. Dividing the system would lead to higher costs and reduced efficiency for both PGE and the PUDs, PGE representatives said. It may not be necessary for the PUD to own such facilities as regional substations in order to serve its customers. Witnesses told your committee that, from an engineering standpoint, it is relatively simple to develop procedures for effectively sharing and dividing these kinds of facilities to provide the most efficient electric service. However, it is not known what the cost of such arrangements will be to the new PUD. Similarly, it is not known what costs may be associated with this for PGE's remaining customers outside of the PUD.

Your committee believes that negotiations for the transition from private to public power could be heated and disruptive. However, the experience of the Emerald and Columbia River PUDs indicates that once a price is determined, either through condemnation proceedings in court or through negotiation, the actual technical work to accomplish the transition can be accomplished smoothly and cooperatively. It is impossible at this time to accurately estimate what the total cost to the PUDs might be for completing this process.

D. Retail Electric Rates in a PUD

Backers of the Pioneer PUD measures claim that rates can be reduced 12 to 28% as a result of lower costs for power, financing and operations, from the rates currently charged by PGE. The Emerald and Columbia River PUDs have a policy of maintaining rates at least five percent below those of PGE and Pacific Power and Light Co. (PP&L). However, it is not clear whether the Emerald and Columbia River cases offer meaningful comparisons to the Pioneer PUDs. Because of their size and urban nature, the Pioneer PUDs may face much different costs for system acquisition and operations. Either of the proposed Pioneer districts would be by far the largest public utility in Oregon.

The two most important factors influencing the retail rates to be charged by the new PUDs are the cost of acquiring power and the cost of acquiring the existing distribution system from PGE. Beyond these two issues, four other factors will primarily influence the eventual rates.

First, as public entities, the PUDs may be able to obtain financing for system acquisition through sale of tax-exempt bonds. Because bond holders do not have to pay income taxes on the interest, the PUD can pay interest rates which are estimated to be 1.5% to 2% lower than the rates paid on taxable
bonds. This is a saving in comparison to the bond financing costs paid by PGE. Potentially, this could result in lower electric rates for PUD customers. However, a November 23, 1987 report by the Oregon Department of Energy stated that PGE currently has "a mix of low and high interest debt." The report concluded that it was not possible to ascertain whether the net cost of capital for the Pioneer PUDs would actually be lower than that of PGE.

The use of tax-exempt bonds is limited by the private activity bond cap established under the Federal Tax Simplification Act of 1986. To reduce the loss of income tax revenue on bonds, the Act implemented a cap on the amount of tax-exempt bonds that can be issued for "private activities" in each state in any one year. The annual cap amount for Oregon has been set by the federal government at $150 million. Bonds issued by PUDs are not generally considered to be for private activities. However, an "anti-takeover" provision of the law applies specifically to the takeover of private utility systems by public utilities. Therefore, bonds issued by the Pioneer PUDs automatically would fall under the cap. If the planned issuance of "private activity" bonds in Oregon exceed the $150 million cap for one year, the Pioneer PUDs conceivably could be unable to issue tax-exempt bonds. As a result, financing costs for the PUD would be higher than claimed by proponents. Although proponents and opponents differed on the likelihood of this occurring, independent testimony to the committee indicated that the $150 million annual limit is not likely to be exceeded within the next few years. Thus, it appears that the PUD would be able to use tax-exempt bonds to finance at least part of its system acquisition costs.

A second factor in the level of retail electric rates is PGE's obligation to pay dividends to corporate shareholders. PUD proponents say that significant savings can accrue to rate-payers of a PUD because it would not have to include a profit for shareholders in its rate structure. However, shareholders contribute a significant amount of financing for PGE, and the PUD would not have the benefit of these funds, and would have to acquire this financing from other sources, such as the sale of bonds. The cost of obtaining this alternative financing would partially offset any savings.

A third factor influencing PUD rates is the lack of income tax costs. As a non-profit government entity, the PUD would not have to pay federal and state income taxes. Proponents claim that PGE pays about $100 million annually in federal and state income taxes and that this cost results in electric rates 15% above what they otherwise could be.

A fourth factor cited by proponents is the cost of management. PGE rates are kept unnecessarily high, proponents say by a large, highly paid administrative staff and the company's involvement in many fields other than delivery of electric service. Direct comparison of staff and salary levels with PGE,
however, may not be legitimate because PGE is a much larger and more diversified company than either of the Pioneer PUDs would be. It is beyond the ability of your committee to determine whether the PUDs could achieve significant improvements over PGE's management cost and efficiency, or whether this is a meaningful issue in the context of all the factors which influence electric rates. Proponents state that by operating efficiently and concentrating only on providing electricity to district customers, PUDs generally have much lower operations and management costs and that this translates directly to lower rates. PUDs do not have to spend money for stockholder relations and other public relations efforts, and their offices are usually utilitarian in nature.

E. The Engineer's Report

If voters approve either measure, the first major action of the new PUD will be to hire a consulting engineer to prepare an Engineer's Report. ORS Chapter 261 governing formation of PUDs includes a requirement that the PUD obtain certification from a qualified engineer that district revenues will be sufficient to cover annual payments of principal and interest on bonds. Based on the results of this report, the PUD Board would decide whether to seek voter approval of a bond issue to pay for system acquisition and begin operations.

The statutes do not set forth specific requirements about the scope of the engineer's study. Proponents state that the Engineer's Report would: "1) examine PGE's rates and its plans for new power supplies to meet local load growth; 2) inventory the present electrical utility system and estimate the cost of acquiring it; and 3) compare the cost ratepayers would pay if the PUD is formed with what they currently pay for PGE."

Funding the Engineer's Report is the primary concrete step that would be accomplished by a yes vote on the Pioneer PUD measures. The small property tax assessments that are part of the measures will pay for the reports in order to give district residents detailed information about the feasibility, advantages and disadvantages of having the PUD take over electric service. Your committee is concerned, however, about the degree to which the report's results will be predetermined by the charge drafted by the PUD Board. We believe that in a strict sense, anything can be determined to be feasible depending on the assumptions used, so that the Engineer's Report will most likely determine that a PUD for the area is feasible. Some factors, however, mitigate against the Engineer's Report being no more than a premeditated justification for establishing a PUD. The information in the report will be reviewed by voters who must approve issuance of bonds, and by the financial markets when the bonds are offered for sale. This report is usually prepared prior to the negotiation of the sale price of the system.
F. Rate-setting Oversight

Proponents claim that PGE directs its main attention to profit margin and shareholder dividends, and has no accountability to the public in setting the rates it charges for electricity. However, PGE's rates are subject to a third-party review before the state Public Utility Commission (PUC) where an opportunity exists for public input. PUD proponents counter that the PUC is understaffed and unable to thoroughly review PGE's financial status to assure that rates are appropriate.

The rates charged by a PUD would not be subject to review by the PUC. All rate-setting authority would rest with the district's elected board of directors. Public testimony could be offered at board rate hearings and residents of the district would have the power of the ballot box to influence the board's decisions. However, in a relatively unpublicized special district, the pressures of elective politics may not be conducive to sound rate-making decisions.

G. Fragmentation of Services

Portland presently is served by two private utilities, PGE and PP&L. Creation of one or two PUDs would mean as many as four different providers of electricity within the city with potentially different rates and policies in each. This is the opposite of efforts in the community to regionalize the provision of government services and reduce the number of overlapping special service districts. The City Club, in its 1986 report, "Regional Government in the Portland Metropolitan Area," voiced strong support for regionalization of services. Establishment of PUDs in small parts of the metropolitan area is contrary to this goal. It was suggested by one witness that if a PUD is a good idea, then a city-wide or region-wide PUD would be a better long-term solution. However, two measures of this nature were recently rejected by area voters.

In addition, your committee was told that there is a shortage of qualified candidates for the many boards and other elective positions which already exist in the metropolitan area. Creation of two PUDs would require even more qualified people willing to enter the political process and finance the costs of election campaigns.

H. Impact on Economic Development Efforts

An issue raised by both proponents and opponents of the measures is the impact of PUD formation on economic development efforts. Proponents state that the competition of lower rates offered by the PUD will have a healthy overall impact on the area's ability to attract and maintain business and jobs. Opponents, however, state that the resulting confusion and fragmentation of services will have a negative impact.

There is evidence of both support and opposition from existing businesses. Many commercial and industrial customers
within the proposed Pioneer PUD areas petitioned the Multnomah County Commission to be excluded from the PUD boundaries (all but one petition was denied). These businesses generally felt that rates were likely to be more favorable under PGE than in a new PUD. However, a bill before the 1987 Oregon Legislature that would have limited the ability of PUDs to annex new areas drew an equally strong response from businesses in an area that was to annexed to the Emerald PUD. These businesses argued that they should have the right to join a PUD and that the state should encourage, rather than hinder competition in electric rates.

It is likely that, over the long-term, businesses and economic development personnel would adapt to the existence of additional electricity providers in the city. While the area would be subdivided more than it is today, there would still be only one utility in a given geographic area. However, it appears likely that passage of the PUD measures would initiate a lengthy period of confusion and uncertainty which, in the shorter term, would be detrimental to economic development. Following the initial months or years of organization, the Engineer's Report would be prepared over a period of at least several months. This might be followed by a hard-fought campaign for and against voter approval of bonds, and then possibly long and hostile negotiations or litigation over acquisition of PGE's system. During this period of several years, businesses in the area would be unable to reliably predict who would be providing electric service or at what cost.

I. Impact on Taxes and Local Government Budgets

The formation of the Pioneer PUDs would affect taxes and local government budgets. The PUDs would not pay the state and federal income taxes now paid by PGE. While this would result in lower electric rates, the lost tax revenue would have to be offset by reduced government services or higher rates. The PUDs would pay local property taxes, however. In fact, one recently formed PUD found that utility property was re-assessed based upon the price paid for acquisition of the property. The result was that the PUD paid higher property taxes than were paid previously by the private utility that had owned the system. Slightly lower rates for other property tax payers in the district would ensue.

Property taxes in the district will be directly affected by approval of the PUD measures because a one-time assessment on property would be made to pay for the Engineer's Report. This is estimated at $1.80 on a $60,000 home in Pioneer PUD #1, $2.40 in Pioneer PUD #2.

A memo prepared by City of Portland staff for Commissioner Earl Blumenauer summarizes the projected impact on the City's budget. Based on "rather gross assumptions" made without the benefit of a feasibility study or more specific data, the memo stated that a 25% reduction in electric rates would save the
City approximately $660,000 in energy costs, with most of the savings occurring in dedicated funds for such services as street lighting, water and wastewater. Conversely, the City currently collects a utility license fee of five percent of gross sales from PGE. If, as assumed by the city calculations, the Pioneer PUDs took over one-third of PGE's total gross sales and implemented a 25% rate reduction, the city would lose approximately $700,000 in revenue from the utility license fee. This revenue loss would be in the already strapped General Fund which pays for discretionary services such as police, fire and parks. Under existing City budget procedures, it would not be possible to transfer money from the dedicated funds, where electric rates savings occurred, into the General Fund.

The assumption of a 25% rate reduction may be overly optimistic, since this is considerably higher than the reduction that occurred in the Emerald and Columbia River PUDs. With smaller rate reductions, the City revenue loss could be less dramatic.

J. Public vs. Private - A Philosophical Issue

Both sides in the debate over the proposed Pioneer PUDs believe passionately in the ultimate good of their cause. Proponents see the issue as one of public vs. private control of a valuable resource. Opponents view the issue as one of free enterprise fighting against government takeover. But, in contrast to previous campaigns, these viewpoints seem to be largely self-centered rather than representative of opposing sides in a fundamental public debate. The philosophical question of whether public or private power is inherently better was not directly raised by either proponents or opponents.

Your committee heard that some members of Congress believe the BPA and other public power supply systems are failing to repay debts to the federal government fast enough, and with a fair rate of interest. Tax payers nationwide, they say, are unfairly having to subsidize public utility ratepayers.

Another issue raised is the role in the community played by a large corporation like PGE. PGE's extensive contributions program, financed by stockholders, provides support to many local arts, service and educational organizations. As public entities, PUDs would not legally be allowed to make such donations and a reduced-in-size PGE may also be unable to continue its current level of philanthropy.

VI. CONCLUSIONS

The formation of Pioneer PUDs #1 and #2 is an issue with city-wide interest and the outcome may potentially have impacts throughout the metropolitan area. However, it is an issue which will be decided only by voters living within the two districts. While establishment of PUDs may result in slightly lower electric rates for those within the district, this advantage may be outweighed by adverse affects which would be felt throughout the metropolitan area.
Your committee has concluded that establishment of Pioneer PUDs #1 and #2 would be undesirable for the following reasons:

1) The fragmentation of electrical service providers in the metropolitan area would be confusing and would have an adverse impact on economic development efforts.

2) The creation of two additional government entities, with elected boards performing identical functions, would be an undesirable proliferation of special service districts.

3) The division of a complex urban electrical system will be a time- and resource-consuming task with unknown costs.

4) The cost to the PUDs of acquiring electrical distribution systems may well be substantially greater than claimed by proponents.

5) While some reduction of rates may occur under a PUD, it is likely that this reduction will be less than predicted by proponents of the measure, and will be outweighed by the problems listed above.

During its review of the substantive issues regarding the measures, your committee became concerned about the process used to form PUDs. Although the measures require that an engineer's report be completed before the PUD can seek authority to issue bonds, voters are now being asked to approve establishment of a PUD without access to any independent information about the ultimate costs of their decision. It would be extremely helpful to voters if Oregon law required preparation of a comprehensive, independent engineer's report dealing with PUD costs and projected electric rates before voters are asked to form the PUD.

VII. RECOMMENDATION

Your committee recommends that the City Club of Portland support a "No" vote on Ballot Measures 26-7 and 26-8.

Respectfully submitted,
Rosemary Fisk
Bill Long
Jim Nelson
Angel Pilato
Ross Simmons
Bob Weil
Jim Knoll, Chair

Approved by the Research Board on April 14, 1988 for transmittal to the Board of Governors. Approved by the Board of Governors* on April 18, 1988 for publication and distribution to the membership, and for presentation and vote on May 13, 1988.
*Pursuant to the Club's conflict of interest policy, the following members of the Board of Governors took no part in the decision to approve this report for publication: Patricia M. Bedient, William R. Lesh, Marlene Bayless Mitchell, Selina R. Ottum, and William W. Wyatt. The following members of the Board of Governors were not present for any deliberations with respect to approving this report for publication: Philip R. Bogue, William J. Fronk, Charles F. Hinkle, Charlotte T. Kennedy, Kris Olson Rogers and William W. Wessinger.
This map is for illustration only. The boundaries shown are approximately the boundaries for each proposed district. Although not entirely shown on this map, the proposed PUD #1 includes all of Sauvie Island in Multnomah County and all area in Multnomah County between U.S. Highway 30 and the Multnomah Channel west of Sauvie Island.
APPENDIX B

Persons Interviewed

Jeff Carr, Economist, Public Power Council
Gale Carson, Consulting Engineer
Charles Davis, former Oregon Public Utility Commissioner
Lee Armstrong, Program Analyst, Bonneville Power Administration
Earl Blumenauer, Portland City Commissioner
Roy Hemmingway, former deputy Oregon Public Utility Commissioner, former member Northwest Power Planning Council
Walt Higgins, Vice President of Distribution, PGE
Marion Hemphill, Executive Director, Oregon People's Utility Districts Association
William June, Vice President of Public Policy, PGE
James Lazar, Economic Consultant
Michael A. Lewis, Vice President, Seattle Northwest Securities Corp.
Philip Livesley, Lower Columbia Area Power Manager, Bonneville Power Administration
Rebecca Marshall, Senior Vice President, Government Finance Associates
Dan Meek, Attorney, organizer for Pioneer PUD Campaign
Dan Ogden, Director, Public Power Council
Lon Peters, Senior Economist, Public Power Council
Fergus Pilon, General Manager, Columbia River PUD
Lynne Saxton, Branch Manager for Public Affairs, PGE
Enid Smith, Consumer and Public Relations Manager, Emerald PUD
Kay Stepp, President of Energy Services Division, PGE
Linda Williams, Attorney and Chief Petitioner

APPENDIX C

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City Club of Portland:


Oregon Revised Statutes Chapter 261.

The Oregonian.


"Property owners asks to be left out of PUD." December 2, 1987.


"Data lacking in pamphlet.' March 1, 1988.


APPENDIX D

Candidates for Pioneer PUD Boards of Directors

Pioneer PUD #1

Richard Beetle
Frank Carsner
Easton Cross
Linda L. Ekhoff
Gayle Highpine
Linda Krugel
Janet E. Penner
Sharon J. Roso

Pioneer PUD #2

Richard Brandman
Pat deGarmo
Phil Dreyer
Ralph Frohwerk
Ed Lyle
Andrew (Andy) Nebergall
Roger Redfern
Alan Rohr
Charles Treinen